



**DATE:** April 17, 2018

**TO:** Mayor and City Council  
Redevelopment Successor Agency Board  
Housing Authority Board

**FROM:** Director of Finance

**SUBJECT** Presentation of Proposed FY 2019 Operating Budget and Update on Five-Year Plan

## **RECOMMENDATION**

That Council receives and comments on the Proposed FY 2019 Operating Budget and the Update to the Five-Year Plan.

## **SUMMARY**

The Proposed FY 2019 Operating Budget is presented to the City Council in advance of the April 28, 2018 Saturday work session. Council will receive and comment on the Proposed FY 2019 Operating Budget and the updated Five-Year Plan.

## **BACKGROUND**

The FY 2019 Operating Budget process began earlier than previous fiscal years in January of 2018. Over the last several months, Finance staff and the various departments met to review the respective FY 2019 department budget proposals before presenting them to the City Manager. On March 7, the FY 2019 Operating Budget Process was presented to the Council Budget and Finance Committee.

[In October 2017, the City held a Fiscal Sustainability work session](#), where City Council was presented with the new General Fund Long Range Financial Model (Model), as well as options for revenue generating, cost shifting, expenditure control, and changes in provision of services to assist in closing the City's long term structural budget gap. City Council supported exploration of options primarily from revenue, expenditure control, and cost shifting.

## **DISCUSSION**

### Proposed FY 2019 Operating Budget

The purpose of this agenda item is to present Council with the Proposed FY 2019 Operating Budget document in advance of the April 28, 2018 Saturday work session. The Council will

consider the annual budget over the coming weeks prior to the planned adoption on May 22, 2018. The City Manager’s Budget Message & Budget Overview provides Council with a summary of the various considerations, recommended changes, and highlights of the FY 2019 budget, included herein as **Attachment II** and **Attachment III**.

The full FY 2019 Proposed Budget document will be available on-line on the City’s web site after 5:00 pm, Monday, April 16, 2018 and in hard copy on April 17, 2018. The proposed FY 2019-2028 Capital Improvement Program budget is scheduled to be presented to and discussed by Council on May 8, 2018.

Update on Five-Year Plan

City Council reviewed the Model at the budget work session on October 14, 2017, and reviewed **Attachment IV**, which illustrated that, if the City took no action, the General Fund reserve level would fall below the City’s 20% General Fund Reserve Policy, to 14.9% in 2019, 8.2% in 2020, and depletion of all the City’s General Fund reserve by 2021, leaving a -1% General Fund ending fund balance.

**TABLE 1: FIVE-YEAR GENERAL FUND PROJECTION (OCTOBER 2017)**

<b>FIVE-YEAR GENERAL FUND PROJECTION OCTOBER 2017</b> <i>in thousands</i>	<b>FY 2019</b> <b>Year 1</b>	<b>FY 2020</b> <b>Year 2</b>	<b>FY 2021</b> <b>Year 3</b>	<b>FY 2022</b> <b>Year 4</b>	<b>FY 2023</b> <b>Year 5</b>
Revenues	\$158,113	\$160,690	\$164,181	\$170,353	\$176,909
Expenditures	163,266	170,963	180,068	189,690	195,683
<b>Beginning Balance</b>	<b>\$29,424</b>	<b>\$24,271</b>	<b>\$13,998</b>	<b>(\$1,890)</b>	<b>(\$21,227)</b>
<i>Change in Reserve - Surplus / (Shortfall)</i>	<b>(\$5,153)</b>	<b>(\$10,273)</b>	<b>(\$15,887)</b>	<b>(\$19,337)</b>	<b>(\$18,774)</b>
<b>Ending Balance</b>	<b>\$24,271</b>	<b>\$13,998</b>	<b>(\$1,890)</b>	<b>(\$21,227)</b>	<b>(\$40,001)</b>
Target to maintain 20% GF Reserves in Operating Expenses	\$32,653	\$34,193	\$36,014	\$37,938	\$39,137
General Fund Reserve Level as % of Total Expenses	14.9%	8.2%	-1.0%	-11.2%	-20.4%
Amount Above or (Below) Target 20%	<b>(\$8,383)</b>	<b>(\$20,195)</b>	<b>(\$37,903)</b>	<b>(\$59,165)</b>	<b>(\$79,138)</b>
Percentage Above or Below Target 20%	-26%	-59%	-105%	-156%	-202%

Mid-Year Adjustments and Impact on Five Year Forecast

During the mid-year review of the FY 2018 Adopted Budget, a mid-year expenditure adjustment of \$2.15 million in the General Fund was made in order to ensure the Model was updated to reflect the FY 2017 audited actuals, FY 2018 revised revenue projections, and FY 2018 mid-year expenditure adjustments. **Attachment V** shows the General Fund reserve level falling below the City Council’s 20% policy level to 12.6% in 2019, 4.5% in 2020, and an exhaustion of the City’s General Fund reserve in 2021, with -6% ending fund balance.

<b>FIVE-YEAR GENERAL FUND SUMMARY - FY18 MID-YEAR PROJECTION</b>	<b>FY 2019</b>	<b>FY 2020</b>	<b>FY 2021</b>	<b>FY 2022</b>	<b>FY 2023</b>
<i>in thousands</i>	<b>Year 1</b>	<b>Year 2</b>	<b>Year 3</b>	<b>Year 4</b>	<b>Year 5</b>
Revenues	\$158,150	\$160,700	\$164,161	\$170,353	\$176,909
Expenditures	166,163	173,924	183,093	192,779	198,838
<b>Beginning Balance</b>	<b>\$29,000</b>	<b>\$20,987</b>	<b>\$7,763</b>	<b>(\$11,168)</b>	<b>(\$33,595)</b>
<i>Change in Reserve - Surplus / (Shortfall)</i>	<b>(\$8,013)</b>	<b>(\$13,224)</b>	<b>(\$18,932)</b>	<b>(\$22,426)</b>	<b>(\$21,929)</b>
<b>Ending Balance</b>	<b>\$20,987</b>	<b>\$7,763</b>	<b>(\$11,168)</b>	<b>(\$33,595)</b>	<b>(\$55,524)</b>
Target to maintain 20% GF Reserves in Operating Expenses	\$33,233	\$34,785	\$36,619	\$38,556	\$39,768
General Fund Reserve Level as % of Total Expenses	12.6%	4.5%	-6.1%	-17.4%	-27.9%
Amount Above or (Below) Target 20%	<b>(\$12,245)</b>	<b>(\$27,021)</b>	<b>(\$47,787)</b>	<b>(\$72,150)</b>	<b>(\$95,292)</b>
Percentage Above or (Below) Target 20%	<b>(37%)</b>	<b>(78%)</b>	<b>(130%)</b>	<b>(187%)</b>	<b>(240%)</b>

During the October 14, 2017 budget work session, City Council identified several budget balancing strategies and directed staff to explore the following options for potential implementation beginning in FY 2019. These strategies are included in **Attachment VI**:

<b>Options</b>	<b>Estimated Annual Fiscal Impact</b>	<b>Additional Details</b>
<b>Revenue Generation Strategies</b>		
<i>Real Property Transfer Tax (RPTT)</i>	\$4,020,000 - \$16,890,000	Potentially Place on Ballot in 2018 (\$7-\$15 per \$1,000) FY 2020 could be first full year
<i>Transient Occupancy Tax (TOT)</i>	\$356,000 - \$1,370,000	Potentially Place on Ballot in 2018 (10%-14%) FY 2020 could be first full year
<i>Business License Tax (BLT)</i>	\$2,900,000 - \$4,000,000 increase	Potentially Place on Ballot in 2020 \$19.06-\$26.02 per capita
<i>Cannabis Tax</i>	\$750,000-\$2,500,000	Assume 2% growth annually FY 2019 is first full year
<b>Expenditure Controls and Cost Shifts</b>		
<i>Update Cost Allocation Plan</i>	\$100,000	
<i>Employee Cost Sharing</i>	\$1,000,000	
<b>Service Delivery Changes</b>		
<i>Prioritized Use of Measure C Revenue after Projects Completed - Transfer to GF</i>	\$7,000,000 - \$7,500,000	Beginning in FY2021
<i>Fleet Utilization Study</i>	\$121,975	

If the City does not implement any changes and only adopts the FY 2019 budget as proposed, **Attachment VII** shows the General Fund reserve level falling below the City Council's 20% General Fund Reserve Policy to 14.7% in 2019, 8.5% in 2020, and complete depletion of the City's General Fund reserve in 2021, leaving a -1% ending fund balance.

<b>FIVE-YEAR GENERAL FUND SUMMARY - FY 2019 PROPOSED BUDGET</b>	<b>FY 2019</b>	<b>FY 2020</b>	<b>FY 2021</b>	<b>FY 2022</b>	<b>FY 2023</b>
<i>in thousands</i>	<b>Year 1</b>	<b>Year 2</b>	<b>Year 3</b>	<b>Year 4</b>	<b>Year 5</b>
Revenues	\$159,748	\$162,774	\$166,492	\$172,774	\$179,454
Expenditures	165,219	172,324	181,570	191,282	197,351
<b>Beginning Balance</b>	<b>\$29,713</b>	<b>\$24,242</b>	<b>\$14,691</b>	<b>(\$386)</b>	<b>(\$18,894)</b>
<i>Change in Reserve - Surplus / (Shortfall)</i>	<i>(\$5,471)</i>	<i>(\$9,551)</i>	<i>(\$15,078)</i>	<i>(\$18,508)</i>	<i>(\$17,897)</i>
<b>Ending Balance</b>	<b>\$24,242</b>	<b>\$14,691</b>	<b>(\$386)</b>	<b>(\$18,894)</b>	<b>(\$36,791)</b>
Target to maintain 20% GF Reserves in Operating Expenses	\$33,044	\$34,465	\$36,314	\$38,256	\$39,470
General Fund Reserve Level as % of Total Expenses	14.7%	8.5%	-0.2%	-9.9%	-18.6%
Amount Above or (Below) Target 20%	(\$8,802)	(\$19,773)	(\$36,700)	(\$57,151)	(\$76,261)
Percentage Above or (Below) Target 20%	(27%)	(57%)	(101%)	(149%)	(193%)

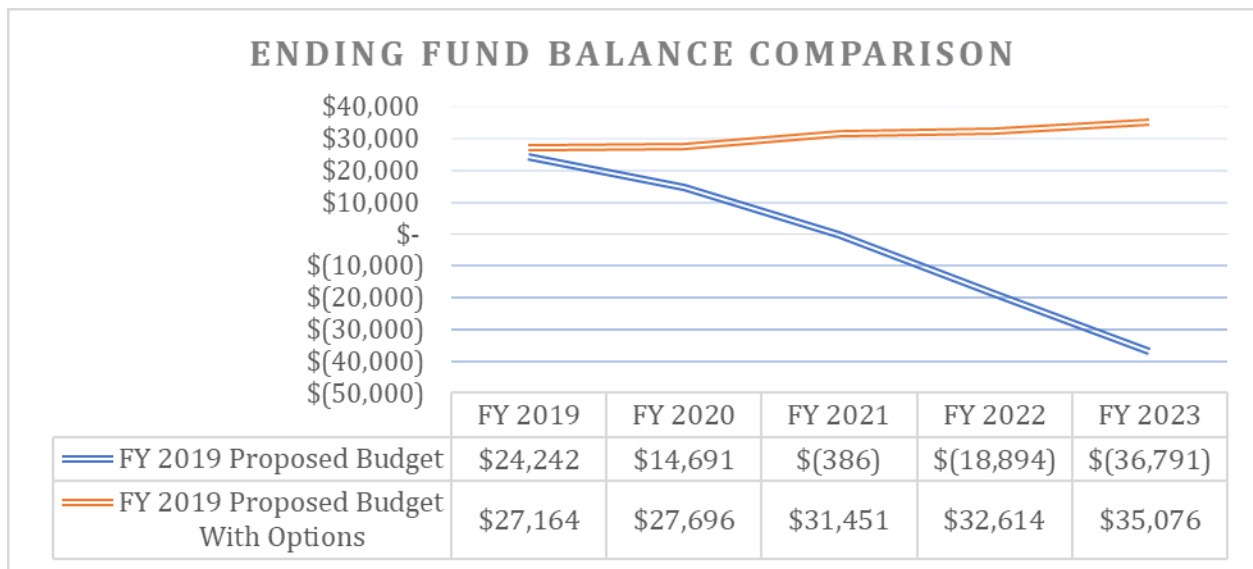
While the proposed FY 2019 General Fund budget is balanced with the reluctant use of \$5.5 million of General Fund reserves, achieving this balance is the result of some difficult choices. While the budget does not contain expenditure reductions, it maintains current service levels and includes limited growth in necessary areas. It also restores full funding to the City's internal fleet and information technology (IT) funds, consistent with FY2017 levels. In FY 2018, the Council made a one-time reduction to transfers to these internal service funds to balance the FY 2018 budget. These reductions are not sustainable long term as they prevented the City from making key investments and replacements of critical fleet and IT equipment. The ultimate adopted FY 2019 budget may again incorporate some one-time balancing measures to reduce this proposed use of General Fund reserves.

**Attachment VIII** shows the impacts on the five year forecast with the FY 2019 proposed budget and the Council directed options being implemented. In this model, the General Fund reserve level falls below the City Council's 20% General Fund Reserve Policy to 16.3% in 2019, 16.0% in 2020, 17.2% in 2021, 17.0 in 2022, and 17.7% in 2023. With the inclusion of the City Council directed options, there is very gradual restoration of General Fund reserves. This option includes the following changes in conditions:

- Increase Real Property Transfer tax to \$9.95/\$1,000 in 2019
- Increase Transient Occupancy Tax to 12% in 2019
- Increase the Business License Tax by 25% in 2021
- Cannabis Tax revenues at \$750,000 in 2019
- Cost Allocation Plan Update - \$100,000 annually
- Employee Cost Sharing - \$1,000,000 annually
- Prioritized Use of Measure C Revenue Transfer to GF in 2021 - \$7,500,000 annually
- Fleet Utilization Study - \$121,975 annually

FIVE-YEAR GENERAL FUND SUMMARY - FY 2019 PROPOSED BUDGET With City Council Directed Options <i>in thousands</i>		FY 2019	FY 2020	FY 2021	FY 2022	FY 2023
		Year 1	Year 2	Year 3	Year 4	Year 5
Revenues		\$163,693	\$173,908	\$186,409	\$193,561	\$200,964
Expenditures		166,241	173,376	182,653	192,398	198,502
<b>Beginning Balance</b>		<b>\$29,713</b>	<b>\$27,164</b>	<b>\$27,696</b>	<b>\$31,451</b>	<b>\$32,614</b>
<i>Change in Reserve - Surplus / (Shortfall)</i>		<i>(\$2,548)</i>	<i>\$531</i>	<i>\$3,755</i>	<i>\$1,163</i>	<i>\$2,462</i>
<b>Ending Balance</b>		<b>\$27,164</b>	<b>\$27,696</b>	<b>\$31,451</b>	<b>\$32,614</b>	<b>\$35,076</b>
Target to maintain 20% GF Reserves in Operating Expenses		\$33,248	\$34,675	\$36,531	\$38,480	\$39,700
General Fund Reserve Level as % of Total Expenses		16.3%	16.0%	17.2%	17.0%	17.7%
Amount Above or (Below) Target 20%		(\$6,084)	(\$6,980)	(\$5,080)	(\$5,866)	(\$4,624)
Percentage Above or (Below) Target 20%		(18%)	(20%)	(14%)	(15%)	(12%)

As we continue to work toward exploration and implementation of the City Council directed options in pursuit of fiscal sustainability, work remains. If the structural gap cannot be resolved over the long-term, future budgets are likely contain recommendations for service reductions even without significant change to economic conditions.



## STRATEGIC INITIATIVES

The Proposed FY 2019 Operating Budget includes budget augmentations to fund projects that support the three Council Strategic Initiatives. These will be discussed further as part of the upcoming Saturday budget work session.

## NEXT STEPS

Upcoming opportunities for public input and comment are:

April 28<sup>th</sup> All-day Special Work Session of Council, including Departmental budget presentations

May 1<sup>st</sup> Budget Work Session #1 at regular Council meeting (if needed)

May 8<sup>th</sup> Presentation of FY 2019-2028 Capital Improvement Program Budget  
(regular City Council meeting – work session)

May 8<sup>th</sup> Budget Work Session #2

May 22<sup>nd</sup> Public Hearing and Adoption for FY 2019 Operating and Capital budgets

*Prepared by:* Nicole Gonzales, Budget Officer  
Monica Davis, Management Analyst II

*Recommended by:* Dustin Claussen, Director of Finance

Approved by:



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Kelly McAdoo, City Manager