



REPORT TO COUNCIL

22

City of Sacramento

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Staff Report

October 30, 2007

**Honorable Mayor and
Members of the City Council**

Title: FY2007/08 Budget Status Report and Recommended Action

Location/Council District: Citywide

Recommendation: Adopt a **Resolution** authorizing the City Manager to reduce the FY2007/08 General Fund operating budget as necessary in response to anticipated funding gaps in FY2007/08 and to prepare for FY2008/09 and direct staff to report back to Council on the strategies and impacts of these reductions.

Contact: Leyne Milstein

Presenters: Russell Fehr and Leyne Milstein

Department: Finance

Division: Budget, Policy and Strategic Planning

Organization No: 1140

Description/Analysis

Issue: At the conclusion of the FY2007/08 budget hearings, the Mayor and City Council requested periodic updates of the City's financial status. Following is a status report on the City budget.

There is a growing gap between on-going expenditures and on-going revenues in the General Fund as current revenue growth is insufficient to support committed expenditure increases. It is important to note that the decline in revenue growth that the City is experiencing is not limited to the City of Sacramento as local governments in this region, Sacramento County, the State of California and the national economy are seeing similar results. In recent years, the Mayor and City Council took prudent action to set aside reserves, including the \$30 million Economic Uncertainty Reserve, to be available in times of economic slow down such as what we are currently experiencing.

In FY2007/08, the gap will grow during the remainder of the year unless measures are taken to slow the growth in expenditures. Without concerted efforts to reduce the expenditure growth, expenditures will continue to grow faster than revenues over the next several years. For FY2008/09, the gap between on-going expenditures and revenues could grow to between \$45 million

and \$55 million. Development restrictions in the Natomas Basin could further depress revenue growth and make the budget gap even larger.

Based on this assessment, the City Manager has directed that actions be taken immediately to address the pressure on the current year FY2007/08 budget and to prepare for FY2008/09.

The Growing Budget Gap

The approved budget for the current year, FY2007/08, includes the use of \$27 million in reserves including \$4.5 million from the Economic Uncertainty Reserve and increased salary savings to balance the budget. The presence of this budget gap and its continued growth are the result of the following factors:

- Expenditures continue to increase due to commitments to employees and programmatic and service enhancements;
- Revenue growth is declining reflecting the national "housing crisis" and its impact on property and sales tax revenues;
 - The significant decline in the local residential real estate market is deeper and greater in duration than most anticipated.
 - There have been lower sales of both new and existing residences than was anticipated in the budget estimates.
 - There have been and it appears will continue to be reductions in the average market value of properties.
 - Both the sales volume and the market values have been further depressed by the credit problems of both borrowers and lenders.
 - The impact of what was termed the "wealth effect" has been reversed as individuals and families are curtailing discretionary expenditures, particularly purchase of expensive items such as electronic equipment, furniture, and autos.
- Development restrictions in the Natomas Basin will only compound these trends.

FY2006/07 Year End

In the past fiscal year, FY2006/07, actual discretionary tax revenues were approximately \$5.8 million less than budgeted. The estimates used in the budget assumed slowing growth in Property, Sales, Utility User Taxes, and actual reductions in Supplemental and Transfer Taxes. Actual results reflected the impact of the housing crisis on property tax and sales tax revenue. Additional detail on budget versus actuals for major tax revenues is included in the Background section of this report (Attachment 1). The results of this revenue shortfall are:

- The close of FY2006/07 will not provide additional resources for allocation in FY2007/08; and,
- The base for future year revenue estimates is lower.

FY2007/08: Current Year Status

There is significant negative pressure on the current year budget, the result of a number of factors outlined below:

- The housing crisis continues to dampen revenue growth. Both sales and market values continue to drop.
 - The Development Services Department estimates that development activity will be 60% less than prior years.
 - Possible development restrictions in the Natomas Basin will further accelerate this trend.
- The Sacramento County Assessor has proactively initiated the Proposition 8 process of lowering the value of tens of thousands of parcels on the tax roll.
- Unemployment has increased in the region.
- While the City of Sacramento voters approved the City's Utility User Tax rate in 1988, in other jurisdictions there have been successful legal challenges to portions of the Utility User Tax.

There are other potential fiscal challenges to the City's General Fund:

- The State Budget also has a growing gap between revenues and expenditures. Under Proposition 1A, the State could impose a one-year shift of local government revenues.
- Utility User Tax revenue growth could be negatively impacted by changes in telecommunications, cable television market share, and various legal challenges.
- The City is required to determine the cost of retiree medical benefits on an actuarial basis. In future years, the City may be required to fund a portion of the benefit.

Current staffing and service levels are not sustainable given the current weakness in revenue growth. The actual budget gap for FY2007/08, closed with reserves in the budget plan, will grow during the remainder of the year unless measures are taken to slow the growth in expenditures. Without concerted efforts to reduce the expenditure growth, expenditures will continue to grow faster than revenues over the next several years.

Recognizing the potential impact of continued slowing in revenues in FY2007/08 and the reality that if we do not take action now, the problem will compound in FY2008/09 and beyond. The City Manager has initiated hiring controls effective October 1st to begin the process of slowing expenditures. Nearly 66% of the General Fund budget is the cost of labor, thus, a reduction in staffing levels represents the largest opportunity to change expenditures.

Implementation of the hiring controls is coordinated by the City Manager and approval of the City Manager is required to fill all vacant positions. There are limited categories of exemption to the hiring controls such as critical public safety, revenue generating, and mission critical positions. In addition to the hiring controls, the City Manager is implementing preliminary expenditure reductions effective November 1, 2007. These reductions, in addition to the hiring controls, will provide both a mechanism to mitigate further revenue loss, should actual revenue results be less than expected for FY2007/08 year end, as well as the initial efforts to reduce expenditure growth in FY2008/09.

Understanding that the solution must be broad based, the City Manager has also directed Departments to immediately begin reducing discretionary expenditures wherever possible including travel, professional services, and other discretionary expenditures. Finally, departments are working on identifying the impacts of these reductions and we will provide a report to the Mayor and Council in December outlining the impact of these reductions on programs and service levels.

An integral part of FY2008/09 budget development will be identification of the impact of making budget reductions on services to City residents under different budget scenarios. Potential impacts will be brought back to Council for consideration as soon as possible. In addition, Departments will be working on developing additional revenue capacity. Revenue enhancement proposals will be brought forward for Council consideration along with proposed expenditure reductions as part of the FY2008/09 budget development process.

Policy Considerations: Realignment of revenues and expenditures is consistent with the City Council's Strategic Planning – Strategic Budgeting process.

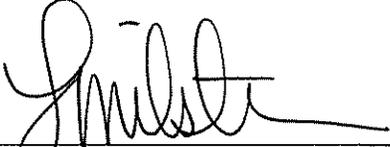
Environmental Considerations: This report concerns administrative activities that will not have any significant effect on the environment, and that do not constitute a "project" as defined by the California Environmental Quality Act (CEQA) [CEQA Guidelines Sections 15061(b)(3); 15378(b)(2)].

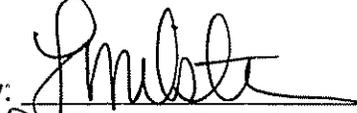
Commission/Committee Action: None.

Rationale for Recommendation: There is a growing gap between on-going expenditures and on-going revenues in the General Fund. If we do not take action now, the problem will compound in FY2008/09 and beyond.

Financial Considerations: The City's budget must be balanced. Expenditures are currently growing faster than revenues. While one-time resources such as reserves may be used as a funding source, the reserves and other one-time resources available to fund General Fund expenditures are insufficient to close the gap expected in FY2008/09. In order to remain fiscally solvent, the City must develop a broad based multi-year plan to close the gap between revenues and expenditures.

Emerging Small Business Development (ESBD): None

Respectfully Submitted by: 
Leyne Milstein, Budget Manager

Approved by: 
for Russell Fehr, Director of Finance

Recommendation Approved:

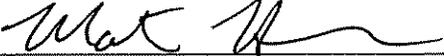

for Ray Kerridge
City Manager

Table of Contents:

Report	pg. 1-6
Attachments	
1 Background	pg. 7
2 Resolution	pg. 8

Attachment 1

Background

FY07 Major Tax Revenues: Budget vs Actuals

The following table represents the budget estimates and actual results for the FY2006/07 discretionary tax revenues of the General Fund:

<u>Major Revenue Categories</u>	<u>FY07 Budget</u>	<u>FY07 Actual</u>	<u>\$ Diff</u>	<u>% Diff</u>
Secured Property Tax	83,916,000	80,513,715	(3,402,285)	-4.1%
Supplemental Property Tax	3,000,000	8,111,471	5,111,471	170.4%
Property Transfer Tax	10,000,000	12,469,019	2,469,019	24.7%
Sales Tax	75,291,000	69,475,578	(5,815,422)	-7.7%
Utility User Tax	59,020,000	55,514,949	(3,505,051)	-5.9%
Vehicle License Fee	36,001,000	35,365,378	(635,622)	-1.8%
Subtotal Major Rev Categories	267,228,000	261,450,110	(5,777,890)	-2.2%

- Secured Property Taxes were impacted by the housing crisis and a concentration of commercial property sales in redevelopment areas. Revenue growth was impacted by Proposition 8 tax roll value reductions of the Assessor.
- Supplemental Property Tax growth was greater than anticipated due to the Assessor working down a backlog of real estate transactions and the sale of high value commercial properties.
- Transfer Tax growth appears to be due to the sale of commercial properties. This revenue is not affected by the presence of redevelopment areas.
- Sales Tax revenue was under budget due to significant declines in sales of wholesale and retail construction materials, electronic equipment, and autos.
- Utility Tax growth was less than anticipated due to more mild weather, lower prices of natural gas, the new low income tax exemption program, changes in telecommunications, and changes in cable/satellite television services.

RESOLUTION NO. xxx

Adopted by the Sacramento City Council

FY2007/08 Budget Status Report and Recommended Action

BACKGROUND

- A. The City Council has an adopted policy to maintain a fiscally sustainable, balanced budget.
- B. In the General Fund, there is a growing gap between ongoing revenues and expenditures.
- C. The City's budget must be balanced. If we do not take action now, the problem will compound in FY2008/09 and beyond.
- D. The City Manager is recommending current year expenditure reductions in order to provide both a mechanism to mitigate further revenue loss as well as initiate efforts to reduce expenditure growth in FY2008/09.

BASED ON THE FACTS SET FORTH IN THE BACKGROUND, THE CITY COUNCIL RESOLVES AS FOLLOWS:

- Section 1. The City Manager is authorized to reduce FY2007/08 General Fund department operating budgets as necessary in response to anticipated funding gaps in FY2007/08 and to prepare for FY2008/09.
- Section 2. The City Manager is authorized to make the necessary adjustments to the FY2007/08 budget to implement the reductions.
- Section 3. The City Manger will report back to the City Council on the impact of these reductions.