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COUNCIL COMMITTEE ITEM SUMMARY REPORT

MEETING DATE: July 26, 2017

TO: Finance & Administration Committee

FROM: Linda Ruffing, City Manager
Victor Damiani, Finance Director

AGENDA ITEM TITLE: **Review FY 2017/18 Adopted Budget and Consider Making Recommendations to City Council**

BACKGROUND:

On May 25, 2016, the City Council conducted the FY 2016/17 Budget workshop. At that time, staff informed Council of an accounting error that was discovered when the City prepared a new Cost Allocation Plan. The cost allocation error had occurred in previous years and over-allocated non-personnel overhead costs to the City's enterprise funds. The error and its consequences were discussed at length and it was explained that it likely would take several years for the General Fund to recover from the error.

On January 23, 2017, the City of Fort Bragg Comprehensive Annual Financial Report pertaining to FY 2015/16 was delivered to the City Council. The following statement is found on page xii of the document:

> "The FY 2016/17 budget process, however, uncovered an accounting error in previous years which resulted in over-allocations from the general fund to the enterprise funds. While the error has been remedied in regard to previous years, the general fund is likely to continue to see budget deficits for the next few years. In the short term, the City will likely be able to fill budget deficits with appropriated fund balance. "

In keeping with the City of Fort Bragg's annual budget process, an extensive amount of time and effort has been invested in the creation of the fiscal year (FY) 2017/18 Budget, as explained below.

On March 15, 2017, the City Council conducted a mid-year budget review work session. The meeting lasted six hours and included presentation of FY 2015/16 year-end results as well as a status update on the results for FY 2016/17 through December 31, 2016. In addition, Council goals were discussed, supplemental appropriations were proposed and upcoming financial challenges were presented.

From mid-March to mid-May, staff prepared a first draft of the FY 2017/18 Budget. The Finance Department prepared revenue forecasts, payroll projections and budget spreadsheets for all City departments. Each department head developed an initial appropriations request for their department(s). Over the course of many days, the City Manager and Finance Director met with each department to review appropriations requests. In these meetings, initial requests were revised and reduced to ensure a lean appropriations budget. The City Manager, Finance Director and Public Works Director met at length to develop the capital projects work plan for FY 2017/18 and to develop long-term plans for the Facilities Internal Service Fund and the Fleet Internal Service Fund. Finance Department staff then summarized and analyzed all of the initial figures and prepared a 286-page budget document for City Council review.

On May 24, 2017, the City Council conducted the FY 2017/18 Budget workshop. The meeting lasted six hours and included presentation of key City budget guidelines and fiscal policies, a summary of the budget from an "all funds" perspective, a summary of the General Fund budget, a presentation of the long term plans for the City's Internal Service funds, presentations of departmental budgets, and presentation of the City's capital work plan. At the workshop, the draft FY 2017/18 Budget was presented with General Fund expenditures exceeding estimated revenues by $331k and a recommendation that undesignated fund balance be used to plug the gap. Council reviewed multiple supplemental appropriations requests, proposed revenue adjustments and cost cutting measures, and provided direction to staff for revisions to the draft FY 2017/18 Budget.

Simultaneous to the development of the budget, the City was engaged in labor negotiations with its employee groups. The FY 2017/18 Budget was initially developed using modest assumptions regarding cost of living increases (1.5%) and other benefits costs. In early June, when the revised budget was prepared, assumptions regarding cost of living increases were adjusted upwards (3%) to better correlate with progress that had been made in the ongoing negotiations.

At the June 26, 2017 City Council meeting, staff presented a revised FY 2017/18 Budget to the Council for adoption. Once the Council-directed revisions to the draft budget were input along with adjustments to cost of living increase assumptions, the General Fund deficit grew to $415k. A detailed list of the items contributing to the increase in the General Fund deficit is presented in a subsequent section of this report. At the June 26, 2017 meeting, the Council adopted the FY 2017/2018 Budget with the stipulation that the Finance and Administration Committee should review the FY 2017/18 Adopted Budget and consider making recommendations to the City Council in order to reduce the budgeted General Fund deficit.

DEFICIT DEFINED (CLARIFIED):

The City Council's Budget Guidelines provide guidance on the use of unassigned fund balance for on-going annual costs versus one-time expenditures. The guidelines are found on page 13-14 of the FY 2017/18 Adopted Budget and are discussed in more depth subsequently in this report. In brief, the guidelines state that recurring annual expenditures should be funded with ongoing revenues and that unassigned fund balances should not be used for ongoing operations.

The following three appropriations in the FY 2017/18 Adopted Budget are one-time costs: $25k Body worn cameras; $18k Storm Drain Enterprise rate study; $22k prior year Animal Care invoices. When these three one-time expenditures are removed from the calculation, the true <u>operating</u> deficit is $350k.

Despite the operating deficit, the FY 2017/18 Budget has been balanced through the use of unassigned fund balance as expressly authorized by the City Council on June 26, 2017.

HISTORICAL CONTEXT:

To put the FY 2017/18 Budget into perspective, it is useful to look at the historical trend of adopted budgets and how the budgeted revenue and expenditure projections compare at year-end to the actual results. It is also important to keep in mind the Council's policy of conservative budgeting when reviewing the trend. The City develops the annual budget for what might be considered the "worst case scenario." In this context, budgeted deficits forecast on a conservative basis rarely come to pass when actual results are examined at year-end. Nevertheless, it is a prudent technique to budget on a conservative basis. In years when actual results show a positive variance to budget, the surplus is used to build fund balance and to fund emergency reserves. In years when the "worst case scenario" comes to pass, the City has sufficient fund balances to withstand an annual deficit.

	ADOPTED Budget			CAFR - Actual					
	Conservative			Most Likely			Variance		
FY	Revenue	Expend	Surp/def	Revenue	Expend	Surp/def	Revenue	Expend	Total
2008/09	7,396,029	7,296,546	99,483	7,475,596	7,062,027	413,569	1%	3%	4%
2009/10	7,232,457	7,500,068	(267,611)	7,414,805	7,152,157	262,648	3%	5%	7%
2010/11	6,638,086	6,828,304	(190,218)	6,972,910	6,679,747	293,163	5%	2%	7%
2011/12	7,222,242	7,672,856	(450,614)	7,413,748	7,204,505	209,243	3%	6%	9%
2012/13	7,445,091	7,884,583	(439,492)	7,527,293	7,639,709	(112,416)	1%	3%	4%
2013/14	7,882,796	8,449,216	(566,420)	8,110,867	8,305,851	(194,984)	3%	2%	4%
2014/15	8,011,252	8,504,167	(492,915)	8,612,863	8,361,792	251,071	8%	2%	9%
2015/16	8,810,345	8,906,695	(96,350)	9,113,664	8,475,345	638,319	3%	5%	8%
2016/17*	8,141,399	8,697,935	(556,536)	8,385,641	8,436,997	(51,356)	3%	3%	6%
2017/18*	9,077,034	9,492,354	(415,320)	9,349,345	9,207,583	141,762	3%	3%	6%

* FY2016/17 and FY2017/18 actual results are estimated using the averages from the previous 8 years

The chart above shows that, on average, actual results show a positive revenue variance of 3% and a positive expenditure variance of 3% for a total positive variance of 6%. As can be seen in the chart, adopting a deficit budget is not unusual for the City. The chart shows that in nine of the last ten years the City has adopted a deficit budget. Further, the chart shows deficit budgets of higher magnitude than the FY 2017/18 Adopted Budget in five of the last ten years. The last time a surplus budget was adopted dates back to FY 2008/09 which was before the impacts of the Great Recession were felt by the City. When looking at actual year-end results however, deficits only occurred in three of the past ten years. If long-term trends continue, a conservatively developed budget showing a $415k deficit is most likely to produce a $142k surplus.

BUDGET REVIEW:

1. Positive Features of FY 2017/18 Adopted Budget

- Increased services: PEG, Economic Development, Coastal Trail maintenance
- Includes robust Capital Projects work plan, with emphasis on water, wastewater and streets infrastructure
- Capital funding includes $11M of grant funds
- Assumes Cost of Living Adjustment of 3% for City employees, a rate higher than the national average and which affords the City the ability to attract and maintain the best possible workforce for delivering services to the Citizens of Fort Bragg
- Implements long-term (10-year) plans for Fleet and Building Maintenance ISFs, a goal which has been actively pursued by the City for several years and which has just now been accomplished

- Funded 15% General Fund Operating Reserve and $200k Litigation Reserve
- Received Distinguished Budget Presentation award from GFOA for the FY 2016/17 budget and anticipate receiving the award again for the FY 2017/18 budget

All of the positive features listed above have been accomplished while delivering a budgeted deficit which has been shown historically to be manageable. Considering the loss of $700k in General Fund revenue due to the new cost allocation plan (implemented beginning FY 2016/17) and the continued and significant increases for employee pension costs, the FY 2017/18 Adopted Budget is a remarkable achievement.

2. Review Budget Guidelines & Fiscal Policies

The City's Budget Guidelines are found beginning on page 13 of the FY 2017/18 Budget. The City's Fiscal Policies are found beginning on page 15 of the FY 2017/18 Budget. The Budget Guidelines and Fiscal Policies have been developed over several years and at the direction of various sitting Councils. Staff recommends review of the following:

- Guideline 4 of the City's Budget Principles (refer to page 13 of the FY 2017/18 Budget)

  Staff believes the guideline is sufficient as written. One possible change however would involve changing bullet point #1 to provide a percentage range of acceptable deficits.

- Guideline 5 of the City's Budget Principles (refer to page 14 of the FY 2017/18 Budget)

  Staff recommends updating this guideline to include language describing in detail the operating procedure in the event the budget is not passed prior to July 1 annually. The guideline would explain that, in accordance with State law, the Council can approve a "continuing resolution" prior to June 30th to allow for continued operations at the service and staffing levels authorized in the prior year adopted budget for a period not to exceed 45 days. It would also explain the challenges that such an action presents with regard to necessary but unappropriated expenses for materials and services, capital projects, etc. Additionally, failure to adopt a timely operating budget can adversely impact a city's credit rating.

- Policy 1 of the City's Fiscal Policies (refer to page 15 of the FY 2017/18 budget)

  a) Staff believes the policy is sufficient as written. There is room for improvement however concerning the manner in which liquidation of prior year encumbrances is reported.
  b) Staff believes the policy is sufficient as written. One possible change however would involve providing a percentage range of acceptable deficits and usage of fund balance for balancing the budget. Further, there is room for improvement concerning the manner in which one-time expenditures are reported so that an accurate picture of the operating deficit or surplus is presented.
  c) Staff believes the policy is sufficient as written and points to the Internal Service Fund long-term plans developed for the Fiscal Year 2017/18 budget as an example of this policy in practice.

- Policy 4 of the City's Fiscal Policies (refer to page 16 of the FY 2017/18 budget)

  Staff believes the expenditure policies are sufficient as written and recommends no changes. Review of the policies is useful.

- Policy 9 of the City's Fiscal Policies- Fund Balance & Reserve Policies (refer to page 17 of the FY 2017/18 budget)
    a) No recommended change.
    b) No recommended change.
    c) Staff recommends reducing the General Fund burden for the Emergency Contingency Reserve from 10-15% to 5% with the Water and Wastewater Enterprises similarly providing 5%. Likewise, Staff recommends reducing the General Fund burden for the Economic Stabilization Reserve from 5-10% to 2.5% with the Water and Wastewater Enterprises similarly providing 2.5%.
    d) Staff recommends adding an Emergency Contingency Reserve and Economic Stabilization reserve for the Water and Wastewater enterprises as outlined in C) above.

Emergency reserves under current policy:

Funded by General Fund only:

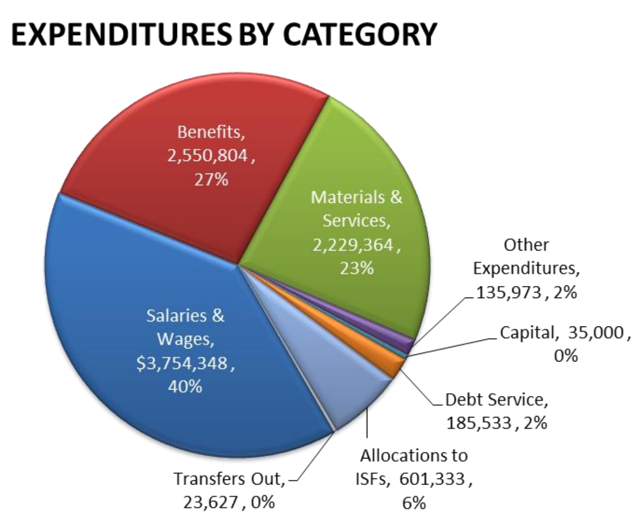
Emergency Contingency Reserve (10%)	907,703
Economic Stabilization Reserve (5%)	453,852
Total	1,361,555

Emergency reserves under proposed policy change:

Shared by three major operating funds:

Emergency Contingency Reserve (GF @ 5%)	453,852
Emergency Contingency Reserve (W @ 5%)	133,337
Emergency Contingency Reserve (WW @ 5%)	167,185
Total Emergency Contingency Reserve	754,374
Economic Stabilization Reserve (GF @2.5%)	226,926
Economic Stabilization Reserve (W @2.5%)	66,669
Economic Stabilization Reserve (WW @2.5%)	83,592
Total Economic Stabilization Reserve	377,187

3. Review FY 2017/18 General Fund Expenditure Projections



The above chart shows General Fund expenditures summarized by category. Personnel costs are the largest expense for the City at 67%, with Materials & Services representing the second largest expense at 23%.

4. Consider Actions to Decrease General Fund Expenditures

Perhaps the first place to look for budget reductions it to examine the revisions made at the Council's budget workshop. Below is a reconciliation of the proposed budget to the adopted budget. Staff recommends reviewing each line item in the event the Council would like to revisit any of the decisions made on May 24th or subsequently.

Reconciliation of Proposed to Adopted Budget

Original deficit presented:	$ 331,236
Revisions:	
Reduce Promotions budget	(13,500)
Remove Cannabis elections cost	(5,000)
Roll Forward Body Worn Cameras purchase	25,219
Cut Pool House rehab from Facilities ISF	(23,186)
AV-Tech; net of decreased prof. services & increased revenue	(4,500)
Grants Assistant	45,818
Increase in cost of living adjustment assumption	59,233
Adopted Budget deficit *	$ 415,320

* The operating deficit is $350k after removing one-time expenditures

As was discussed earlier in this report, each departmental appropriations request was examined in detail and reduced wherever possible in order to produce a lean operating budget. Reductions were made prior to presenting a proposed budget to Council. Despite the cuts previously made, following is a list of further cost cutting options for the Council to consider:

- Reduce travel, training and meeting budgets
  Cost savings: ~$5k-10K
  Cons: long term detriment to knowledge base and skill set of City staff, some training is required by law

- 5% staff layoffs (approximately 3 employees)
  Cost savings: ~$200k
  Cons: job losses, service reductions

- Cut PEG service – the City contributes revenue from General Fund franchise fees
  Cost savings: ~$18k

Cons: no PEG TV in Fort Bragg, service reduction, job losses

- Reduce capital work plan – by reducing the capital work plan, it may be possible to leave one of the Public Works engineering positions unfilled
  Cost savings: ~$21k
  Cons: service reduction, job losses, minimal General Fund savings

- Spend down Facilities ISF reserves in FY 2017/18 resulting in lower contribution from General Fund
  Cost deferral: ~ $120k
  Cons: short term fix, contribution amount will increase in subsequent years to ~$135k per year

5. Review FY 2017/18 General Fund Revenue Projections

The following chart illustrates the estimated revenue for the General Fund in FY 2017/18:

GENERAL FUND
SUMMARY OF REVENUES BY CATEGORY
FY 2014/15 THROUGH FY 2017/18

GENERAL FUND	FY 2014/15 FYE AUDITED	FY 2015/16 FYE AUDITED	FY 2016/17 Amended BUDGET	FY 2016/17 FYE PROJECTED	FY 2017/18 PROPOSED BUDGET	% INCR/ -DECR
Property Taxes	$ 884,602	$ 972,948	$ 964,067	$ 988,855	$ 1,018,521	3.0%
Sales Taxes	1,666,675	1,600,866	1,716,489	1,575,500	1,671,540	6.1%
Transient Occupancy Taxes	1,857,831	1,947,702	2,123,931	2,147,120	2,604,314	21.3%
Other Taxes	657,950	664,739	656,000	670,380	679,900	1.4%
Total Taxes	**5,067,057**	**5,186,255**	**5,460,487**	**5,381,855**	**5,974,275**	**11.0%**
Reimbursements	2,811,789	3,332,126	2,179,341	2,440,341	2,546,357	4.3%
Charges for Services	417,374	206,854	161,978	176,810	221,100	25.0%
Intergovernmental	113,839	113,936	77,800	64,904	96,800	49.1%
Licenses & Permits	89,084	99,317	95,340	93,642	99,629	6.4%
Other Revenues	59,073	112,311	73,974	132,796	67,974	-48.8%
Use of Money & Property	33,101	44,054	65,000	44,180	34,200	-22.6%
Fines & Forfeitures	21,550	18,849	27,479	31,205	36,700	17.6%
TOTAL GENERAL FUND	**$ 8,612,867**	**$ 9,113,702**	**$ 8,141,399**	**$ 8,365,733**	**$ 9,077,034**	**8.5%**

6. Consider Actions to Increase General Fund Revenues

Besides cutting costs with reduced expenditures, staff layoffs and reductions in services, another tool available to the Council to align budgeted appropriations with budgeted revenues is to increase revenue. Municipal revenue enhancement options generally fall into three categories: fees, fines or taxes. Revenue generation requires a longer-term outlook than cost-cutting and it is doubtful any revenue generation measures can be implemented quickly enough to improve the FY 2017/18 budget. Below is a list of possible revenue generating options for the Council to consider in the long-term:

- Establish storm drain enterprise
  Type: fee
  Revenue generation: ~$150k per year
  Pros: Relieve the General Fund from storm drain costs, generate capital reserve for storm drain capital projects
  Cons: relatively small base of ratepayers, not likely to eliminate deficit till FY 2020/21, increase cost of living for residents

- Establish business license tax for commercial cannabis uses
  Type: tax
  Revenue generation: ~$10k to $50k per year assuming tax rate of 2.5%
  Pros: general revenue
  Cons: Unknown if any establishments will open or how much revenue they will generate, cash only business placing cash burden on Finance Department, unlikely to eliminate deficit

- Increase parking fines
  Type: fine
  Revenue generation: ~$10k per year assuming an increase from $35 to $45
  Pros: general revenue, revenue generated by City residents as well as visitors, helps keep parking available in the downtown retail area
  Cons: unlikely to eliminate deficit

- Establish parcel tax to fund City's share of Fire Protection services
  Type: tax
  Revenue generation: ~$400k assuming rate set to cover costs only
  Pros: wider tax base, likely to eliminate deficit by FY 2018/19

- ¼ cent general sales tax
  Type: tax
  Revenue generation: ~$415k per year
  Pros: general revenue, widest tax base, revenue generated by City residents as well as visitors, likely to eliminate deficit by FY 2018/19
  Cons: increase cost of living for residents

- Utility users tax
  Type: tax
  Revenue generation: ~$120k assuming a 5% tax on an average $70 electric bill and approximately the same number of accounts as water accounts (2,800)
  Pros: general revenue
  Cons: relatively small base of taxpayers, increase cost of living for residents, not likely to eliminate deficit till FY 2020/21

Budget projections - Please note the assumptions that drive the projections.

		FY 12-13	FY 13-14	FY 14-15	FY 15-16	FY 16-17	FY 17-18	FY 18-19	FY 19-20	FY 20-21
		Audited	Audited	Audited	Audited	Projected	Projected	Projected	Projected	Projected
General Fund										
Revenue:	Sales Tax	$ 1,619,165	$ 1,625,916	$ 1,666,675	$ 1,600,866	$ 1,575,500	$ 1,671,540	$ 1,660,530	$ 1,649,592	$ 1,638,726
	Property Tax	880,949	894,217	865,161	972,948	988,855	1,018,521	1,049,902	1,082,249	1,115,593
	Transient Occupancy Tax	1,536,395	1,667,580	1,857,831	1,947,702	2,057,120	2,170,262	2,333,594	2,509,218	2,584,495
	TOT AA					90,000	434,052	466,719	501,844	539,612
	Other	3,486,301	3,923,154	4,223,201	4,592,147	3,654,258	3,782,659	3,933,965	4,091,324	4,254,977
	Total Revenue	7,522,810	8,110,867	8,612,868	9,113,663	8,365,733	9,077,034	9,444,709	9,834,227	10,133,404
Expenditures:	Non Compensation Related	2,538,423	2,644,001	2,723,349	2,710,642	2,747,009	2,605,581	2,484,067.49	2,508,908	2,533,997
	TOT AB					90,000	434,052	466,719	501,844	539,612
	Employee Compensation	4,991,160	5,514,281	5,490,874	5,617,134	6,019,073	6,305,152	6,570,788	6,859,573	7,176,419
	Debt Service	147,569	147,569	147,569	147,569	147,569	147,569	147,569	147,569	-
	Total Expenses	7,677,152	8,305,851	8,361,792	8,475,345	9,003,651	9,492,354	9,669,143	10,017,893	10,250,028
Net Transfers		380,378	526,843	(112,992)	(7,614)	(2,081,588)	(23,627)	(12,000)	(12,000)	(12,000)
Net Increase (Decrease) to Fund Balance		226,036	331,859	138,084	630,704	(2,719,506)	(438,947)	(236,434)	(195,666)	(128,625)
Storm Drain Enterprise	assuming $150k revenue							$ (86,434)	$ (45,666)	$ 21,375
Cannabis Tax	assuming $50k revenue							$ (186,434)	$ (145,666)	$ (78,625)
Parking Fines	assuming $10k revenue							$ (226,434)	$ (185,666)	$ (118,625)
Parcel Tax	assuming $400k revenue							$ 163,566	$ 204,334	$ 271,375
1/4 cent General Sales Tax	assuming $415k revenue							$ 178,566	$ 219,334	$ 286,375
Utility User Tax	assuming $120k revenue							$ (116,434)	$ (75,666)	$ (8,625)

Assumptions

Revenue:

Sales Tax	Used 4 year average of .5%
Property Tax	Used 4 year average of 3%
Transient Occupancy Tax	5.5% for 17-18 which is most recent 2 year average. 7.5% for 18-19 and 19-20 which is 4 year average, as promotions are expected to pick up.Used 3% for FY20-21
TOT AA	5.5% for 17-18 which is most recent 2 year average. 7.5% for 18-19 and 19-20 which is 4 year average, as promotions are expected to pick up.
Other	4 yr run rate without CAP revenue, and grant admin revenue is 6%. Conservatively used 4%.

Expenditures:

Non Personnel Costs	Netted out $327k of caspar landfill payments in FY16-17 which resulted in -1% 4 year average. Conservatively used 1% increase
TOT AB	assumed same as revenue

			FY 17-18	FY 18-19	FY 19-20	FY 20-21
Personnel Costs	Salaries	assumed 2% COLA beginning FY18/19	3,754,348	3,829,435	3,906,024	3,984,144
	Benefits	5% assumed rate (all benefits except for PERS)	1,448,678	1,521,112	1,597,167	1,677,026
	PERS	17% per PERS calculations - reduction of discount rate	654,201	765,415	895,536	1,047,777
	OPEB unfunded liability trust payment	-2%per Actuarial report	247,925	244,826	240,346	235,947
	OPEB Pay go costs	5% assumed rate (same as benefits rate)	200,000	210,000	220,500	231,525
			6,305,152	6,570,788	6,859,573	7,176,419

Net Transfers GF share of school playing fields water bill

RECOMMENDATIONS:

Staff recommends no further cost-cutting measures at this time and a tight rein on budget amendments as the year progresses. Staff further recommends exploration and pursuit of revenue-generating options in the next one to two years.

ALTERNATIVES:

Any combination of cost-cutting measures and revenue generating measures the Council finds prudent, whether from the list of options presented in this report or otherwise.