



City of Santa Fe Springs

City Council Meeting

June 14, 2018

STUDY SESSION

Introduction and Discussion of City's Proposed Fiscal Year 2018-19 Budget and Related Items

RECOMMENDATION

That the City Council give staff direction regarding revenue and expenditure matters included in the Fiscal Year 2018-19 Proposed Budget.

BACKGROUND

It is my pleasure to present the fiscal year ("FY") 2018-19 Proposed Budget. The budget is the result of several months of work, including multiple sessions with each of the City Council Budget Subcommittees. After two two-year budget cycles, this proposed budget presents only one year, FY 2018-19, due to the significant fiscal challenges facing the City. Over the past 10 years the City has faced a number of fiscal challenges, each seemingly growing in significance over time.

Beginning in fiscal year 2007-08 the City felt the impacts of the Great Recession seeing sales tax revenue plummet 27% from \$26.4 million in FY 2006-07 to \$19.2 million in FY 2009-10. In response, the City cut expenditures by offering early retirement incentives and implementing furloughs for active employees along with creating a 2nd tier for new employees related to pension and health care benefits. Revenues were improved through the passage of a utility users tax in 2010 offering more diversification and stabilization than with sales tax alone.

Just as the economy was beginning to improve, the State of CA dissolved redevelopment agencies in January 2012, which had a major impact on the City. The former redevelopment agency collected approximately \$32 million annually in property taxes and was the major source of funding for capital improvement projects ("CIP"). The net impact to the City's General Fund was approximately \$13 million annually in addition to the General Fund becoming the primary source of funding for CIPs. A number of measures were then implemented to address the loss in funding, including another round of early retirement incentives, the elimination of approximately 25% of full-time positions, the conversion of furloughs into the permanent payment by employees of their share of the Public Employees Retirement System ("CalPERS") contributions, and a reduction in some service levels. On the revenue side, the utility users tax, originally set at 3.5%, was increased to 5%, the maximum amount authorized by the voters in 2010.

Over the subsequent four fiscal years, the economy continued to improve and increases in all major revenue sources were realized. The organization stabilized and adjusted to the "new normal". Beginning in FY 2015-16, however, a number of



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changes dramatically affected the City's required payments to CalPERS. Already faced with mounting unfunded liabilities, the CalPERS Board adopted several policies which have the result of doubling the City's required contributions over the next seven years. Assumption changes to the anticipated rate of return on CalPERS investments, extending the life expectancy of retirees, and funding policy changes that shortened the time period over which gains/losses are spread all combined to produce a dramatic increase in payments towards the unfunded liability. While the changes will improve the financial stability of the fund in the long-run, the short-term effect is the addition of an additional \$7+ million annually in required contributions by FY 2023-24.

The FY 2017-18 budget, when originally adopted as the second year of a two-year budget in June 2016, showed a deficit of approximately \$2.8 million. This deficit was planned to be covered through the collection of loan repayments from the Successor Agency of \$1.8 along with the reduction in planned CIP set-aside monies of \$1.0 million. By June of 2017 the deficit grew to \$5.0 million primarily due to budgeted increases in revenues not materializing along with the growth in mandatory CalPERS contributions. The growth in the deficit was dealt with by eliminating the remaining planned CIP transfer for \$1.8 million along with the use of other set-aside funds held in the Equipment Replacement, Insurance Stabilization, and Employee Benefits Funds.

The proposed budget for FY 2018-19 continues in the path of these trends. The structural deficit has grown to approximately \$5.8 million. The economy continues in a positive direction and modest increases in revenues are expected. Additionally, savings in labor have been realized through the freezing of several vacant positions. However, the growth in the mandatory CalPERS contributions exceeds these savings and revenue growth, causing an overall increase in the deficit.

Although not a viable long-term strategy, the FY 2018-19 budget proposes to use the loan repayments from the Successor Agency, the reduction of transfers to the CIP Fund, and the use of set-aside funds to close the budget gap. The use of this strategy preserves the General Fund's \$21.9 million unassigned and available fund balance reserves. By its nature though, the strategy is short-term as these non-recurring sources will soon be depleted. FY 2018-19 will see the third annual repayment from the Successor Agency towards the approximately \$10 million that was owed to the General Fund when the redevelopment agency was dissolved in 2012. Based on the state law that determines the amount which can be repaid each year, the loan is expected to be fully repaid by June 30, 2020. In addition, the set-aside funds are expected to have less than \$750,000 by June 2019, down from \$2.9 million in June 2017.



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The City is considering a number of revenue options in order to preserve existing service levels, including a sales tax measure which could be placed on the November 2018 ballot. If sufficient revenues are not generated to close the structural budget deficit, significant cuts in expenditures will ultimately be necessary, with a resulting decline in service levels and ability to complete needed capital projects.

Turning to the City's Water Utility, the FY 2018-19 budget projects a positive increase in the fund of approximately \$760,000. However, the increase is recommended to be set-aside in the fund's capital improvement reserve. There is a continuing need for CIP's related to the source of water to aid in stabilizing the growing cost of water from outside sources. The cost to have an operating well in both of the City's water zones is expected to be approximately \$10 million. The Water Utility is expected to have approximately \$4.8 million in the CIP reserve by the end of June 2019. So while there are operating funds available to increase the CIP reserve, the amount available falls well short of the needs.

In addition, rates for purchased water continue to increase significantly every year, further reducing excess operating funds available for CIPs within the current rate structure. The last rate increase for the City was in August 2016, which while it was an 11% increase, the last increase before that was March 2012. Overall the City's rate increases have not kept pace with increases in operating costs and CIP needs.

With the above in mind, where we find ourselves is in a position to rebuild our revenue base in a way that enhances our ability to sustain the level of service that we provide to the public on into the future. Key strategies in that regard are: 1) building the City's reserves to a level that will help lessen the impact of the next downturn in the economy; 2) continuing to reassess what the City's "Core Services" are, so as to ensure that the City's ability to provide those services that only the City can provide are not diminished as a result of "spreading ourselves too thin"; and, 3) looking at ways to broaden and diversify our revenue streams, so as to lessen our dependency on sales tax revenue.

The Proposed Budget for Fiscal Year 2018-19 moves the City closer to the above objectives. As well, the proposed budget provides an unwavering commitment to making Santa Fe Springs a safe and great place to live, work and play. It furthers the City's mission to deliver exemplary municipal services responsive to our entire community and consistent with our history, culture and unique character.

Following is a more detailed review of the budget specifics:

Proposed Budget: FY 2018-19

For the FY 2017-18 Final Estimate, it is anticipated that there will be a \$723,300 operating deficit with a \$1.8 million increase in fund balance at year's end due to the



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receipt of the Successor Agency loan repayment. Staff recommends restoring a portion of the transfer to the CIP fund as well as replenishing a portion of set-aside funds in the Equipment Replacement, Insurance Stabilization, and Employee Benefits Funds. We estimate that the FY 2018-19 General Fund uses will exceed sources by \$5.8 million.

Following is a summary of the Proposed Budget activity for FY 2018-19, along with the June 2017 Revision and Final Estimate for FY 2017-18:

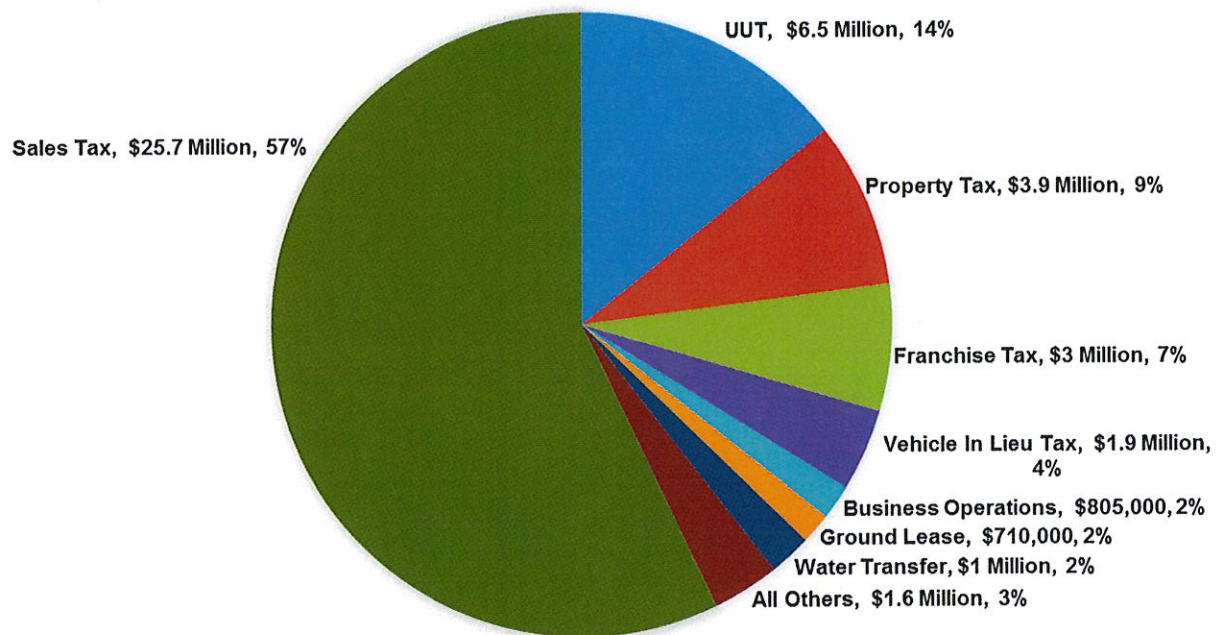
	June 2017 Revision 2017-18	Final Est. Fiscal Year 2017-18	Proposed Fiscal Year 2018-19
Sources:			
General Revenues	\$ 43,675,000	\$ 44,387,000	\$ 45,085,000
Transfer from Employee Benefits Fund	-	892,800	-
Total Sources	43,675,000	45,279,800	45,085,000
Uses:			
Departmental Expenditures	46,477,200	44,884,800	47,319,700
Capital Improvement Projects	1,800,000	-	2,800,000
Non-Recurring	250,600	1,118,300	783,100
Equipment Replacement Fund	210,700	-	-
Total Uses	48,738,500	46,003,100	50,902,800
Operating Surplus/(Deficit)	\$ (5,063,500)	\$ (723,300)	\$ (5,817,800)

Revenues / Sources

During FY 2018-19 we are expecting City General Fund revenues (not including the Water Utility Fund) to total \$45.1 million. This does not include "applied" General Fund revenues that are derived from the operations of specific departments and allocated to offset those same departmental expenditures. FY 2018-19 General Fund revenues are projected to be about \$687,000 greater than the current year estimate, largely due to modest increases in property, sales, franchise, and motor vehicle in lieu taxes. The graph below illustrates an overall view of the City's revenues for the next fiscal year.



FY 2018-19 City Revenues - \$45.1 Million



Sales Tax Revenue – Historically, the City has benefitted greatly from the large business community and the sales tax revenue generated. Conversely, during the Great Recession the City's revenues were disproportionately impacted by the downturn in the economy. Since then, modest gains have generally provided for a slow but steady rise. In FY 2014-15 sales tax revenue reached the pre-recession high of \$26.4 million followed by two years of declines to \$25.1 million in FY 2016-17. Sales tax continues to be the City's largest and most volatile revenue source. In the FY 2017-18 Final Estimate, we anticipate an increase of almost \$400,000 from the prior year, with a modest uptick in FY 2018-19 (\$260,000) to \$25.7 million.

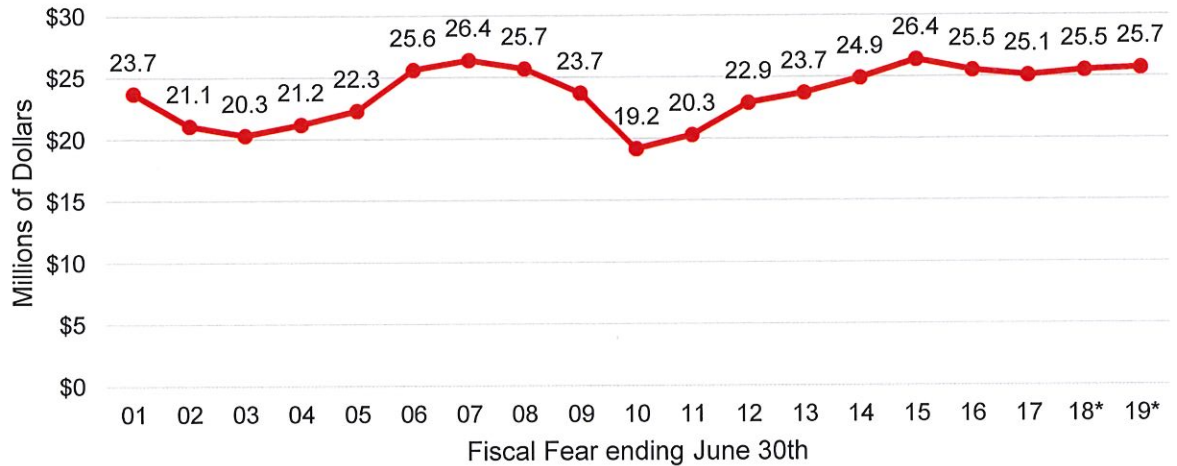


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Sales Tax Revenue History FY 2000-01 through FY 2018-19



*Estimate

Utility User's Tax - The City's utility user's tax (UUT) has continued to provide much-needed revenue diversification that reduces the City's reliance on sales tax revenue and the disproportionate impact an economic downturn has on the City of Santa Fe Springs compared to other communities. The City anticipates receiving \$6.43 million for FY 2017-18 with a slight increase to \$6.50 million for FY 2018-19.

Other Revenues – The Proposed Budget also includes modest anticipated increases in property taxes (\$74,000), property tax pass through from the Successor Agency (\$163,000), franchise taxes (\$90,000), and motor vehicle in lieu taxes (\$67,000).

Other Sources – Included in the budget are loan repayments stemming from the dissolution of the former City of Santa Fe Springs Community Development Commission (Redevelopment Agency) to the City. The repayments are expected to be paid back through the Redevelopment Property Tax Trust Fund (RPTTF) distributions as recognized obligations of the former redevelopment agency. Anticipated in FY 2017-18 and FY 2018-19 are \$2.53 million and \$2.80 million, respectively, in General Fund monies from the \$9.2 million original loan plus interest.

The budget figures presented represent the net impact to the General Fund after setting aside 20% of the loan repayments into the Housing Assets Fund in accordance with State law. The mechanics of receiving the loan repayments requires receipt of the entire proceeds into the General Fund along with a transfer of the required amounts



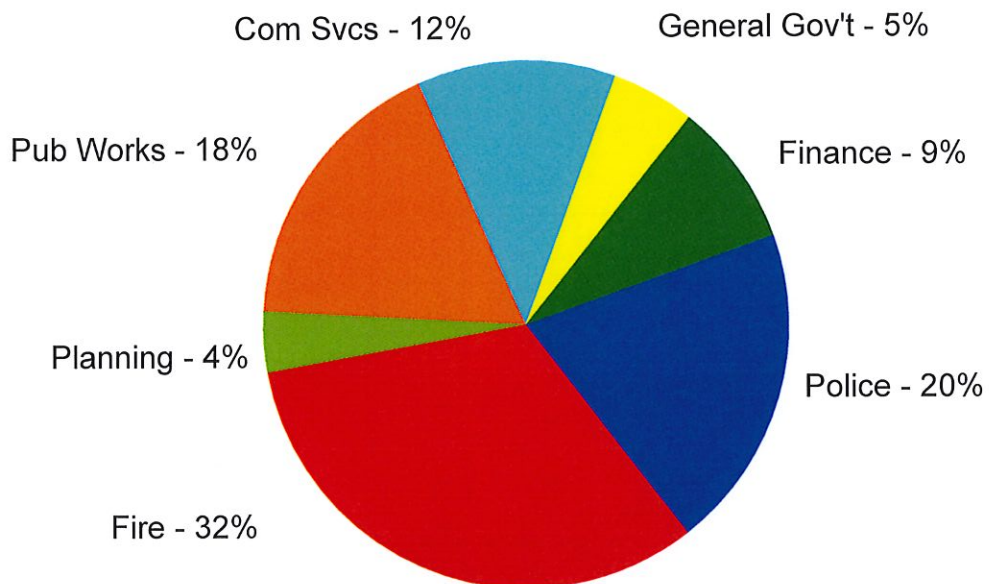
into the Housing Assets Fund.

Expenditures

Overall, General Fund expenditures and fund transfers are expected to total approximately \$50.9 million in FY 2018-19, or about \$4.9 million greater than the final estimate for FY 2017-18 of \$46.0 million. This is largely the result of departmental savings realized in FY 2017-18 due to a number of employee retirements during the year along with the elimination of CIP funding for FY 2017-18.

Departmental expenditures, net of applied revenues, are estimated at \$47.3 million in FY 2018-19. As noted above, budgeted labor costs for FY 2018-19 have declined from the original FY 2017-18 budget, however, the overall growth in the operating departments is the result of increasing required contributions towards the City's unfunded pension liabilities. The three largest department expenditure components (based on gross expenditures) are Fire, Police, and Public Works. Combined, the amounts spent on public safety (Police and Fire-Rescue Departments) account for slightly more than half of the City's operating expenditures.

FY 2018-19 Departmental Expenditures - \$47.3 Million *



*Amount is net of applied revenues. Pie chart illustrates department budgets prior to applied revenues.



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Proposed Changes To Close Budget Deficit for FY 2018-19

Based on meeting with the Council Budget Subcommittees, a number of actions are suggested as a means to preserve the General Fund's existing unassigned reserve fund balance of \$21.9 million through the end of FY 2018-19. The anticipated net increase for FY 2017-18 is recommended to be set-aside for a number of uses, some of which can be used in FY 2018-19 to offset the structural deficit.

The recommended actions for **FY 2017-18** consist of the following:

Unadjusted Projected Decline in Unassigned Fund Balance **(\$ 723,300)**

Recommended Actions:

Use the Successor Agency loan repayment to offset the projected decline in fund balance and provide additional funding	\$ 2,526,800
Restore a portion of the transfer to the CIP Fund	(852,500)
Reduce the budgeted transfer from the Employee Benefits Fund by \$147,800 from \$892,800 to \$745,000 and set aside an additional \$300,000 for anticipated retirements in FY 2018-19	(447,800)
Reduce the transfer from the Insurance Stabilization Fund by \$300,000 from \$473,700 to 173,700	(300,000)
Restore a portion of the Equipment Replacement Fund funding originally planned for FY 2017-18	(200,000)
Miscellaneous adjustments to department expenditures	(3,200)
Total Recommended Actions	<u>\$ (723,300)</u>

Adjusted Change in Projected Unassigned Fund Balance **\$ -**

These actions will: (1) partially restore a portion of the transfers and set-asides that were planned for FY 2017-18 prior to the June 2017 actions to reduce the budget deficit, (2) reduce transfers into the General Fund which were not originally planned but were part of the June 2017 revision to reduce the budget deficit, and (3) set aside additional funds which can be used in FY 2018-19 as part of reducing the budget deficit.



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The recommended actions for **FY 2018-19** consist of the following:

Unadjusted Projected Change in Unassigned Fund Balance **(\$5,817,800)**

Recommended Actions:

Use the Successor Agency loan repayment to offset a portion of projected decline in fund balance	\$ 2,800,000
Reduce the planned CIP transfer by \$1.8 million from \$2.8 million To \$1.0 million	1,800,000
Utilize General Fund fund balance which was assigned for Economic Contingencies in FY 2015-16	530,000
Utilize funds from the Employee Benefits Fund to cover anticipated costs of employee retirements during FY 2018-19	500,000
Utilize funds from the Insurance Stabilization Fund to offset costs of the General Fund's Risk Management Activity	376,800
Reduce originally reported transfer from Waste Management Fund	(167,300)
Adjust department expenditures to eliminate one part-time position to and create one full-time position	(\$44,700)
Adjusted other miscellaneous expenditure accounts	<u>23,000</u>
Total Recommended Actions	<u>\$5,817,800</u>

Adjusted Change in Projected Unassigned Fund Balance **\$ -**

These actions, although not sustainable over the long-run, will allow the City to preserve the General Fund unassigned reserves for one final year while revenue options are considered. The receipt of the loan payment will be the third annual installment of four total repayments anticipated, with the final payment expected in June 2020. In addition, the set-aside funds (Equipment Replacement, Insurance Stabilization, and Employee Benefits) will go from approximately \$2.9 million in June 2017 to less than \$750,000 by June 2019.

The recommended actions include the elimination of one part-time Administrative Intern and the addition of a full-time City Clerk Technician. The net cost of these personnel related actions is an additional cost of approximately \$44,700.

Lastly, the originally published budget book also contained a couple items which require correction, including the transfer from the Waste Management Fund, which needs to be reduced by \$167,300 due to the level of eligible expenditures. In addition, other miscellaneous corrections were noted which amounted to \$23,000 in expenditure savings.



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Conclusion

As has been made clear over the last few years, the City has been in transition due to the hard-learned lessons of the "Great Recession" and the devastating loss of Redevelopment. These losses are now compounded by dramatically increasing required contributions towards the City's unfunded pension liabilities. The overall challenge of the last few years has been, how can the organization emulate the wonderful achievements and outcomes of the past in an environment where we have dramatically fewer fiscal resources and as a result, fewer human resources? Achieving the same outcomes with fewer fiscal resources requires changing the way we do things in order to gain greater efficiencies.

Although the City has accomplished much of this over the past several fiscal years, the structural deficit continues to grow. The City has been able to protect the level of General Fund reserves through the receipt of non-recurring sources and deferral of CIP funding. The non-recurring sources will be depleted over the next two fiscal years and the deferral of CIP funding reduces available resources to deal with the City's infrastructure needs. In short, significant changes in the City's budget structure are required over the next year to deal with the structural deficit in the long-term.

Proposed revenue options include a City sales tax which is under consideration for the November 2018 general election. If the City is unable to produce additional revenues, significant cuts in operating expenditures would be necessary to balance the structural deficit.

A handwritten signature in black ink that reads "Raymond R. Cruz". The signature is fluid and cursive, with a long, sweeping tail on the letter "z".

Raymond R. Cruz
City Manager