City of LOMPOC

City Council Agenda Item

City Council Meeting Date: March 19, 2019

TO: Jim Throop, City Manager

FROM: Dean Albro, Management Services Director
d_albro@ci.lompoc.ca.us

SUBJECT: Fiscal Year 2018-19 Mid-Year Budget Update and Request for Council Discussion and Direction on Development of the 2019-21 Biennial Budget.

Recommendation:

Staff recommends the City Council:

1) Review and accept the Biennial Budget Fiscal Year (FY) 2018-19 mid-year financial status; and

2) Give direction for the Biennial Budget FYs 2019-21 to include revenues from a presumed one cent sales tax in the budget preparations process; or

3) Give alternate direction for the development of the Biennial Budget FYs 2019-21.

Background:

The Biennial Budget FYs 2017-19 was adopted on September 5, 2017, with further directions by the City Council clarifying certain aspects at the November 21, 2017, City Council meeting. The City Council subsequently requested a review of actual results for the first six months of the biennial budget cycle. That review was provided to the City Council at its April 3, 2018, meeting were staff provided a follow-up presentation to address the projected budget to actual variances for FY 2017-18, ending June 30, 2018. On June 5, 2018, staff provided another follow-up presentation to provide information regarding the staff vacancies anticipated results through the end of the Biennial Budget FYs 2017-19, and to recommend a budgetary adjustment realizing savings for FY 2017-18 with Resolution No. 6187(18).

The goal of this presentation is to provide additional information to the City Council regarding the current status of staff vacancies anticipated, operating expenditures, and revenues results through the end of the Biennial Budget FYs 2017-19.

Discussion:

This mid-year budget update provides an opportunity to update the City Council on major financial factors affecting the City's current budget, and make recommendations for developing the upcoming Biennial Budget FYs 2019-21.

Expenditure Update FY 2018-19

The General Fund personnel budget is inclusive of all assumed staff vacancies for the current fiscal year. The following vacancies were budgeted to try and realize a balanced budget for FY 2018-19:

Police – 3 sworn full time employees (FTEs)	$290,045
Fire – 3 FTEs	299,045
Parks – 1.75 FTEs	110,429
Non-Departmental vacancy savings	542,318
Volunteer furloughs	111,500
Total budgeted salary savings	$1,353,937

While the funding for 6 public safety positions was included as salary savings in preparing the Biennial Budget FYs 2017-19, public safety is a priority for the City Council. City Administration offset those contrary paths by using new vacancies elsewhere in the General Fund to fulfill the overall goal of holding positions open to create cost savings during the Biennial Budget FYs 2017-19 cycle to realize the savings anticipated in the budget from 7.75 FTE positions.

The General Fund budgeted vacancies for FY 2018-19 was $542,318 with volunteer furloughs at $111,500 for a total of $653,818. With the history of vacancies and the continuing trend of retirements, recent budgets have included the value of vacancy savings in the Non-Departmental Program, while actual savings from vacancies have historically been realized in the department or division where the vacancy occurs. The following is the personnel cost by department for the period March 2, 2019, actuals with projected salaries through June 30, 2019.

Personnel Cost Variances Divisions		**Under(Over) Budget**
General Government	$	164,830
Police		88,923
Fire		(474,808)
Building		55,410
Community Development		143,370
Parks		157,835
Recreation		114,093
Library		52,931
Facilities		15,677
Projected Salary Savings		318,260
Personnel Budgeted Salary Savings		
Vacancies (Normal)		(542,318)
Volunteer Furloughs		(111,500)
Total Budget Salary Savings	$	(653,818)
Total (Deficit) Surplus to Budget		(335,558)

With the projected deficit from personnel costs, the City has enacted steps to reduce budget line items and reduce the overall operating budget by $211,000 to help mitigate budget shortfalls. The number of vacancies estimated to be needed for a revised balanced General Fund at June 30, 2019, is likely to be 28, or more, for the remainder of the budget cycle, depending on the individual savings amounts for individual FTE positions.

Revenue Update FY 2018-19

The City has historically estimated revenues every two years, consistent with its biennial budget estimation process. The City's primary tax revenues change from year to year based on several variables. Discretionary tax revenues are generally used to fund General Fund services. Beginning with the Biennial Budget FYs 2017-19, the City's Finance Division received external/independent assistance with two additional major tax resources: Property Tax and Property Tax in Lieu of Vehicle License Fees. Sales Tax estimates have historically been done with external/independent assistance.

As provided by HdL Coren & Cone (HdL), the City's external source of property tax analysis, the FY 2018-19 property tax growth is projected to be 5.28% rather than the 3.82% growth estimate included in the Biennial Budget FYs 2017-19. The additional growth is anticipated to increase property tax revenues in FY 2018-19 by approximately $53,000.

Staff meets with HdL on a quarterly basis. HdL provides updates for estimated sales tax revenues. As provided by HdL on February 7, the City is estimated to receive approximately $36,000 less sales tax than budgeted for FY 2018-19.

Based on historical averages for the Transient Occupancy Tax (TOT) received through December 2018, the estimated revenues for FY 2018-19 are projected to be $70,000 more than budgeted, which will be an annual increase of 15% year-over-year.

The overall increase projected for major tax revenues over the original budget for FY 2018-19 is approximately $87,000.

Summary Biennial Budget FYs 2018-19

As detailed in the Annual Financial Report and presented by staff on December 8, 2018, the FY 2017-18 General Fund reported a deficit of $545,350. With the 2018-19 budget adopted with a use of reserves at $526,000 and the detailed information above, the projected deficit for FY 2018-19 is estimated to be $649,576.

Preparation of Biennial Budget FYs 2019-21

As mentioned above, a $1.2 million deficit is projected from the General Fund for the Biennial Budget FYs 2017-19. In preparation of the Biennial Budget FYs 2019-21, staff is requesting direction from the City Council on the next steps to address the estimated $3.6 million structural deficit.

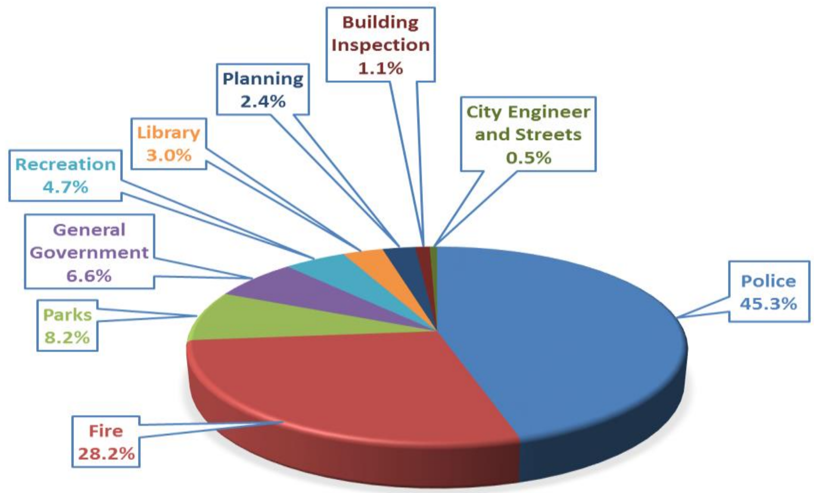
There have been two methodologies expressed by the City Council. One, through expenditure reductions, which will result in reductions in essential services. The other is to maintain service levels by revenue enhancements, such as a sales tax initiative. This would assume revenues for the FY 2020-21 portion of the budget only, with the assumption that a March 2020 ballot measure is successful.

Expenditure Reductions

On March 9, 2019, the City Council held a Goal Setting Workshop to establish goals for the Biennial Budget FYs 2019-21. The outcome was very similar to the close to 1,000 residents who took the City Survey. The top priorities being Public Safety, Community Development that improve opportunities for residents and business, Community Involvement for improving the City, and Financial Sustainability by developing a financial plan to tackle the General Fund's structural deficit.

As mentioned above, the structural deficit projected for the Biennial Budget FYs 2019-21 is estimated at $3.6 million. That would be approximately $1.8 million per year, assuming no held positions. The graphs on the following page show the required budgetary reductions if allocated to the divisions based on the net expenditures as presented to the City Council on December 8, 2018, from the results of the 2018 Comprehensive Annual Financial Reports (CAFR):

FY 2018 General Fund - Net Cost



Budget Reductions by Net Cost Percentages

Department	% of Total Reductions	Per Year Reduction	% of Net Cost
Police	45.3%	$ 809,100	8.7%
Fire	28.2%	504,400	8.7%
Parks	8.2%	146,100	8.7%
General Government	6.6%	117,000	8.7%
Recreation	4.7%	83,200	8.7%
Library	3.0%	53,800	8.7%
Planning	2.4%	43,700	8.7%
Building Inspection	1.1%	19,200	8.8%
City Engineer and Streets	0.5%	9,800	8.7%
	Total	**$ 1,786,300**	

As outlined above, the reduction in Public Safety would be over $1.3 million or 8.7%. Even though this is not recommended, it does illustrate the magnitude of the reductions required. With the average salary and benefits for Police and Fire averaging $130,000, that would equate to a reduction of ten full time employees in public safety only. However, there are other side effects, if the cutting of expenditures methodology was used to balance the budget. It does not address the looming issue of the increasing CalPERS debt. If we look at just Public Safety at June 30, 2018, the CalPERS Net Pension Liability was $30 million and is projected to increase in one year to $30.5 million by June 30, 2019. Even with an incremental increase in CalPERS payments at $371,227, the debt still grows by $504,000 annually. When you look at the Miscellaneous group plan the issue is the same, but the numbers are twice as much, with an incremental increase of $755,488 and a liability increase of $820,534 citywide. In both plans, the debt continues growing, since the annual interest exceeds the payments.

When we explore this in more detail, the City's General Fund tax revenues increases year-over-year at an optimistic 3.6% or $650,000. When we compare that to the General Fund's year-over-year incremental increase in their portion of the CalPERS payments, it equates to relatively the same amount of $640,000. That leaves the City with little to no funding to address comparable compensation concerns, normal cost of living raises, and the ability to maintain operating supplies or contractual obligations, as the buying power of the dollar is eroded with normal inflation.

Revenue Enhancements

As detailed, the impact of expenditure cuts would result in service levels that would not be in the best interests of residents and would impact their quality of life. Various options to increase revenues have been carefully considered, and most require voter consideration. It should be noted the City Council does not have the authority to enact a tax increase, only to place the measure on the ballot for voter consideration.

There are four different types of revenue enhancements available as possible options to help mitigate the General Fund's structural deficit. The following shows the enhancements and the potential revenues.

The Most Viable Option

1.) **Establishing a sales tax (transactions and use tax) measure.** A one cent increase on sales made in the City (per Board of Equalization – excludes food purchased as groceries or prescription medication) would raise approximately $4.9 million per year. That tax would be a shared tax, as non-residents making purchases in the City would be picking up a share of the cost. In order to pass the measure, 50% + 1 of voting residents would need to approve it in an election. Based on the expertise from our sales tax consultant, this would make a one cent sales tax annual cost per capita of $52, or $4.30 per month based on the City's demographics ($20,650 per capita income x 25% taxable purchases x .01 sales tax = $51.63 / 12 = $4.30). With the median household income from the U.S. Census Bureau at $49,074, the annual cost per average household would be $123 or $10.22 per month (.34/per day).

Less Viable Options

2.) **Utility User's Tax (UUT).** Every 1% in the UUT would provide ongoing revenues of approximately $705,000. However, closing the current structural deficit and addressing fiscal sustainability would require a 6% UUT. That tax would be paid fully by every property owner in the City and would require approval of 50% + 1 of voting residents in an election.

3.) **Increasing the Hotel Bed Tax also known as the Transient Occupancy Tax (TOT)**. With 50% + 1 approval of voters in an election, the TOT rate could be increased from the current 10%. A common rate in neighboring cities is 10% to 14%. If this increase were approved by the voters, the City would receive additional ongoing revenues of approximately $220,000 per year for each 1% increase. However, this is only a partial solution and would not address the structural deficit, much less the long term goal of fiscal sustainability. The positive side is that this tax would be paid by visitors to the City and there would be no direct impact on residents.

4.) **Other options.** Selling advertising space on City vehicles, code compliance fines, and vehicle parking permit fees. None of those options meet the goal of the fiscal sustainability plan. Cumulatively, they add up to only a fraction of the current structural deficit needs and would still result in severe cuts to public safety and other essential City services.

After carefully assessing all the options and listening to community feedback, which overwhelmingly indicated a desire to maintain and restore public safety service levels, the only option that would:

- Maintain vital City services and meet the needs of residents and the business community;
- Begin to address the General Fund structural deficit;
- Move the City towards its stated goal of Fiscal Sustainability, which should include cash solvency / budget solvency / long term solvency / service solvency;

is a local transaction and use (sales) tax measure.

Fiscal Impact:

With a sales tax (transactions and use) the City would have the opportunity to maintain Public Safety and other essential City services. A sales tax measure would address the City's current structural deficit and the ability to return its unrestricted fund balance reserves levels (currently at approximately 5%) to adopted policy levels of 25%, and address the unfunded pension by utilizing revenue enhancements to extinguish debt obligations.

Conclusion:

It is recommended that the City Council direct staff to prepare the City's Biennial Budget FYs 2019-21 with a one cent sales (transaction and use tax) measure for consideration on the March 2020 ballot for voter consideration or to provide alternative direction.

Respectfully submitted,

Dean Albro, Management Services Director

APPROVED FOR SUBMITTAL TO THE CITY COUNCIL:

Jim Throop, City Manager