CITY COUNCIL AGENDA REPORT

MEETING DATE: **October 20, 2009** **ITEM NUMBER:**

SUBJECT: **FISCAL YEAR 2009-2010 FIRST QUARTER BUDGET UPDATE**

DATE: **OCTOBER 8, 2009**

FROM: **FINANCE DEPARTMENT/FINANCIAL PLANNING**

PRESENTATION BY: **BOBBY YOUNG, BUDGET & RESEARCH OFFICER**

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RECOMMENDATION:

Receive and file the Fiscal Year 2009-2010 (FY 09-10) First Quarter Budget Update.

BACKGROUND:

The nation and much of the industrialized world has been entrenched in a serious economic recession for over a year. The impacts of the recession have affected every walk of life in every community across the country including Costa Mesa. During the 08-09 fiscal year as the recession continued with financial markets severely strained, the City initiated steps to curtail spending in the wake of reduced tax revenues Steps to hold positions vacant and reduce discretionary expenditures began shortly after the beginning of the fiscal year. At the November 12, 2008 City Council Study Session, staff detailed a proactive approach to reduce General Fund operating expenditures in FY 08-09 by $2.8 million. At the February 10, 2009 City Council Study Session, staff presented the Mid-Year Budget Report which detailed reductions of previous estimates to Sales Tax, Property Tax and Transient Occupancy Tax (TOT) as well as the expenditure reductions made on November 12, 2008.

In preparation of the 09-10 budget and with the added unstable condition of the State's budget, it was evident that much more serious steps would be necessary for the coming fiscal year At the April 14, 2009 City Council meeting, management presented the 09-10 Budget Development Strategy, a significant part of which included a 10 point Budget Management Strategy. The Budget Management Stargey was approved by the City Council and incorporated into the budget as approved on June 16, 2009.

Throughout the month of September 2009, the City's independent auditors reviewed the City's ledgers and transactions for FY 08-09. They have since completed their fieldwork and Finance staff will begin preparing the City's Comprehensive Annual Financial Report (CAFR) for the auditor's to give an opinion on. After such time, the CAFR will be available for City Council and the public. For purposes of this update, staff will present the preliminary year end amounts that it believes will also be shown in the CAFR.

The following is an update on the 08-09 fiscal year end and the individual items included as part of the 10 point Budget Management Strategy.

ANALYSIS:

For purposes of this update, the following analysis is of the General Fund only. Below are the preliminary year end balances for revenues, expenditures and fund balance.

PRELIMINARY FY 08-09 ENDING BALANCES – GENERAL FUND

	Adopted	Amended	Actual	Difference
Revenues	$ 112,377,023	$ 108,233,497	$ 93,711,979	$ (14,521,518)
Expenditures	118,835,464	123,240,322	112,819,684	10,420,638
Total Use of Fund Balance	($ 6,458,441)	($ 15,006,825)	($ 19,107,705)	$ (4,100,880)

For purposes of comparing with the numbers above, the "actual" column is the only one used. The following is compared to FY 07-08 financial statements:

- Total revenue decreased $9.6 milion.
  - Sales Tax of decreased $6.33 million or 18.61%.
  - Transient Occupancy Tax (TOT) decreased $1.04 million or 17.93%.
  - Property Tax increased $657,000 or 2.23%.

Sales Tax, Property Tax and TOT are the City's top 3 revenue sources and the decreases for Sales Tax and TOT can be solely attributed to the continued national recession.

- Total expenditures increased $278,000.
  - Salaries and Benefits increased $3.4 million.
  - Maintenance and Operations (M&O) and transfers decreased $3.1 million.

Salaries and Benefits increased because of: employee contractual obligations in August 2008, overtime and retirement costs. Maintenance and operations accounts decreased as a result of the reductions made at the November 12, 2008 Study Session.

- Total use of fund balance increased $11.96 million. **Projected total fund balance at June 30, 2009 will decrease from $66.2 million to $47.1 million.** With projected Reservations at $15.5 million, Designation of Emergency Capital at $14.125 million, that will leave approximately $17.5 million available for all other designations and Undesignated Fund Balance.

The following is an update on the implementation of the 10 point Budget Management Strategies.

1. **Reduce department operating budgets by an additional 5% for an average reduction of 10% by departments from the prior fiscal year which will require elimination of approximately 23 full time positions. Original estimate - $6,318,134.**

- From an amended budget in FY 08-09 of $120.9 million to an adopted budget in FY 09-10 of $102.4, the City reduced the General Fund budget by $18.5 million or 15.30%. Department budgets reflected the reductions to be made in employee compensation, overtime and retiree medical contributions as noted in Strategies #2, #3, & #7 below. Adjusting for the projected savings from these three adopted strategies the final adopted amount would have been $107.5 million and the reduction would have been approximately $13.4 million or 11.08%
- The City has chosen not to eliminate positions at this time pending implementation of the early retirement option - #6 below. However, the FY 09-10 adopted budget took into account anticipated savings from 18 previously vacant positions.
- **As of the completion of the first quarter of the fiscal year, all Departments are operating well within the adopted FY 09-10 budget limitations.**

2. **Negotiate reduction in employee compensation equating to approximately 5% of salary. Original estimate - $3,623,663.**

- The City successfully negotiated a reduction in employee compensation equal to 5% by way of furloughs for all employees except Costa Mesa Firefighters Association (CMFA) employees. Although the furloughs did not start simultaneously with the fiscal year, the furloughs will continue for 26 pay periods (the equivalent of one fiscal year) for a total savings of $3.0 million. It is anticipated savings of approximately $2.5 million will be recognized in FY 09-10, therefore the remaining $500,000 of savings will be recognized in FY 10-11.
- Since the City negotiated a new contract with CMFA, the savings from that plan will happen as soon as retirements take place and positions are left vacant. With 12 positions held vacant at an approximate budget amount of $150,000 each for an annual savings of $1.8 million, the savings will offset the cost of the retirement plan change from 3@55 to 3@50 (approximately $700,000 per year) for a net savings of approximately $1.1 million a year.
- **The combination of the 5% salary reduction and the contributions from reduced staffing in the Fire Department will result in savings of $2.75 million for FY 2009-10.**

3. **Reduction of $1 million in non-reimbursable overtime for Police and Fire departments. Original estimate - $1,000,000.**

- The Police Department is taking a strategic approach to reduce non-reimbursed overtime. Because the department is also having to schedule furloughs, management - while ensuring all basic services are still provided - is allowing overtime only when absolutely necessary.
- The Fire Department has shifted to a variable staffing model as per the new contract because of the current reduction of staff (as discussed in #4 below), which will produce a reduction in overtime.

- **By the conclusion of the first quarter of the fiscal year, 33% of the non-reimbursed overtime budget for both departments had been expended.**

4. **Negotiate suspension of minimum manning requirements in the Fire Department in order to accomplish the aforementioned reduction in overtime. Original estimate - $0.**

- The City successfully negotiated a reduction in minimum manning requirements in the Fire Department from the previous level of 32 personnel per shift. As per the new contract with CMFA, current variable staffing levels are at 30 per shift and upon the implementation of 3@50 and the close of a Retirement Incentive window, staffing will then be at a minimum 28 per shift. The current change to variable staffing is producing a savings in overtime by giving the shift command the ability to not immediately backfill for vacant positions because of retirements or vacation/sick leave. The reduction comes from having a staff of 3 (instead of 4) fire personnel on 2 of the 8 apparatus.

5. **Seek Federal Stimulus funding for ten police officer positions to be eliminated due to Police Department budget reductions. Original estimate - $1,052,010.**

- Unfortunately the City of Costa Mesa was not selected for Federal Stimulus funding for Police Officers in the COPS Hiring Recovery Program (CHRP) by the Department of Justice (DOJ) thereby reducing estimated revenues by $1.05 million. This federal program had funding of $1 billion and was reported to have received applications in excess of $8 billion. Although the City was not initially selected, staff is continuing to track this grant in case more funding becomes available.

6. **Offer PERS Retirement Incentive to create vacancies to (1) reduce the number of personnel that may be laid off as a result of reductions in departmental operating budgets and (2) create additional vacancies needed for budgetary purposes (assumes total of 50 employees opting to retire of which 25 positions would be eliminated). Original estimate - $3,485,000.**

- The City began offering the Retirement Incentive of 2 years additional service credit on August 18, 2009. The window to take advantage of the incentive is scheduled to close December 31, 2009. To date, 34 employees have either retired or have officially filed the necessary paperwork to retire. Staff is anticipating more retirements by the December 31 deadline. After the deadline, management will determine if adopted service levels can be sustained without filling any of these vacancies. After such time, an annualized savings will be calculated.
- **While the window is still open for personnel to take advantage of the early retirement option, the number of personnel to date who have retired or filed for retirement is tracking well with the budgetary goal of 50 personnel exercising this option.**

7. **Suspension of the Retiree Health Savings (RHS) Plan (contributions are comprised of 1% by employer and 1% by employee). Original estimate - $508,764.**

- The City successfully negotiated the suspension of the RHS plan with all represented and non-represented employees for a period of 26 pay periods. The suspension began with the pay period of August 29.
- **Since the suspension did not start at the beginning of the fiscal year, it is estimated the City will recognize a savings of about $420,000 in FY 09-10 and the remaining $80,000 in FY 10-11.**

8. **Implement various cost recovery programs including resident EMS fees, inspection fees, and Police and Fire Cost Reimbursement Fees. Original estimate - $959,700.**

- On May 5, 2009, City Council authorized staff to implement a Motor Vehicle Accident Cost Recovery Program, which seeks reimbursement of staff time and materials, mostly by the Fire Department, when responding to an auto accident. It is estimated this new program will generate approximately $180,000 in new revenue for the City's General Fund. By the end of the first quarter of the fiscal year, 92 claims have been processed resulting in $41,000 revenues to date.
- On June 2, 2009, City Council authorized staff to implement a Hazardous Materials Disclosure Late Fee, which is estimated to generate approximately $4,000 in new revenue for the City's General Fund. Billings for Hazardous Materials are sent in July each year due in 30 days. By the end of the first quarter of the fiscal year, a total of about $200 in late fees had been received. The bigger impact of this fee is the incentive to pay on time. So far staff has noticed a greater number of payments received in a timely manner compared to prior years because the fee is in place.
- Also on June 2, 2009, City Council adopted a resolution for Fire Prevention User Fees and Charges which established a flat rate for those fees rather than the 1997 Uniform Administrative Code tables. Because of this change in calculation, an estimate of the increase in revenue could not be completed.
- Other programs proposed but not adopted: Apartment Inspection Fees, Business Inspection Fee, and modification of Emergency Medical Services (EMS) billing without regard to residency. The total estimated revenue from the fees not implemented – $925,000.

9. **Renegotiate/extend the Golf Course Operator's agreement for a greater share of the revenues and institute formula adjustments to the greens fees. Original estimate - $244,850.**

- The City successfully renegotiated the Golf Course Operator's agreement with Mesa Verde Partners with the approval of City Council on June 16, 2009. The new agreement provides that 2.5% of greens fees be directed to the City's General Fund – approximately $122,500, and that the City receive one half of the existing balance available for golf course capital improvements – approximately $175,000, for a total increase of revenues in FY 09-10 of $297,500.
- **Revenues for the first quarter as compared to the first quarter of FY 08-09 have increased by $10,000.**

10. **Utilization of undesignated unreserved General Fund Balance. Original estimate - $2,900,000.**

- As adopted, the projected use of fund balance was $4.65 million. Some of the items above have been initiated (item #9) while others were either not implemented until after the start of the fiscal year (items #2, #7) or were not implemented altogether (items #5 and parts of #8), the resulting projected use of fund balance would be $6.35 million. However, this does not include any savings and costs from the PERS Retirement Incentive (item #6) or from the extended CMFA contract (item #4) as those amounts could not be estimated at the time of this update. The combination of savings from item #4 and item #6 can realistically reduce the projected increased use of fund balance by $2 million.
- Also, while preparing the FY 10-11 budget, staff will incorporate appropriation reductions (items #2 and #7) of at least $580,000.

SUMMARY

During the 08-09 fiscal year, Costa Mesa along with communities nationwide was impacted by the continuing recession. Staff began taking direct action to reduce operating expenditures as early as August 2008. With total revenues down $9.6 million and expenditures up $278,000 from FY 07-08, preliminary use of fund balance for FY 08-09 is $19.1 million. The City is projected to have $47.1 million in total fund balance as of June 30, 2009.

While preparing the FY 09-10 budget, it was projected the national recession would continue with the added impact to the City of the State's budget dilemma. Therefore, management requested City Council endorsement of the 10 point Budget Management Strategy to help balance the budget. Staff began working on different aspects of the 10 point plan as early as January 2009. As of September 2009, all 10 points have been implemented, to different degrees, with some completed. The current status of each is stated above.

ALTERNATIVES CONSIDERED:

No alternatives were considered.

FISCAL REVIEW:

With preliminary revenues of $93.7 million and preliminary expenditures of $112.8 million, the use of fund balance for the 08-09 fiscal year was $19.1 million. The City is projected to have $47.1 million in total fund balance as of June 30, 2009.

As it relates to the adopted budget and the current status of the 10 point plan, the projected use of fund balance for FY 09-10 is $6.35 million. This use of fund balance is expected to decrease as the results from the PERS Retirement Incentive and reduction of minimum manning in the Fire Department take place.

LEGAL REVIEW:

No legal review is required for this item.

CONCLUSION:

While there are reported signs of economic recovery nationally, it is premature to be making any assumptions of substantive improvement in the local economy and a consequent increase in tax revenues. Unemployment is still near record levels and consumers have not demonstrated confidence that the recession is over. Taking into account the substantial reductions in fund balance to maintain operations, the City should not consider adding items back into the operating budget at this time. With only one quarter complete in the current fiscal year and the 10 Point Management Budget Strategy still in the process of being implemented, it is far too early to depart from the adopted plan. In fact, management would suggest that we need to continue to look for additional opportunities for savings and reductions in the cost of providing services. In so doing, the City will be better positioned as the economy recovers to address deferred maintenance, capital projects and the reinstate of programs eliminated or reduced for budgetary purposes.

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