THE CITY OF BENICIA CALIFORNIA

JOINT BENICIA CITY COUNCIL & FINANCE COMMITTEE
SPECIAL MEETING AGENDA

City Council Chambers
February 03, 2015
6:00 PM

Times set forth for the agenda items are estimates. Items may be heard before or after the times designated.

I. CALL TO ORDER (6:00 PM):

II. CONVENE OPEN SESSION:

A. ROLL CALL.

B. PLEDGE OF ALLEGIANCE.

C. REFERENCE TO THE FUNDAMENTAL RIGHTS OF THE PUBLIC: A plaque stating the fundamental rights of each member of the public is posted at the entrance to this meeting room per section 4.04.030 of the City of Benicia's Open Government Ordinance.

III. ADOPTION OF AGENDA:

IV. OPPORTUNITY FOR PUBLIC COMMENT:

This portion of the meeting is reserved for persons wishing to address the Council on any matter not on the agenda that is within the subject matter jurisdiction of the City Council. State law prohibits the City Council from responding to or acting upon matters not listed on the agenda. Each speaker has a maximum of five minutes for public comment. If others have already expressed your position, you may simply indicate that you agree with a previous speaker. If appropriate, a spokesperson may present the views of your entire group. Speakers may not make personal attacks on council members, staff or members of the public, or make comments which are slanderous or which may invade an individual's personal privacy.

A. WRITTEN COMMENT.

B. PUBLIC COMMENT.

V. BUSINESS ITEMS (6:10 PM):

A public hearing should not exceed one hour in length. To maximize public participation, the council requests that speakers be concise and avoid repetition of the remarks of prior speakers. Instead, please simply state whether you agree with prior speakers.

A. PRESENTATION OF THE GENERAL FUND TEN-YEAR FORECAST. (Finance Director)

On February 3, 2014, a special joint meeting of the Finance Committee and City Council will be held to present the General Fund ten-year forecast model. The purpose of a long term forecast is to help create a sustainable financial vision for the City. Budget forecasts do not remain static; it is a dynamic tool that allows for consideration of the most reasonable outcomes. To that end, the forecast will continue to be updated at least annually. This will allow the City to better anticipate future challenges and opportunities, thereby creating a solid foundation to make strategic decisions about the City's financial position. Further, the forecast is reflective of conservative estimations and assumptions based upon what is known today. These assumptions are the beginning groundwork for the FY 2015-2017 budget and provides fiscal context for the budget process. It should be noted that the report represents the financial outlook assuming the City maintains what services it has today and into the future.

Recommendation:
Receive a presentation from the Finance Director on the ten-year forecast for the General Fund.

VI. ADJOURNMENT (7:30 PM):

Public Participation

The Benicia City Council welcomes public participation.

Pursuant to the Brown Act, each public agency must provide the public with an opportunity to speak on any matter within the subject matter jurisdiction of the agency and which is not on the agency's agenda for that meeting. The City Council allows speakers to speak on non-agendized matters under public comment and on agendized items at the time the agenda item is addressed at the meeting. Comments are limited to no more than five minutes per speaker. By law, no action may be taken on any item raised during the public comment period although informational answers to questions may be given and matters may be referred to staff for placement on a future agenda of the City Council.

Should you have material you wish to enter into the record, please submit it to the City Manager?

Disabled Access or Special Needs

In compliance with the Americans with Disabilities Act (ADA) and to accommodate any special needs, if you need special assistance to participate in this meeting, please contact Anne Cardwell, the ADA Coordinator, at (707) 746-4211. Notification 48 hours prior to the meeting will enable the City to make reasonable arrangements to ensure accessibility to the meeting.

Meeting Procedures

All items listed on this agenda are for Council discussion and/or action. In accordance with the Brown Act, each item is listed and includes, where appropriate, further description of the item and/or a recommended action. The posting of a recommended action does not limit, or necessarily indicate, what action may be taken by the City Council.

Pursuant to Government Code Section 65009, if you challenge a decision of the City Council in court, you may be limited to raising only those issues you or someone else raised at the public hearing described in this notice, or in written correspondence delivered to the City Council at, or prior to, the public hearing. You may also be limited by the ninety (90) day statute of limitations in which to challenge in court certain administrative decisions and orders (Code of Civil Procedure 1094.6) to file and serve a petition for administrative writ of mandate challenging any final City decisions regarding planning or zoning.

The decision of the City Council is final as of the date of its decision unless judicial review is initiated pursuant to California Code of Civil Procedures Section 1094.5. Any such petition for judicial review is subject to the provisions of California Code of Civil Procedure Section 1094.6.

Public Records

The agenda packet for this meeting is available at the City Manager's Office and the Benicia Public Library during regular working hours. To the extent feasible, the packet is also available on the City's web page at www.ci.benicia.ca.us under the heading "Agendas and Minutes." Public records related to an open session agenda item that are distributed after the agenda packet is prepared are available before the meeting at the City Manager's Office located at 250 East L Street, Benicia, or at the meeting held in the Council Chambers. If you wish to submit written information on an agenda item, please submit to the City Clerk as soon as possible so that it may be distributed to the City Council. A complete proceeding of each meeting is also recorded and available through the City Clerk’s Office.

AGENDA ITEM
CITY COUNCIL MEETING DATE - FEBRUARY 3, 2015
STUDY SESSION ITEM

DATE : January 28, 2015

TO : City Manager

FROM : Finance Director

SUBJECT : **PRESENTATION OF THE GENERAL FUND TEN-YEAR FORECAST**

RECOMMENDATION:
Receive a presentation from the Finance Director on the ten-year forecast for the General Fund.

EXECUTIVE SUMMARY:
On February 3, 2014, a special joint meeting of the Finance Committee and City Council will be held to present the General Fund ten-year forecast model. The purpose of a long term forecast is to help create a sustainable financial vision for the City. Budget forecasts do not remain static; it is a dynamic tool that allows for consideration of the most reasonable outcomes. To that end, the forecast will continue to be updated at least annually. This will allow the City to better anticipate future challenges and opportunities, thereby creating a solid foundation to make strategic decisions about the City's financial position. Further, the forecast is reflective of conservative estimations and assumptions based upon what is known today. These assumptions are the beginning groundwork for the FY 2015-2017 budget and provides fiscal context for the budget process. It should be noted that the report represents the financial outlook assuming the City maintains what services it has today and into the future.

BUDGET INFORMATION:
This presentation does not have a direct impact on the City's budget, as it does not include any proposed 2015-2017 budget items. Rather, the forecast is the preliminary mechanism to set the fiscal context toward development of the FY 2015-2017 budget.

STRATEGIC PLAN:
Relevant Strategic Plan Goals and Strategies:

- Strategy Issue #3: Strengthening Economic and Fiscal Conditions
- Strategy #4: Manage City finances prudently

BACKGROUND:
On May 27, 2014, Management Partners presented the ten-year General Fund forecast model developed for the City. As intended, staff has used this model to update the forecasts annually. As staff begins the development of the next biennial budget, it is important to look ahead at the fiscal sustainability of the City's General Fund. By doing so, the City will be better prepared to react in a fiscally responsible manner to maintain a desirable level of service.

A budget forecast is just one of many strategic tools for sustainability and should be used for future strategic planning discussions. The forecast should be looked at in terms of the short term, the next biennial budget and a few years beyond; and it also should be considered for in the long term, 5-10 years out. For purposes of this meeting, the intent is to show, if nothing were to change, where would the City's financial position lead? The forecast allows the City to view its current trajectory. It sets the stage for discussions on what is both a desirable outcome and what is an attainable outcome.

Budget forecasting is made up of internal and external factors influencing the City's resources. The forecast presented here reflects what is currently known about the revenue and expenditures, the FY 2014-2015 budget; and it represents a conservative approach to estimating the future year outcomes. In revenues, the City is heavily concentrated around its top 25 property and sales tax producers all of which are centered in the industrial park. In services, the City is a full service city, offering public safety, street and parks maintenance, library, recreation, and utility services. Together they make up a desired quality of life heavily supported and endorsed by its residents and businesses. There are also outside factors that are beyond the City's control like State legal mandates, external economy, and inflation that must be considered.

As the biennial budget process begins, the forecast offers an opportunity to look beyond the immediate needs to future needs, many of which cannot be funded without either a shift in spending or a change in revenues. The General Fund has a list of unmet staffing, capital, and improvements needs. In addition, the City's has a past practice of deferring facility and equipment needs until they are critical. A ten-year forecast model allows the City to have the discussion of these future costs and their related policy and funding needs. The forecast itself is only a part of the larger Sustainable Community Services Strategy (SCSS) process that is currently underway and, further, it underlines the need to complete the SCSS given the City's ongoing struggle with balancing resources and service levels.

As the Council is aware, the City is currently engaged in the SCSS with the goal of creating a fiscally sustainable organization. Currently, an organizational scan is being completed and will be presented to the Council in March, which will serve to highlight many current unmet needs across the City's various departments. In the meantime, the General Fund ten-year forecast has been updated with known information at this time in order to provide the Council with context prior to entering the 2015-2017 budget process.

Finally, there are limitations on what the forecast will be able to accomplish. It cannot remain static and not all future impacts will ever be known at any given point in time. The numbers presented in today's reports have been vetted and considered with great attention. However, the economic conditions and assumptions will not all hold indefinitely. The ten-year forecast will need to be regularly evaluated for significant impacts and changes; and thus, the City's ten-year forecast will evolve overtime.

Continue to next page.

ANALYSIS:

The current General Fund ten-year forecast is summarized in Table 1 below (see Attachment 1 for detail). The report's expenditures and revenues are based off of the FY 2014-2015 budget. The underlying assumption throughout the ten-year forecast is that the FY 2014-2015 budget's services are presumed to be continuous. It should be noted that does not equate to flat or fixed numbers; each has a unique compounded inflation escalator. Starting in FY 2015-2016, Sales Tax generated from voter approved Measure C provides a much needed increase in revenues to support City capital and services. However, the City still faces escalation in operating costs outside of their control which are outpacing total revenue growth. General Fund total revenues have an average annual increase of less than 1.5%; whereas, total expenditures have an average annual increase of more than 1.7%. In the long term, as expenditures continue to outpace incoming revenues, the General Fund will experience strain. The reduction in City debt payments reduces some of this financial strain. However, the report also highlights areas of unmet needs especially in capital which have the potential to overwhelm the financial stability of the fund.

Table 1 Summary of General Fund Projected Revenue, Expenditures and Fund Balance

(in thousands)	2013-2014	2014-2015	2015-2016	2016-2017	2017-2018	2018-2019	2019-2020	2020-2021	2021-2022	2022-2023	2023-2024
Revenue	31,264	30,298	34,733[b]	35,345	35,867	36,375	36,766[c]	37,168 [c]	37,832	38,514	39,068
Expenditures	29,852	31,281[a]	34,378[b]	34,024	35,014	35,904	36,920	37,445	38,010	38,576	39,165
Transfers - In (Out)	(288)	(579)	(639)	(660)	(734)	(768)	(793)	(800)	(808)	(815)	(823)
Net Change - Increase (Decrease)	1,124	(1,562)	(284)	661	119	(298)	(947)	(1,077)	(986)	(877)	(920)
Beginning Reserve	7,041	8,165	6,603	6,319	6,981	7,100	6,802	5,855	4,778	3,792	2,915
Ending Reserve	8,165	6,603	6,319	6,981	7,100	6,802	5,855	4,778	3,792	2,915	1,995

	Year Over Year % of Change									
Revenue	-3.1%	14.6%	1.8%	1.5%	1.4%	1.1%	1.1%	1.8%	1.8%	1.4%
Expenditures Including Transfers	5.7%	9.9%	-1.0%	3.1%	2.6%	2.8%	1.4%	1.5%	1.5%	1.5%

[a] Increase in expenditures is primarily due to increases personnel expenditures

[b] Initial year of Measure C; anticipated increase in CalPERs

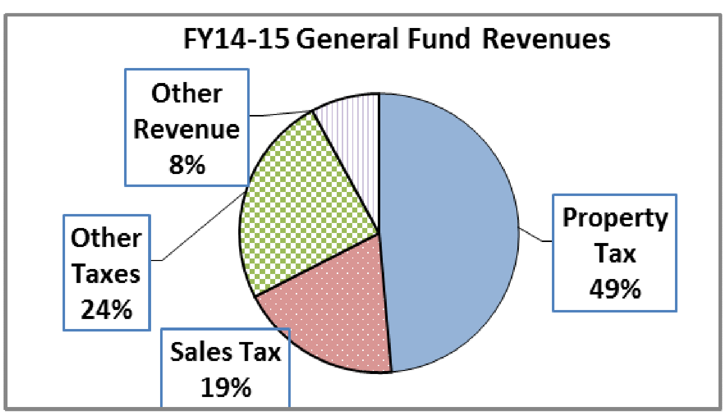
[c] The historic trend of cyclical sales tax revenue is assumed to suppress revenue in FY2019-21 followed by positive sales tax growth

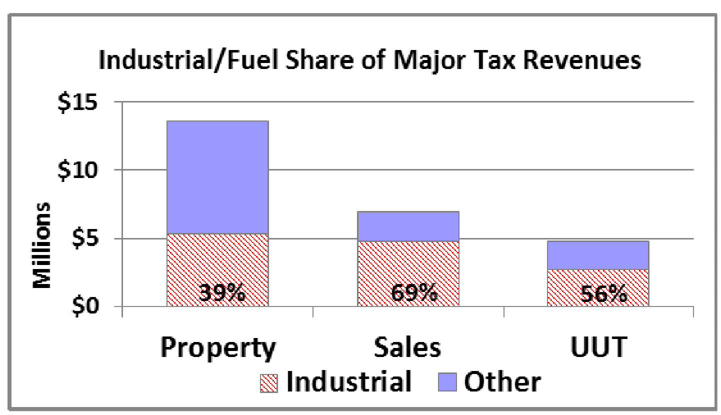
I. REVENUES

The City's General Fund revenues are dominated by Property Tax (along with Vehicle License Fee) at 49% and Other Taxes (Sales Tax, Utility User Tax, Business License Tax and Franchise fee) at 43%. All other revenues are less than 15% of the City's General Fund resources. This suggests that the City has direct control of less than eighty-five percent of its incoming revenues. Property Tax and Vehicle License fee are capped at Proposition 13 up to 2% growth. All other Property Tax growth is market driven, meaning the City's revenue growth can only occur if a property sells above the County's assessed value. Other Taxes are also predominantly outside of the direct control of the City. Sales Tax was increased by the voter, but its volatility is based on market concentration and cyclical recessions. Business License Tax is also established by the voters, but has a direct correlation to Sales tax volatility and the cyclical highs and lows. Similarly tied and similarly volatile is Utility User Tax and Franchise Fees. These two revenues are showing the most decline year-over-year as customers respond to changes in technology and consumer habits change. These compounded losses have a mounting impact on the General Fund as expenditures increase exponentially.

Added to the market and economic factors that surround most cities, Benicia finds that its market and revenue sources are concentrated in its Industrial Park. In Sales Tax last year, the City's Sales tax generators were concentrated in *Business and Industry Services*, and *Fuel and Service Stations* by nearly 70% (source HdL Fourth Quarter 2013). Almost $4.4 million of $6.3 million in Sales Tax revenue was concentrated in these two economic areas. That's nearly 15% of the City's General Fund revenues alone. When this concentration in Utility User Tax and Business Licenses are combined with Sales Tax, the revenue reaches almost $8 million, or more than 25%. A similar concentration exists in Property Tax, although not as high. The categories of *Industrial*, *Unsecured*, and *Commercial* are almost 40% of total General Fund Property Tax. (source HdL FY 2013/2014 Property Tax Assessment Report).

Chart 1 Projected General Fund Revenue Sources





Given that the City's General Fund's revenue is so concentrated on its commercial base, much of the ten-year revenue forecast has been centered on what assumptions can be drawn and how much influence the City has on the growth or retraction of these markets. The first consideration is Property Tax and the long term effects of Proposition 13. The second is focus the local economic outlook and impacts Sales Tax, Business License Tax, and Utility User Tax.

Property Tax - Traditionally, Property Tax is considered a fairly stable revenue source with a moderate, but steadily, increasing escalation. The housing boom and subsequent recession has revealed much of this revenue's volatility and its vulnerability to the ups and downs of the economy. However, much of these phases have currently stabilized and this revenue is expected to return to pattern of moderate, but steadily, increasing escalation. Over the course of the next ten-year forecast, it is anticipated that the City will receive at least the full Proposition 13 (2%) annual assessment growth in residential. The median home price is also steadily climbing which indicates there is still potential for market growth in residential properties.

The industrial and commercial properties have not had any significant change in ownership or development which would drive their assessments higher than the Proposition 13 CPI inflation of 2% (56 sales since 2009). Recalling that non-residential properties are almost 40% of City's Property Tax base, this portion of the revenues will have a slight drag on the moderate residential housing growth. The projections assume an average of 3% in the short term, with the residential housing markets driving growth above the 2%; long term, the escalator is 2.2% to more closely reflect the Proposition 13 cap. These estimates include current assumptions on property appeals, which staff continues to monitor.

Sales Tax - The City's historical look at Sales Tax is not unlike most cities looking back at the last recession. The City saw steep declines from 2008-2012 and the economy has slowly recovered; however, the tax collection have not fully returned to prerecession levels. The City's primary sales tax producers are located in the industrial park. "The City has experienced nearly a 20% drop in business sales tax generated by the Benicia Industrial Park (BIP) from its high point, and a 14% drop quarter to quarter 2013 to 2014." (Chabin Concepts, Market Demand Study:2014) Slowly there has been a shift in the industrial park from less business to business sales to more warehousing usage. The City FY 2014-2015 Sales Tax is projected to be 3.6% lower than FY 2013-2014 (source HdL Sales Tax report Second Quarter 2014); but this is the net drop. The County pool, the shared sales tax from Solano County, is mitigating Benicia's losses. "Most receipts from use tax and some transactions where the points of sale are difficult to track are placed in a county or state allocation pool and distributed back to local jurisdictions on a pro rata basis." (HdL). As a result, the City's direct Sales Tax loss was over 8% while the Solano County collection grew 5%.

Despite the overall recession recovery, it is expected that Benicia's Sales Tax, aside from Measure C tax initiative (as discussed below), will continue to decline. In the short term, the direct Sales Tax will continue to shrink as the shift in BIP continues to gravitate toward warehousing and away from sales tax generating businesses. The City's revenue base is too concentrated in this area to suggest a different outcome, unless the City can attract more Sales Tax generating businesses.

The long term may actually be more volatile than the short term. Sales Tax has an almost predictable economic cycle of climbing for 7-8 years and pulling back for 2-3 years before it starts to once again rebound. This is important, because the City is presently not benefiting from the current "recovery" (or climb) in the economy. The City is experiencing declining Sales Tax while State and Solano County are experiencing growth. Whether the recession is 5 or 7 years away, it is prudent to consider that the cycle in the economy during the latter part of this forecast. Considering the likelihood today of the next recession and future revenue losses prepares the City to address the outcomes in the long term.

These changes in assumptions are currently impacting the forecast more than any other. The May 2014 ten-year forecast assumed that Sales Tax would increase 3% each year. The current forecast, supported by the City's Sales Tax auditors and the market demand study, assume that an average 1% decline each year is expected in the short term, FY 2015-2018. A recession is assumed in FY 2019-2021 of another 3% decline each year, but recovers at 2% after, FY 2022-2024. This is an opportunity for the City to utilize the forecast and set policies that will encourage economic growth in Sales Tax generating businesses.

Sales Tax and Measure C- The voters approved an additional 1% Sales Tax initiative in November 2014. It is currently estimated that this will produce additional revenue of $3.7 million for the General Fund. The industries generating sales for this revenue are over the counter sales at grocery stores, general retail stores, service stations, lumber and building material stores, and restaurants. Other types of sales which usually involve sales to customers outside the City are *not* eligible for the local sales tax and are thus excluded. Conversely, sales outside of Benicia that are expected to be used within the City, such as auto sales, the local tax is collected and will remitted to Benicia.

Unfortunately, until the tax begins to be collected and reported, the estimates cannot be accurately adjusted up or down. It is unknown how much of the Sales Tax from Measure C will change over the course of the forecast, because the data is not available today. For conservative reasons, the revenue is assumed to be flat, staying at $3.7 million each year. The impact of cyclical patterns of growth and contraction predicted to influence Sales Tax cannot be anticipated without more information as to their industry source. This item will continue to be monitored and updated in the forecast as new information is available.

Business License, Franchise Fees, Utility User Tax, and Other Taxes- Historically, these four revenues have constituted almost 24% of the General Fund resources. Of that total, Utility User Tax (UUT) is 15% and Franchise Fees is 5%. Business License Tax follows the same cyclical pattern of Sales Tax; but at less than 2% of the General Fund, the impacts of variations from this revenue source are minimal.

The trends in UUT and Franchise Fees are notable, because of two outside economic trends. First, legislative policies are segregating out previously taxable utilities, such as solar. Similarly, utilities accounting of previously bundled utilities are now more distinct. The utilities' improvements in billing enable them to separate services subject to UUT, such as cell phone and internet plans. This is driving collections down in telecommunication based UUT and is unlikely to rebound. The second factor is consumer spending habits. The consumer is attracted to alternative energy options; they are moving away from land based telephone lines; and they are accessing more video options via the internet. These changes in legislation, technology advancements, and consumer preferences are driving down UUT collections. Directly correlated to UUT cost drivers is Franchise Fee cost drivers. The forecast reflects a short term loss in Other Taxes in FY 2015-2016 to reflect these market conditions. Past this first year of the forecast, revenue is expected to hold to historical escalation of about 1.75%.

Table 2 Projected General Fund Revenue by Source

(in thousands)

	2013-2014	2014-2015	2015-2016	2016-2017	2017-2018	2018-2019	2019-2020	2020-2021	2021-2022	2022-2023	2023-2024
Property Tax	14,291	14,724	15,327	15,777	16,157	16,510	16,872	17,243	17,623	18,013	18,372
Sales Tax	6,430	5,718	9,306	9,286	9,238	9,201	9,036	8,876	8,975	9,080	9,080
Other Taxes	7,565	7,451	7,290	7,454	7,599	7,726	7,865	8,009	8,156	8,308	8,464
Other Revenue	2,979	2,404	2,810	2,828	2,873	2,938	2,993	3,041	3,078	3,113	3,152
Total Revenue	31,264	30,298	34,733	35,345	35,867	36,375	36,766	37,168	37,832	38,514	39,068

II. EXPENDITURES

Personnel and CalPERs costs - Personnel cost drivers include salary and benefits based upon current staffing levels. There are currently 210 full time employees and approximately 155 seasonal and part time positions budgeted Citywide; of this 150 full time and almost 90% of the part time are in the General Fund. Personnel costs make up 75% of the General Fund operating budget.

The ten-year forecast model considers both the staffing costs and the benefits for the total personnel costs. Salaries in the short term are moderated by the bargaining units of each group, several of which have three year contracts. Using the industry standard on year-over-year increases, a 1.75% growth factor was assumed past FY 2017-2018. It is important to note that salaries are a controllable cost for the City. In this same way, ancillary benefits also assumed to grow with the same cost escalator, but are similarly controlled by the City. Therefore, in the long term, the City has an opportunity to revise these costs as necessary while remaining conscious of the need to maintain service levels and the need to retain and attract quality employees.

As the City continues to assess sustainable community services via the SCSS, staffing levels and employee compensation and benefits will continue to be evaluated for efficiency and effectiveness. The ten-year forecast model can assist in determining these financial impacts on the budget.

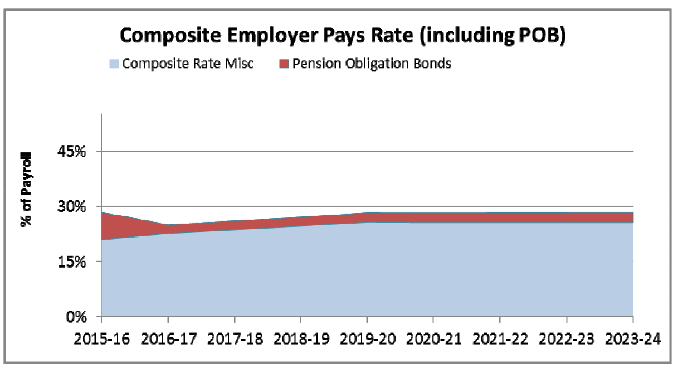
The personnel costs experiencing the greatest escalation are pension benefits. The costs drivers behind pensions are largely out of the control of the City. However, the City has taken an active role in reducing future liabilities of pensions. First, through the purchase of Pension Obligation Bonds, the City has chosen to pay down unfunded pension obligations with terms favorable to the City. The payment structure is such that total pension costs go down in FY 2016-2017. Second, the City through negotiations reduced the pension benefits to employees. This, along with State pension reform (PEPRA), is expected to reduce pension obligations and costs. The City will see these savings in the long term; CalPERs estimates local government may see these reductions 10-20 years out.

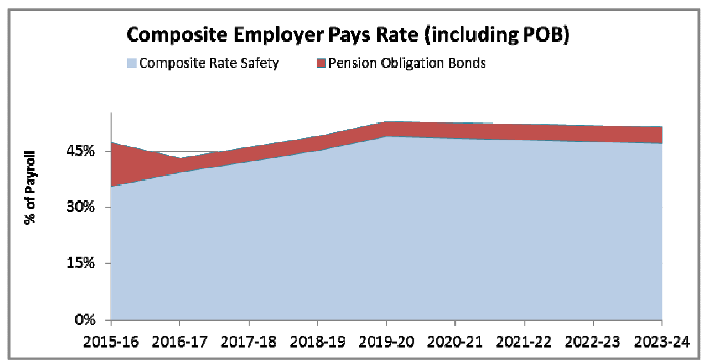
In the short term, the City is experiencing rate increases that level off in the long term. (See Chart 2) Like the rest of the economy, CalPERs is still recovering from the recession and the loss of investment returns it anticipated during this period. This has caused an unfunded liability in CalPERs assumptions. The unfunded liability is defined as the amount, at any given time, by which future payment obligations exceed the present value of funds available to pay them. It is the financial process of setting aside funds as they are earned to pay out future period benefits. An unfunded liability is created when either the expected costs are increased, for example, benefits owed; or income is reduced, for example, investment earnings.

In the City's case, the loss in CalPERs' investment earnings is the primary factor for the City's rate increases. CalPERs' rates are built on the assumption that approximately 30% of the future benefits will be generated through charges to member agencies. These are passed onto the City in the form of pension costs (rates). The other 70% income needed to fund the pension liability is earned through investments. Should either of the two incomes not meet the actuarial assumptions, the losses must still be recuperated to meet the expected future liabilities. When the market does well, the City's pension costs are lowered (decrease rates); but when the market does not preform, CalPERs passes on higher rates to participating agencies.

The direct pass-through of the CalPERs liabilities' market volatility will have the greatest impact to local agencies' ability to manage pension liabilities. The development of proactive policies, such as rate stabilization policies, will allow the City to smooth out the market highs and lows. The City can manage the volatility by saving during market highs and drawing down during market lows. The ten-year forecast can be an advantageous tool to steady the impacts of the CalPERs' costs within the City funds.

<u>Chart 2 Pension Composite Rates</u>





Operating Expenditures - The service levels and related supplies and operations of the General Fund is assumed constant in the ten-year forecast. A simple 3% escalator is applied to all categories. It should be noted here that this immediately causes expenditures to outpace revenues. This is a common and realistic problem in local government. Long term revenue growth continues to be outpaced by expenditure growth by more than 1%.

While the costs are controlled through the budget review and adoption, there is a secondary cost impact that is often not quantified in budgets. This cost is the loss of buying power over time. A simple analogy is used to explain. Today it is assumed the budget can fix two (2) linear feet of sidewalk. In ten years, as costs inflate over time, today's budgeted amount buys only one (1) linear foot. Revenue growth allows the budget to grow; but since they are not keeping pace at the same rate, the purchasing power does not ever return to the original two (2) linear feet of sidewalk.

Capital Projects and Purchases - "Capital assets include major government facilities, infrastructure, equipment, and networks that enable the delivery of public sector services.…" Budgetary pressures often impede capital program expenditures or investments for maintenance and replacement, making it increasingly difficult to sustain the asset in a condition necessary to provide expected service levels. Ultimately, deferring essential maintenance or asset replacement could reduce the organizations ability to provide services and could threaten public health, safety and overall quality of life." (Government Finance Officer Association-GFOA: 2010) As part of Measure C, the City has made a commitment to increasing General Fund capital expenditures. The General Fund ten-year forecast includes $2 million in capital maintenance and replacement annually. In the short-term, the City's General Fund capital items have been identified and adopted by City Council in Resolution 14-96. In the long term, the General Fund has $2 million in capital funding associated with Measure C Sales Tax revenue to maintain its current infrastructure.

Given the level of resources compared to City services provided, the City does not have consistent capital funding for critical infrastructure assets, including storm drains, streets, buildings, and equipment. The City has over $100 million dollars in capitalized assets in the City's governmental funds. The annual depreciation is almost $4 million. Measure C capital budget is only half of the financial costs of replacement of the assets. In other words, the current capital funding levels leave financial exposure of another $2 million annually in unmet capital planning. The problem is longer deferred maintenance and replacement; the results are higher risk of impairment of the assets. Staff will return in the summer 2015 with a ten-year forecast update on capital and equipment maintenance and replacement as further informed by the SCSS process.

Debt - City has exercised debt to finance capital improvements over time. Debt allows the current costs of equipment and infrastructure to be spread over the useful life of the asset. In this way, current and future users share in funding the expense. As debt retires, the City resources can be reallocated to new debt or immediate operation savings. The General Fund will experience some debt relief following FY 2015-2016. The 2006 Pension Obligation Bond calls for the payments to be reduced by nearly $800,000 offsetting CalPERs rate increases. (As seen above in Chart 2). Also in FY 2015-2016, the General Fund completes its payment on the Police Building and Marina Area Storm Drain Improvements Capital Lease which reduces debt payments by $250,000 annually.

There are three additional debt streams not paid directly in the forecast. The first of these are the 2011 Certificates of Participation Energy Conservation Projects. Those payments continue through 2036 and are covered as part the solar and lighting payments made by the General Fund. The second is the State of California Marina Loans which is subsidized via the transfer from the General Fund to the Marina Fund. These payments continue through 2027.

Table 3 Projected General fund Expenditures by Source

(in thousands)

	2013-2014	2014-2015	2015-2016	2016-2017	2017-2018	2018-2019	2019-2020	2020-2021	2021-2022	2022-2023	2023-2024
Personnel Expenditures	20,631	23,185[a]	24,604	24,386	25,054	25,684	26,422	26,791	27,164	27,533	27,917
Operating Expenses	8,555	7,415 [a]	7,393	7,463	7,785	8,045	8,323	8,479	8,671	8,869	9,074
Capital Outlay	267	283	1,982	2,060	2,060	2,060	2,060	2,060	2,060	2,060	2,060
Debt Payments	399	398	398	114	114	114	114	114	114	114	114
Total Expenditures	29,852	31,281	34,378	34,024	35,014	35,904	36,920	37,445	38,010	38,576	39,165

a Personnel expenditures increase and operating expenses decrease in part due to the implantation of the Cost Allocation Plan

I. RESERVES

The General Fund ten-year forecast demonstrates the fluctuations that occur in reserves as revenues do not keep pace with expenditures. The forecasts projections show only three out ten years in which revenues exceed expenditures. While the City's has discretion over what it budgets on expenditures, this report shows areas where cost drivers like CalPERs are still volatile. On the revenue side, the General Fund has even less control as more than eighty-five percent of the revenue has controls as to its growth. The results are that in the long term, the City will need to work at developing policies and sustainable planning to meet current service levels.

Also of notable interest are the implications of the current reserve policy, which are currently 20% of revenues. The policy of setting reserves at 20% of revenues will create the need for a larger reserve resulting from an overall increase in revenues primarily, due to Measure C. For example, in first year of Measure C, the fund reserve level is $900,000 higher than the previous year based on 20% of estimated total revenues. The forecast was presented with the current estimates of Measure C revenues having been totally allocated between capital and operations. This has left the reserves under the 20% policy. The preliminary biennial budget would assume that reserves levels drop to 18% of General Fund revenues. Over time, as revenues continue to outpace expenditures and assuming reserves are used, the reserve level continues to drop to 5% of revenues, or 15% under reserves.

Table 4 Projected Expenses by Source and Fund Balance

(in thousands)

	2013-2014	2014-2015	2015-2016	2016-2017	2017-2018	2018-2019	2019-2020	2020-2021	2021-2022	2022-2023	2023-2024
Beginning Reserve	7,041	8,165	6,603	6,319	6,981	7,100	6,802	5,855	4,778	3,792	2,915
Ending Reserve	8,165	6,603	6,319	6,981	7,100	6,802	5,855	4,778	3,792	2,915	1,995
Reserve as a % of revenue	*26.1%*	*21.8%*	*18.2%*	*19.7%*	*19.8%*	*18.7%*	*15.9%*	*12.9%*	*10.0%*	*7.6%*	*5.1%*

II. NEXT STEPS: SUSTAINABILITY

"Balance the need to realize short term savings with the need to achieve long-term sustainability," (Eggers and O'Leary reported in GFOA: 2010).

In the short term, most of the variable assumptions are known and outcomes fixed and expected. In the long term, if nothing were to change, the forecast provides the trajectory of the current variables. The City must decide if this path takes the desired direction. By utilizing the forecast, the City can see if it is headed in a manner that meets service level demands given its anticipated resources.

The City is currently in the SCSS process, along with updating the Project Priority list. These reports, alongside the ten-year forecast, will help direction of the City in the short term, as well as, with long term financial planning. The City will have the opportunity to continue to evaluate, plan, and create a dynamic budget for which to manage and support City services, including:

- Plan for capacity and resource management to meet current and future service levels demands
- Create a plan for sustainable employee pay and benefits
- Develop equipment and infrastructure maintenance and replacement policies
- Evaluation of unfunded liabilities and planning for future uncertainty
- Expand the diversity of revenues
- Explore the economic volatiles for strengths and weaknesses
- Expect change and encourage adaptability

- Increase efficiency and effectiveness through technology advancements
- Provide transparency through multiple mediums
- Create dialog in the community about realistic resources and the representative services

Immediate next steps will include a priority setting study session with the City Council to develop a Budget Implementation Plan for the FY 2015-2017 budget. This is scheduled for February 24th. That meeting will be followed by a series of budget related meetings in preparation for consideration of the proposed FY 2015-2017 budget in June 2015. Additionally, as noted previously in the report, staff will be returning in the summer of 2015 with another update to the ten-year forecast focused on capital and equipment maintenance and replacement, and integration with updates from SCSS, organizational scan, that is currently underway.

The purpose of tonight's presentation is to provide a foundation for upcoming budget discussions for the FY 2015-2017 budget, and provide both the Finance Committee and the Council to ask questions and offer input.

Attachment:

- General Fund Projected Revenue, Expenditures and Fund Balance

General Fund Projected Revenue, Expenses and Fund Balance

(in thousands)	Actual 2013-2014	Budget 2014-2015	Forecast 2015-2016	Forecast 2016-2017	Forecast 2017-2018	Forecast 2018-2019	Forecast 2019-2020	Forecast 2020-2021	Forecast 2021-2022	Forecast 2022-2023	Forecast 2023-2024
Revenue											
Property Tax	14,291	14,724	15,327	15,777	16,157	16,510	16,872	17,243	17,623	18,013	18,372
Sales Tax	6,430	5,718	9,306	9,286	9,238	9,201	9,036	8,876	8,975	9,080	9,080
Other Taxes	7,565	7,451	7,290	7,454	7,599	7,726	7,865	8,009	8,156	8,308	8,464
Other Revenue	2,979	2,404	2,810	2,828	2,873	2,938	2,993	3,041	3,078	3,113	3,152
Total Revenue	31,264	30,298	34,733	35,345	35,867	36,375	36,766	37,168	37,832	38,514	39,068
Expenditures											
Personnel	20,631	23,185	24,604	24,386	25,054	25,684	26,422	26,791	27,164	27,533	27,917
Operating	8,555	7,415	7,393	7,463	7,785	8,045	8,323	8,479	8,671	8,869	9,074
Capital	267	283	1,982	2,060	2,060	2,060	2,060	2,060	2,060	2,060	2,060
Debt	399	398	398	114	114	114	114	114	114	114	114
Total Expenditures	29,852	31,281	34,378	34,024	35,014	35,904	36,920	37,445	38,010	38,576	39,165
Transfers - In (Out)	(288)	(579)	(639)	(660)	(734)	(768)	(793)	(800)	(808)	(815)	(823)
Net Change Increase (Decrease)	1,124	(1,562)	(284)	661	119	(298)	(947)	(1,077)	(986)	(877)	(920)
Beginning Reserve	7,041	8,165	6,603	6,319	6,981	7,100	6,802	5,855	4,778	3,792	2,915
Ending Reserve	8,165	6,603	6,319	6,981	7,100	6,802	5,855	4,778	3,792	2,915	1,995

V.A.16