CITY CHIEF EXECUTIVE OFFICER'S BUDGET MESSAGE

April 21, 2014

Honorable Mayor, Members of the City Council, and Citizens of Costa Mesa:

I am pleased to submit the Fiscal Year 2014-15 Preliminary Operating and Capital Budget. The objectives used in developing this budget were to submit a balanced budget to the City Council; to do the best job possible of maintaining current excellent levels of service to the community; to implement City Council's priorities as feasible; and to be prudent in our revenue estimates and cautiously optimistic overall. The City's management team and staff have put together a preliminary operating and capital expenditure plan that addresses the City Council's priorities while fulfilling the service requirements of the people who live, work, and play in our community.

As presented, this represents a balanced preliminary budget for the coming fiscal year without the use of General Fund reserves and provides the highest level of service to the community within existing financial resources.

Unlike prior years, where the focus has been on reducing programs & services, the proposed budget maintains and, in a few areas, enhances the current level of service from FY 13-14. Having already reduced operating expenditures to a minimum base level in prior years, management decided to keep the FY 14-15 budget at the current level while allowing for Departments to make requests for new items that they believed met the Community and City Council needs. In December 2013, at the beginning of the budget process, management issued updated budget policies. These policies called for a budget that incorporated the following concepts:

- Consistency with Council and CEO priorities
- Balanced budgets with the exception of using fund balances for carry-over or one-time items
- Realistic assumptions for revenue forecasts
- A goal of 5% to 7.5% of General Fund revenues dedicated to funding capital projects
- A goal of at least 1% of General Fund revenues dedicated to increasing reserves
- A goal of $1 million budgeted for contingencies
- Requests for budget increases being offset by reductions in lower priority items where possible
- Flexibility for department heads to reallocate resources in operating accounts during the fiscal year as long as they remain within the budgeted total amount and have the concurrence of the Finance Department

The first set of FY 14-15 preliminary operating budget requests submitted by the departments to the Finance Department totaled $111.8 million; $8.6 million or 8.4% over the prior year. A large part of this increase was due to an increase in retirement costs, new positions added mid-year, increased General Fund contribution to capital projects and other operating cost increases. In addition, departments requested $1.9 million in budget increases and $400,000 to fund four new positions for a total General Fund budget of $114.1 million. During the month of March, the Budget Review Team held meetings with each department to review and discuss the budget requests.

The first set of FY 14-15 preliminary revenue estimates totaled $108.7 million using the assumptions of modest economic growth, a stable real estate market and increasing development activity in the city. Revenue assumptions are discussed in detail in the Summaries of Financial Data section of this budget book.

The departmental budget requests and preliminary revenue estimates described above combined to create an initial budget gap of $5.4 million. The budget gap was closed by making the following adjustments in concert with discussions with the CEO, Finance Department, departmental budget staff and department heads:

- Reduced duplication of part-time, contract and vacant positions saving about $200,000
- Reviewed actual maintenance and operation accounts spending to see where requests for budget increases can be absorbed saving $548,968
- Approved eight of 33 requested vehicles and suspended equipment rental charges to departments for one year saving $977,814
- City Attorney budget set at current year amount rather than including a $246,500 increase
- Public Services design and engineering costs budgeted directly in Measure M funds while still meeting the maintenance of effort requirements saving the General Fund $709,000
- Fire truck lease to be paid off one year early by the Equipment Replacement Fund saving the General Fund $219,641
- Deleted 12 vacant positions in the Fire department related to the new service delivery model approved by the City Council on May 7, 2013. The savings are partially offset by a $300,000 increase in overtime for a net savings of $758,000
- City-wide salary savings of $1,750,000 was increased by $1,075,187 to $2,825,187 representing an average City-wide 3.5% vacancy factor for the entire fiscal year
- None of the five new requested positions were approved saving $477,677
- Department heads met with the CEO on April 2, 2014 for a joint review of all requests for budget increases for further budget reductions of $259,993
- Revenue projections were increased by $575,000 based on updated year-to-date actuals and other items.

As a quick overview, here is the preliminary budget for FY 14-15 for all funds compared to the FY 13-14 adopted budget:

PRELIMINARY BUDGET - ALL FUNDS				
Appropriations/	Adopted	Preliminary	Increase (Decrease)	
All Funds	FY 13-14	FY 14-15	Amount	Percent
Operating Budget	$ 109,508,647	$ 114,937,036	$ 5,428,389	4.96%
Transfers Out	3,985,000	5,517,067	1,532,067	38.45%
Capital Budget	18,054,059	19,421,001	1,366,942	7.57%
Total	$ 131,547,706	$ 139,875,104	$ 8,327,398	6.33%

GENERAL FUND ADOPTED BUDGET

The General Fund provides 90.4% of the total operating budget for all governmental funds. The total preliminary budget is $109.4 million, an increase of $6.2 million or 6.1% from the FY 13-14 adopted budget. Table 1 is a summary of the total resources and requirements for FY 14-15:

Table 1				
PRELIMINARY BUDGET - GENERAL FUND				
	Adopted	Preliminary	Increase (Decrease)	
	FY 13-14	FY 14-15	Amount	Percent
Estimated Revenues	$ 103,250,486	$ 109,430,235	$ 6,179,749	5.99%
Transfers In	-	-	-	
Use of Fund Balance	(59,215)	-	59,215	-100.00%
Total Resources	$ 103,191,271	$ 109,430,235	$ 6,238,964	6.05%
Operating Budget	$ 99,206,271	$ 103,913,168	$ 4,706,897	4.74%
Transfers Out	3,985,000	5,517,067	1,532,067	38.45%
Total Appropriations	$ 103,191,271	$ 109,430,235	$ 6,238,964	6.05%

FINANCIAL OUTLOOK

As a result of the continued improvement in the economy, most revenue sources are projected to continue to increase. The City experienced increases in Sales Tax, Property Tax, Transient Occupancy Tax (TOT) and Building Permit revenue last year and expects those to continue in FY 14-15. The City will evaluate revenues and continue to find ways to mitigate costs. Doing so will continue to stabilize the City's budget, provide necessary services to the community and work towards re-building reserves.

The City remains cautious about its cash position. With the depletion of reserves in previous years, it is very important for the City to maintain a balanced budget and stabilize cash. Based on the timing of the receipt of certain revenues, the City has periods of time when it uses more cash than it receives. That use of cash is replenished later in the fiscal year with the receipt of property tax revenue. The General Fund saw an operating surplus at the end of FY 12-13 which helped to increase the overall cash position. The City is preparing for this trend to continue in the coming fiscal year and in FY 14-15.

HIGHLIGHTS OF THE PRELIMINARY BUDGET

The FY 14-15 preliminary budget contains funding for on-going services to the community. The following highlights reflect some of the changes and facts regarding the preliminary budget:

- The City's portion of employee retirement cost is $21,564,578; an increase of $2,753,606 or 14.6%
- The budget contains funding for an additional payment of $500,000 toward reducing the unfunded liability associated with retirement costs
- The Council has also approved the prepayment of the City's cost of retirement benefits for miscellaneous employees at a savings of $226,551. This savings combined with the additional payment of $500,000 will be used to reduce the balance owed on the Fire Side Fund.
- All mid-year positions approved by the Council on January 21 and February 4, 2014 are included
- General Fund contribution to Capital Projects is 5% of the General Fund budget: $5,450,000 (an increase of $1,615,000 or 42% over FY 13-14)
- Capital Projects include advance funding of a four-year level-pay plan for the next generation of the 800 MHz Coordinated Communication System at $1,584,000 per year. The Police Department will use $1,213,307 of Narcotics Asset Forfeiture funds toward this project.
- A newly created Information Technology Replacement Fund will receive $100,000 from allocated charges to departments. This will begin the process of accumulating funds for future replacements and upgrades.

- An increase of $300,000 is included for service improvements at the Senior Center
- A 4% salary increase for Police Department is included consistent with the September 1, 2007 – August 31, 2010 CMPA and City side letter agreement
- Phased-in conversion from City Jail staffing to G4S contract staffing
- Development Services permit & plan check revenue is estimated to increase by 10% based on projected development activity
- Contingency appropriations are $1,000,000
- All management budget policy goals with the exception of increasing reserves are met.

GENERAL FUND RESERVES/USE OF FUND BALANCE

The General Fund – Total Fund Balance was $45.6 million as of June 30, 2013. The City continues to maintain a $14.125 million emergency general operating reserve, along with reserves for workers' compensation, general liability claims, and compensated absences.

A schedule of estimated fund balances for all funds is found in the Summaries of Financial Data section of this budget book.

CAPITAL IMPROVEMENT PROJECTS

The City is entering its third year of significant funding dedicated to infrastructure improvements in the capital improvement program. The preliminary capital budget is $19.4 million. In reviewing the Capital Improvement budget, it is important to keep in mind that most projects are funded by restricted revenue sources or grants. Consequently, there will potentially be significant differences from year to year in both the numbers of projects adopted and the total dollars budgeted.

Approximately $6.8 million or 35% of the total funding for capital projects comes from the Measure M Funds and another $2.6 million or 13% comes from the Gas Tax Fund. Both the Measure M Funds and Gas Tax Fund are earmarked for streets and/or transportation-related expenditures. Other funding sources for capital improvements are the Air Quality Management District Fund, the Community Development Block Grant (CDBG) Fund, Drainage Fees, Narcotics Asset Forfeiture Funds, Traffic Impact Fees, other grants and the General Fund.

Significant street improvement and maintenance projects were completed in FY 13-14. Table 2 below illustrates the total capital projects funding by category planned for FY 14-15. It reflects an emphasis on streets, traffic planning and operations, storm drains, and the next generation of the 800 MHz Coordinated Communications System. This budget includes $1 million to restructure and make more efficient use of the Neighborhood Community Center and Library facilities. It also reflects a significant increase in General Funds dedicated to capital projects consistent with the goal of dedicating 5% of the General Fund revenues toward capital projects.

Table 2				
CAPITAL IMPROVEMENT PROJECTS				
	Adopted	Preliminary	Increase (Decrease)	
	FY 13-14	FY 14-15	Amount	Percent
Parkway & Median Improvements	$ 300,000	$ 100,000	$ (200,000)	-66.67%
Street Improvements & Maintenance	8,716,962	5,038,307	(3,678,655)	-42.20%
Storm Drain Improvements	3,371,600	2,090,000	(1,281,600)	-38.01%
Curbs & Sidewalks	400,000	550,000	150,000	37.50%
Traffic Planning	1,669,538	3,307,000	1,637,462	98.08%
Traffic Operations	-	3,330,694	3,330,694	N/A
Park Development & Maintenance	3,095,959	1,730,000	(1,365,959)	-44.12%
Building Maintenance	500,000	1,691,000	1,191,000	238.20%
Next Generation 800 MHz Comm. System	-	1,584,000	1,584,000	N/A
Total Appropriations	$ 18,054,059	$ 19,421,001	$ 1,366,942	7.57%
General Funds	$ 3,835,000	$ 5,450,000	1,615,000	42.11%
Other Funds	14,219,059	13,971,001	(248,058)	-1.74%
Total Appropriations	$ 18,054,059	$ 19,421,001	$ 1,366,942	7.57%

NEXT STEPS

The next steps in the FY 14-15 budget process centers on the following events:

- May 13, 2014 City Council study session
- May 27, 2014 Review by the Finance Advisory Committee
- May 27, 2014 City Council study session—Capital Improvement Program
- June 17, 2014 City Council budget hearing and adoption

SUMMARY

Although current economic conditions are improving, and continue to do so, this preliminary budget does not fully support the overall high level of service that the citizens of Costa Mesa had grown accustomed to in the past. Those levels are likely unsustainable. It does however proposed a balanced financial plan, without the use of fund balance or reserves, and maintains and in a few areas, enhances the current level of service.

ACKNOWLEDGEMENT

The development of the preliminary budget takes a great amount of staff time and effort, and has to be completed within a defined timeline. I sincerely appreciate the contribution made by all department directors, division managers, and departmental budget liaisons. Special recognition is extended to the Finance budget team and Central Services staff. I thank the City Council for their continued support in making Costa Mesa a financially stable and well-balanced community and look forward to the study session and budget hearing on this preliminary budget.

Respectfully submitted,

Thomas R. Hatch

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Chief Executive Officer
City of Costa Mesa