



REPORT TO COUNCIL City of Sacramento

915 I Street, Sacramento, CA 95814-2604
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PUBLIC HEARING
June 12, 2007

Honorable Mayor and
Members of the City Council

Subject: FY2007/08 Proposed Budget and 2007-2012 Proposed Capital Improvement Program (CIP): Changes and Technical Adjustments, Reports Back, Growing our Business and Future Fiscal Considerations

Location/Council District: Citywide (All)

Recommendation: Approve an intent motion to implement changes and technical adjustments to the FY2007/08 Proposed Operating and CIP Budgets.

Contacts: Leyne Milstein, Budget Manager, 808-8491

Presenter: Leyne Milstein and Russell Fehr

Department: Finance

Division: Budget, Policy & Strategic Planning

Organization No: 1140

Description/Analysis:

Issue: This report provides information as requested by the City Council on items discussed during budget hearings, identifies additional adjustments necessary to implement the FY2007/08 budget since publication in May 2007, includes an update on efforts to "grow our business," and an overview of future fiscal considerations.

Reports Back – During Budget Hearings the Council requested additional information on several items. The requested information is included in Attachment 1.

Technical Adjustments – Since submittal of the Proposed Budget and CIP, staff have identified various technical budget adjustments that are necessary to effectively implement the FY2007/08 Proposed Budget and 2007–2012 CIP. These technical budget adjustments are detailed in Attachment 2.

Growing our Business – In order to address current fiscal challenges and expanding service needs in the City, efforts are underway to identify and increase funding sources for the City. The City Manager's office is coordinating this effort, including the completion of the General Plan Update, the development

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FY2007/08 Proposed Budget &
2007-2012 Proposed Capital Improvement Program (CIP)

of public safety operational master plans, and the implementation of a comprehensive Economic Development strategy. This includes the identification of new revenue sources including in-lieu payments from other jurisdictions and other options for Council consideration. Staff will report back to the Council as new information becomes available.

Future Fiscal Considerations Overview – This section provides a brief summary of issues that may impact the City's financial picture in the future. This information is included as Attachment 3.

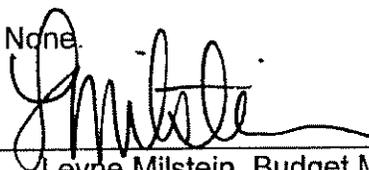
Policy Considerations: Policy considerations associated with the issues discussed in this report are referred to and discussed in the corresponding attachments. In all cases, recommendations are consistent with the City Council's Strategic Planning – Strategic Budgeting process.

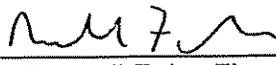
Environmental Considerations: This report concerns administrative activities that will not have any significant effect on the environment, and that do not constitute a "project" as defined by the California Environmental Quality Act (CEQA) [CEQA Guidelines Sections 15061(b)(3); 15378(b)(2)].

Rationale for Recommendation: The rationale for the recommendations related to the issues identified, are discussed in the corresponding attachments.

Financial Considerations: The recommended adjustments contained in this report are necessary to properly implement the proposed operating budget and CIP and will have a minimal impact on fund balances. Given the current condition of the General Fund, none of the recommendations result in additional General Fund expenditures. Detailed descriptions of the financial considerations associated with these recommendations are provided in the corresponding attachments.

Emerging Small Business Development (ESBD): None.

Respectfully Submitted by: 
Leyne Milstein, Budget Manager

Approved by: 
Russell Fehr, Finance Director

Recommendation Approved:


Ray Kerridge
City Manager

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ATTACHMENT 1

REPORTS BACK

1. **Finance** – Utility Users' Tax – What is the total annual revenue from the Utility Users' Tax? How much of the Utility Users' Tax has been given back as a rebate?

Response: The FY2007/08 Proposed Budget includes Utility Users' Tax revenues estimated at \$59.7 million. Currently the City "rebates" approximately \$1.7 million to low income customers. The rebate is automatically implemented for PG&E and SMUD utility customers on specific low income rate plans. These customers are not charged the utility users' tax, effectively reducing the City's revenues by a like amount. The City also continues to rebate utility tax for basic cable television and lifeline telephone service. In FY2006/07 the City refunded \$101,000 to low income residents for utility user taxes paid on these services.

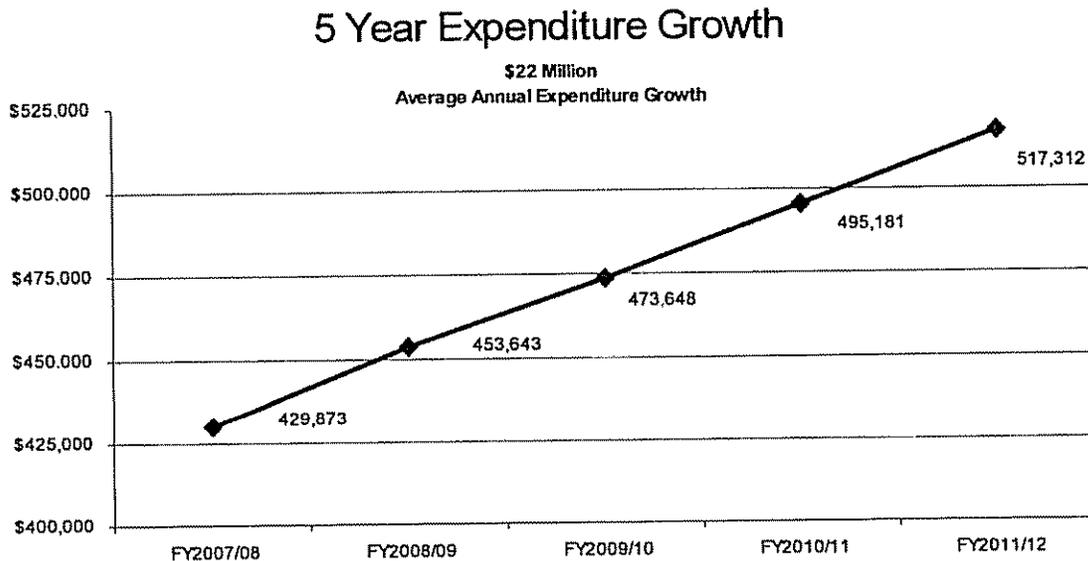
2. **Finance** – General Fund Forecast

Response: To maintain current staffing levels, fully fund contractual obligations, and fund the Council's high priority initiatives, the General Fund Budget will have to increase by an average of an additional \$22 million per year through FY2011/2012. By this time General Fund expenditures will have increased by over \$87 million.

The specific items driving the future expenditure increase include:

- Base labor expenditure growth of between 5 and 6 percent per year;
- Multi-year implementation of the Mayor and City Council high priority initiatives; and
- Operational costs of the new facilities constructed under the CRCIP.

The expenditure forecast through FY2011/2012 is illustrated below:

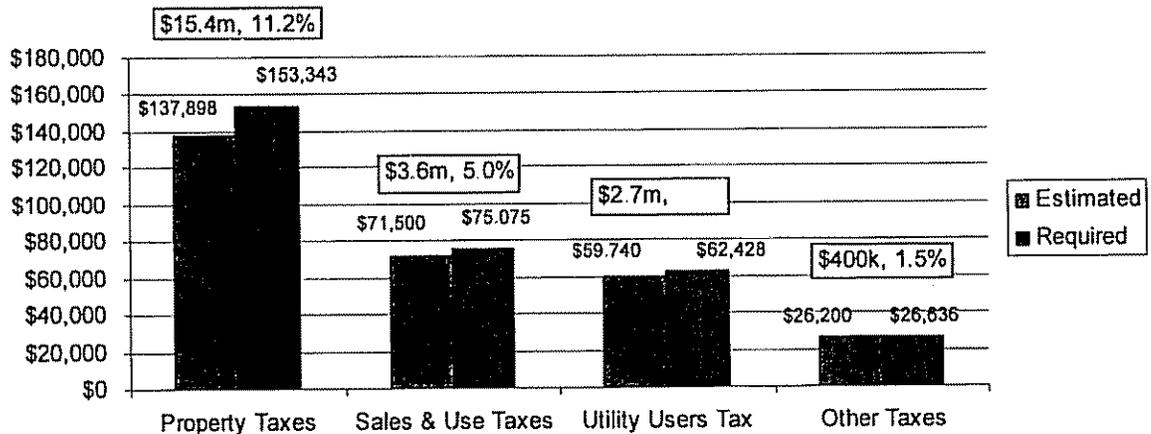


To fund the increasing expenditures, General Fund revenues and other financing sources would also have to increase by at least \$87 million; however, in the FY2007/08 General Fund Budget the costs of providing services are greater than the current revenues. In order to both fund the annual cost increases and close the current gap between expenditures and revenues, funding sources would have to increase by a total of \$117 million by FY2011/2012.

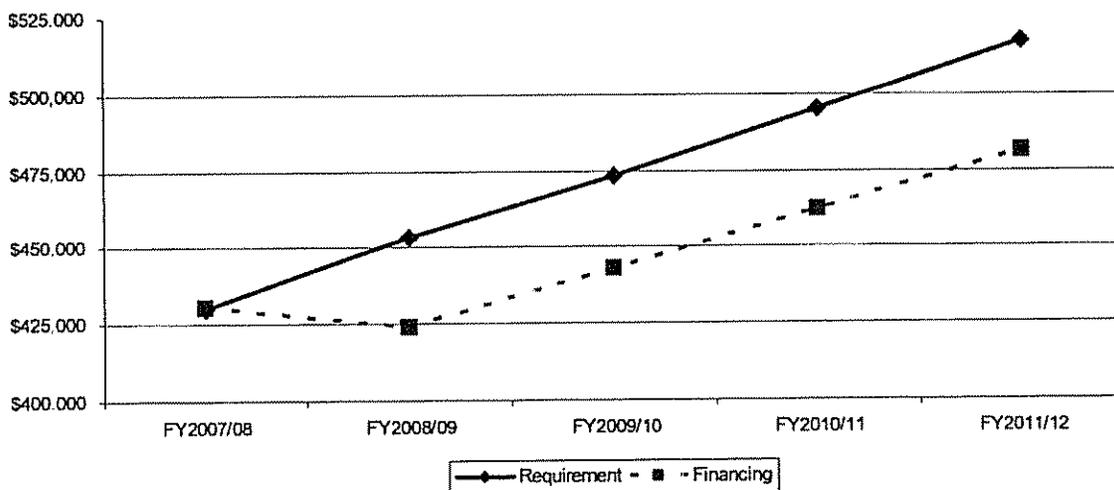
Given the current weakness in General Fund revenue growth and the multi-year nature of a real estate market slowdown, the current General Fund revenue stream may well not grow enough to both close the current funding gap and support the annual expenditure increases. This is a change from previous forecasts which had anticipated greater growth in revenues. These earlier forecasts did not include actual year-to-year reductions in both sales tax and Utility Users' Tax (UUT) and the magnitude of the slowing real estate market.

Estimated Revenue vs Required Revenue

(\$ in 000s)



Based on current economic conditions and the projected expenditure growth, the five-year horizon will present significant challenges to the City's fiscal sustainability. The following illustrates the five year forecast given no changes to the current revenue stream and no measures to slow the rate of expenditure increases:



The vital importance of "Growing our Business" is illustrated by the fiscal picture above. In order to provide financing to close the current gap and regain sustainability over the long term, the City will need to continue to develop new strategies for:

- Increasing tax revenues (not tax rates) through an aggressive economic development strategy based on job creation and retention;
- Increasing the efficiency of current revenue collection efforts;
- Examining departmental revenues and making changes where appropriate; and
- Increasing revenue streams through redevelopment tax increment pass-through and gaining revenues from entities not currently paying to the City.

In addition to these efforts to enhance the General Fund revenue stream, absent an upturn in revenues, the City will need to develop a plan to slow the increase in expenditures.

**FY2007/08 PROPOSED BUDGET AND 2007-2012 CIP
SUMMARY OF CHANGES AND TECHNICAL ADJUSTMENTS**

**SUMMARY OF CHANGES AND TECHNICAL ADJUSTMENTS
TO THE FY2007/08 PROPOSED OPERATING AND CIP BUDGETS**

FY2007/08 OPERATING BUDGET ADJUSTMENTS

Department	Fund	Net \$ Change	Net FTE	Description
City Clerk	General (101)	-	-	Reclassify revenue categories by \$15,000.
City Treasurer	General (101)	-	1.00	1.0 FTE position to be funded within existing resources.
Code Enforcement	General (101)	-	(2.00)	2.0 FTE positions from Code Enforcement to the Utilities Department (Fund 415) and adjust labor reimbursements.
Convention, Culture & Leisure and Non-Department	General (101)	-	1.00	1.0 FTE Arts Administrator to be funded from the annual Arts Stabilization Program (1/2 of one percent of the TOT) budget located in the Non-Department Budget.
Development Services Department and Planning	General (101)	-	-	Transfer 1.0 FTE and associated funding from Planning to DSD to properly align Delta Shores staffing and budget with work load.
Information Technology	General (101)	-	-	Withdraw request to combine four 0.50 FTE positions into 2.0 FTE positions.
Parks and Recreation	General (101)	-	(0.64)	Correct recommended budget augmentations to reflect a reduction in SHRA grant funding for the Workrecreation Summer Hire Program.
Police Department	General (101)	-	(1.00)	Reduce staffing by 1.0 FTE position due to the expiration of the Street Racing grant.
Police Department	General (101)	-	0.20	0.2 FTE to be funded with Alcoholic Beverage Control (ABC) grant.
Police Department	General (101)	-	-	Transfer 83 FTE positions and corresponding funding from org 2127 to 2167 to properly align staffing and budget with workload.
Parks and Recreation - START	START (245)	(\$113,274)	-	Correct recommended budget augmentations to reflect increased State Proposition 49 grant revenue and true-up revenues and expenditures within the fund.
Utilities	Solid Waste (415)	\$88,405	-	Adjust labor reimbursements for Code Enforcement related services.

FY2007/08 Proposed Budget &
2007-2012 Proposed Capital Improvement Program (CIP)

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ATTACHMENT 2

Continued

FY2007/08 OPERATING BUDGET - SCHEDULE 8 ADDITIONS

Organization	Classification	Proposed Reclassification	FTE
Development Services (4883)	Associate Civil Engineer	Associate Electrical Engineer	1 00
Development Services (4811)	Program Analyst	Senior Department Systems Specialist	1 00
Development Services (4811)	Program Manager	Principal Applications Developer	1 00
Development Services (4883)	Supervising Building Inspector	Senior Supervising Building Inspector	7 00
Human Resources (1511/1560)	Program Analyst	Program Specialist	2 00

FY2007/08 CAPITAL BUDGET ADJUSTMENTS

Program	Fund	CIP	Net \$ Change	Description
Utilities	Sewer (414)	XN58	-	Change the CIP number for the S Street Inline Storage 11 th - 14 th Project from XN58 to XN60
Parks & Recreation	Park Impact Fees (791)	LW07/LX23	-	Transfer \$289,000 from the Steve Jones Park (LW07) project to the Hopkins Park Improvements (LX23) project as a result of LW07 grant award

FUTURE FISCAL ISSUES

Other Post Employment Benefits (OPEB)

Issue: The City currently provides a medical insurance subsidy to retirees who meet certain longevity standards. The City has been budgeting and reporting the cost of the retiree medical benefit on a pay-as-you-go basis. Only the regular payments to the vested retirees are included in the Budget reported in the City's Financial Statements. The current pay-as-you-go cost in the Budget is approximately \$6.3 million.

The Governmental Accounting Standards Board (GASB) has set new standards which will go into effect for FY2007/08 and requires reporting of the cost of the retiree medical benefit on an accrued actuarial basis. The City will now have to report the long term costs of providing the retiree medical benefit on the same basis as the pension benefit. With pensions, the long-term costs of providing the benefit for vested retirees and employees is calculated and the annual cost of fully providing the benefit is determined and included in the Budget and reported in the Financial Statements. The annual cost of funding the retiree medical benefit on the same basis as pension benefit will measure in the tens of millions.

Recent Developments: The State has publicized its unfunded liability at \$48 Billion and has formed a task force to determine how to address it. Orange County is negotiating with their employee unions to reduce their unfunded OPEB liability from \$1.4 Billion to \$600 million. Sacramento County eliminated retirement healthcare subsidies to all employees retiring after May 31, 2007. This action will reduce their OPEB liability from an initial estimate of \$300-500 million to \$125 million. Review of other jurisdictions indicates increasing pressure to implement a two tier system to reduce or eliminate retirement health benefits for new hires and to offer health savings accounts instead.

Next Steps: A City working group has been formed to continue to gather data on the potential costs of the retiree medical benefit, monitor other jurisdictions, and explore the City's options for dealing with the new accounting standard. The Mayor and Council will receive periodic updates on the status of this issue and the magnitude of potential fiscal impacts before any decision is required.

Utility Users Tax (UUT)

The UUT is the third largest source of discretionary tax revenue in the General Fund. The current UUT rate is 7.5% and applies to charges on electrical, natural gas, telephone (land line and cellular), and cable television services. In FY2005/06, the City received \$56.4 million in UUT revenue. This represents

ATTACHMENT 3

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nearly a quarter of the total taxes collected and approximately 15% of General Fund revenue. Future UUT revenue is expected to grow by only 4.0 %.

Issues impacting the City's continued ability to levy and collect UUT revenues include:

Market Share Changes: Consumers have more choices in telecommunications services. As companies compete to offer services, customers migrate from traditional service providers to satellite, broadband, and others-- to which our UUT does not currently apply. This may result in the loss of UUT and franchise fee revenue, unless the City were to amend the UUT ordinance to tax new technologies. Such a change would require voter approval under Proposition 218.

Industry Lobbying: There are continuing efforts to standardize or eliminate federal/state/ local telecom taxes and fees, and to obtain national/state cable franchises. These actions reduce local control over UUT franchise revenues.

Legislation: Pending federal legislation includes a proposed ban on Internet access taxes, which would prohibit cities from taxing DSL and cable modem; legislation to prohibit any new local tax on wireless services in the future; and legislation to repeal the Federal Excise Tax (FET). If passed, these bills would affect the City's ability to tax communications in the future.

City Ordinance Clarification: Last year's IRS ruling that repealed the FET on long distance and bundled phone service prompted the City to clarify its UUT ordinance and amend it to de-link the telephone user tax from the FET consistent with the intent of the original ordinance. Although the City could potentially be subject to legal challenge regarding this amendment, such a lawsuit would not likely be meritorious.

Claims/Refunds: The City has received a couple of inquiries in response to last year's FET ruling about the procedure for filing UUT refunds, but to date no claims for refunds have been filed with the City.

The overall fiscal impact of these issues on City UUT revenues is somewhat uncertain and is still being analyzed. The Finance Department will continue to work closely with the CAO to analyze these threats and mitigate their effects.

County of Sacramento

The County provides important public safety, health, and human assistance services to City residents and the City. The County is currently facing both a \$33

ATTACHMENT 3

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million projected funding gap in FY2008 and additional problems in future years. The County will hold, as is typically the case, its annual budget hearings near Labor Day after the State budget is adopted. While county budget reductions will have impact on city residents, it is not possible at this point to know what those impacts will be.

State of California

Since FY2004-05 the State of California has been operating with a structural budget deficit. The State has employed a variety of tactics to close this gap year to year, including shifting of revenues from local governments to the State, issuance of revenue obligation bonds, and expenditure reductions.

In response to the shift of local agency revenues to school funding Proposition 1A was approved by the voters in November 2004 and amends the California Constitution to prohibit the shift of property tax revenues from local governments with certain exceptions. Governor's Fiscal Year 2007-08 proposed budget, as amended in May 2007 provides continued funding for local governments. However, the State still remains in a deficit situation and modifications to the budget will continue to be made until the Legislature and the Governor reach agreement on a final budget package at the end of June. The State's inability to close its structural budget gap remains a concern to local governments and the City of Sacramento. To the extent that the State budget process results in reduced sources of funds available to the City, the City will be required to make adjustments to its budget. A more significant threat is the impact of State actions on the County and the consequent impact on City residents.

