



May 4, 2004

To: The Honorable Mayor and City Council

From: James G. Marshall, City Manager

Subject: FY 2004-05 Budget Message

While the process of developing a budget and presenting it to the City Council is always dynamic, the FY 2004-05 budget development has been one of the most difficult. The difficulty arises from a sea of uncertainty surrounding the State budget, and its impact on the City of Merced General Fund.

As of this date, we are faced with the following uncertainties:

- LOCAL, a coalition of the League of California Cities (League), the California State Association of Counties (CSAC), the Special Districts Association of California (Districts), and the California Redevelopment Association (CRA) have gathered more than 1 million signatures to qualify the Local Taxpayers and Public Safety Protection Act (the Act) for the November 2004 ballot. The LOCAL Coalition will know in mid-June if the measure qualified. If it is qualified for inclusion on the ballot, voters will have the opportunity to amend the State Constitution to prevent the State from raiding local government revenue streams without approval from the electorate. Current revenue sources will be protected. Question: If the measure qualifies, will the electorate approve the Constitutional amendment?

- Governor Arnold Schwarzenegger will release the “May Revise” – a revision to the proposed State Budget for FY 2004-05 on May 13, 2004. The Revise more accurately reflects revenues generated and year-to-date expenditures for carry-over balances in 2004-05. Other amendments impacting local government may also be included. Question: Will the May Revise hurt or help local government?
- As a result of the successful signature collection for the Act, State Legislators have taken note of local government. LOCAL has raised the level of local government as a “player” in the State Capitol. The Governor is now negotiating with LOCAL to accomplish several objectives – protect State programs (his first stated priority), seek a longer timeframe (more than one budget year) to extract the State from its current fiscal plight, recognize the value (and threat of the Act) of local government, and maintain the successful political leadership he has demonstrated through his effectiveness demonstrated by the passage of \$15 Billion in State Deficit Budget Bonds in March 2004. Question: Do we continue negotiations with the Governor, perhaps at the expense of the Act, to reach a win-win solution to State-Local relationships; or, do we force a popular measure (the Act) with perhaps formal opposition by the Governor?
- The State has seldom met its Constitutional obligation to adopt a budget in a timely fashion. Question: If the State is not timely again this year, how are campaign fund raising and promoting the Act impacted?
- The Governor has proposed a number of measures detrimental to local government in the 2004-05 budget; i.e., a \$1.3 billion shift of revenues to the State. Question: How will these revenue shifts be manifested – an additional Education Relief Augmentation Fund shift (ERAF II), a reduction in promised Motor Vehicle In-Lieu (MVIL) Fee backfill, an elimination of Jail Booking Fee reimbursement, or a myriad of other alternatives? Question: How do you estimate both amount and source that impact available revenue and cash flow?
- The recent State Deficit bond secured the bondholders by pledging local government sales tax as the source of repayment. One-quarter cent of the City’s share of sales tax will be shifted to the State, and a

promise has been made to replace the shifted funds with redistributed property tax dollars (the “triple flip”). Aside from changing the city’s cash flow of receipts and, perhaps resulting in insufficient capacity in the property tax to meet the backfill requirement, this shift would place the City at risk of losing \$ 2.5 million annually. Question: Will the State keep their promise and backfill the City?

Clearly, the fiscal and political environment in which we find ourselves will require time, wisdom and patience to resolve. To that end, we have been forced to evaluate several different revenue and expenditure scenarios. There could be no end to the number of options created; however, we have used our best judgment and have created three possible revenue pictures and five expenditure considerations.

The Revenue scenarios are:

Option A – Best Case

All of the revenues anticipated are received with no additional decreases. This assumes a continuation of ERAF, no ERAF II, and full payment of MVIL backfill. Sales tax would be fully funded.

Option B – Mid-Risk Case

This scenario assumes that we will receive all of the revenue under Option A except MVIL Gap – ERAF II of \$321,501 and Booking Fee re-imburement Of \$237,555.

Option C – Worst Case

This scenario assumes that we will receive all of the revenue under Option A except MVIL Gap – ERAF II of \$321,501, Booking Fee re-imburement Of \$237,555, MVIL backfill of \$2,686,030, triple flip backfill of \$2,450,000, and POST reimbursement of \$50,000.

For each of the above scenarios, we prepared a 5-year cash flow projection against which five expenditure versions were evaluated.¹

Version 1 – Core Budget

The Core Budget calculation assumes the status quo based on programs and personnel approved in the FY 2003-04 budget, as amended.

Version 2

This version includes personnel and related expenses for the following requested positions:²

General Fund

- 3 Fire Captains – Station 55
- 3 Fire Engineers – Station 55
- 3 Fire Captains – Truck Captains
- 3 CSO/Dispatchers
- 3 Police Patrol Assistants

Other Funds

- 1 Wastewater Treatment Plant Superintendent
- 1 Water Pump Operator
- 1 Street Sweeper Trainee
- 1 Fleet Mechanic³
- 1 Network Engineer⁴
- 1 Web Analyst⁵

¹ Cash carryover balances are more refined now than when first projected for the State Budget Impact Committee; therefore, the numbers are slightly higher due to realized cost savings from expenditure/personnel freezes instituted mid-year by the City Manager.

² Not all requested positions are included, only those recommended for consideration in this version by the City Manager

³ Partial General Fund Support

⁴ Partial General Fund Support

⁵ Partial General Fund Support

Version 3

This version includes personnel and related expenses for the following requested positions:⁶

General Fund

- 3 Fire Captains – Station 55
- 3 Fire Engineers – Station 55
- 3 CSO/Dispatchers

Other Funds

- 1 Wastewater Treatment Plant Superintendent
- 1 Water Pump Operator
- 1 Street Sweeper Trainee
- 1 Fleet Mechanic⁷
- 1 Network Engineer⁸
- 1 Web Analyst⁹

Version 4

General Fund

- 3 Fire Captains – Truck Captains
- 3 CSO/Dispatchers

Other Funds

- 1 Wastewater Treatment Plant Superintendent
- 1 Water Pump Operator
- 1 Street Sweeper Trainee
- 1 Fleet Mechanic¹⁰
- 1 Network Engineer¹¹

⁶ Not all requested positions are included, only those recommended for consideration in this version by the City Manager

⁷ Partial General Fund Support

⁸ Partial General Fund Support

⁹ Partial General Fund Support

¹⁰ Partial General Fund Support

- 1 Web Analyst¹²

Version 5

- 3 Fire Captains – Station 55
- 3 Fire Engineers – Station 55
- 3 Fire Fighters – Station 55

Other Funds

- 1 Wastewater Treatment Plant Superintendent
- 1 Water Pump Operator
- 1 Street Sweeper Trainee
- 1 Fleet Mechanic¹³
- 1 Network Engineer¹⁴
- 1 Web Analyst¹⁵

As can be seen, every effort is being made to accommodate the Station 55 start-up, with scenarios assuming either a 6-man or 9-man (2 per shift or 3 per shift) allocation. It is also recognized an additional station within the Bellevue Ranch complex will be needed; however, funding from the recently enacted Community Facilities District – Services (CFD) will cover this growth related expense.¹⁶

Regardless of the General Fund Version selected, it is recommended that the “Other Funds” positions be approved. A review of the fund balances (adequate) and identified need for the new positions validates this recommendation.

¹¹ Partial General Fund Support

¹² Partial General Fund Support

¹³ Partial General Fund Support

¹⁴ Partial General Fund Support

¹⁵ Partial General Fund Support

¹⁶ Some of Station 55 operating costs may also qualify for CFD financing because 50% of the capital cost was identified in the Public Facilities Financing Plan (PFFP) as growth related. This allocation will be reviewed when CFD funds develop. If SAFER Act Grant funds become available, they would also be applied.

Additional Considerations and Assumptions

Because the budget building process is so fluid, there are a number of other items that must be recognized – some positive and some as threats.

Our most current revenue estimates lead us to believe that some revenue categories

anticipated in the current FY 2003-04 budget will be stronger than estimated:

Sales and Use Tax -	\$ 400,000
Secured Property Tax -	300,000
CRIS Tax ¹⁷ -	800,000
Various other -	<u>367,000</u>
Total	\$ 1,867,000

There have also been expenditure savings due to personnel, operations and maintenance, and capital outlay freezes established by the City Manager early in the FY 2003-04.

Acquisitions	\$ 225,000
Capital Outlay	291,000
Transfers Reduced ¹⁸	<u>1,000,000</u>
Total	\$ 1, 516,000

The impact of the above savings and revised revenue estimates essentially helps the City to extend its ability to provide services to the citizens of Merced by about one year regardless of actions taken by the State. It is this prudent fiscal management philosophy that, when applied this year, will help the City to grow services to meet growth. The net impact is:

Estimated carry-over to FY04-05 - \$ 8,403,834¹⁹

¹⁷ CRIS – Cost Revenue Impact Study – a one time tax paid to offset general fund costs at the time building permits are issued

¹⁸ Reduced transfers of General Fund revenue to other operating funds

¹⁹ The adopted FY03-04 budget document reflects an ending balance of \$6,812,045 (p.3-43). The amended amount reflects adjustments for additional revenues/expenditure savings post – audit.

State budget impacts FY03-04 -	(1,200,000) ²⁰
Increased Revenue Estimate FY03-04 -	1,867,000
Expenditure Savings FY 03-04 -	1,516,000
Encumbrances and Adjustments	<u>(383,000)</u>

Estimated Opening Balance FY 04-05 \$ 10,203,834

Other considerations from general and enterprise funds that impact our delivery of and cost for services are:

- Wastewater Treatment – As we complete Phase III improvements (regaining 10 mgd capacity), we are faced with the renewal of our National Pollutant Discharge (NPDES) permit. This is the permit that sets the standard(s) the City must meet prior to the discharge of treated wastewater. Based on a review of other recent renewals in San Joaquin Valley communities, the City anticipates significant increases in effluent quality requirements. If tertiary treatment and filtration are mandated, ratepayers will see significant increases in treatment costs and in needed capital financing to construct the additional capital investment. Coupled with Phase IV demands to increase capacity to 15 mgd (pre-engineering currently under contract), the City Council will need to prepare itself for both growth related and regulation related rate increases.
- Water – The regulatory environment also impacts the domestic water system. Arsenic and other standards will impact our ability to continue serving water in our current delivery system configuration. Treatment of delivered water may be required at each wellhead. Also, the age of the current water well infrastructure is causing some concern, especially during high demand periods when wells must be operated to meet system demand. With a new well under construction at the UC site, and two new wells ready to be drilled, the system is making strides to meet customer needs. Nevertheless, some service from new wells may be required vis a vis temporary power generation pending completion of well site development later this fall.

²⁰ Additional ERAF shift and lost MVIL Gap revenues not anticipated at time of City budget adoption. While the City adopts its budget in a timely fashion pursuant to Charter, the State has not adopted its budget commensurate with Constitutional provisions. This creates an environment in which staff is unable to accurately predict State impacts when City adopts its budget.

- Parks – One area where the City has frozen expenditures has been in the Parks maintenance area. All park maintenance is general funded, except for a very small amount included some maintenance districts. As the City grows and more parks are added, park personnel will need to be increased also. Funds are included to offset the impacts of growth through the recently enacted CFD.
- Civic Center – The Civic Center was occupied in 1988. During the severe State budget impact years beginning in 1993, employee census in the structure declined. Now, sixteen years later, we are starting to see the facility reach maximum capacity. Some out-stationing of employees may need to be considered. Also, deferred maintenance at the Civic center will need to be addressed soon.
- Police – The Police Department also has space related needs. Currently, an appraisal is being performed on a structure in North Merced which, if acquired, would allow the Department to relocate from leased space. The Central Station is overcrowded, and the building was not designed for today’s technology. The PFFP provides a source of revenue for Police Capital needs. Additional manpower will be needed to meet growth requirements. The CFD will provide this resource.
- Fire – While efforts are being made to accommodate Station 55 in this budget proposal, it must be recognized that the need for a Station 56 is fast approaching. While 50% of Station 55 operations may be growth related and funded through the CFD, all of Station 56 will be growth related. As permits are issued, a reliable and predictable revenue stream will develop.
- Information Services – The City Council has identified keeping pace with evolving technology as a high priority. The recently completed IS Strategic Plan identifies a pathway, over time, to accomplish this goal. During 2003-04, an IS Director was hired to guide the City organization through this process. Additional depth is recommended this year through the addition of staff.
- Development Services – Given the burst of growth over the last two years, the Development Services staff is at “at capacity”. The City

Council recognized this and authorized six new positions in April, 2004. The positions are all funded from current activity or capital funds, and are not an impact to the General Fund. From Planning, to Engineering, to Inspection Services – manpower is required to remain timely in our processing of applications and to secure needed inspection of capital projects (City and/or developer driven). Housing programs continue to benefit the community through rehabilitation loans, first time homeowner down payment assistance, and public service projects.

- Community Services – There is still a large infusion of general funds into the Recreation Services Division; however, steps are in progress to secure reimbursement for a portion of City costs from non-profit sport recreation users. It is recognized that Recreation Services are a valuable part of the quality of life in Merced, and no cuts are being proposed. However, seeking financial contribution from those directly benefiting from the delivered service (facility and/or program) is essential.

- Streets and Roads – Due to Transit capital requirements, less Local Transportation Funds (LTF) will be available for street and road maintenance. Transit must be fully funded, with no un-met needs, before LTF can be used for maintenance. This year, more than \$840,000 of general fund money will be needed to balance the street maintenance budget. Some of this is resultant from the decreased LTF. Some may be from LTF required to supplant State Transit Assistance Funding (STAF) which the State may withdraw. Also, no Proposition 42 funds will likely be available. Historically, General fund transfers to Streets and Roads have increased annually, from a low of \$161,894 in FY 2000-01, to \$750,473 in FY 2003-04. The City, through participation in a Pavement Maintenance Management System study has identified street segments requiring more than \$52.7 million to repair. This includes:
 - \$ 49.2 million in major repair (more than .2 ft overlay through complete rebuild)
 - \$ 3.1 million in minor repair (sealing through less than .2 ft overlay)
 - \$.365 million in incidental repairs (sealing)

While many of the above items appear to be threats to our ability to serve our citizens, there are actions previously taken, or underway to mitigate some of the concerns:

- The conservative approach to budgeting has allowed us to “buy some time” in our response to State actions (still unknown) with confidence that we can grow service delivery to meet the growing demands of our community. The recommended budget will allow the City to move forward and not face an elimination of general fund cash reserves until 2008. By then, other revenue streams will arrive (CFD, possible ¼ cent sales tax [recommended by State Budget Impact Committee - subject to voter approval], and possible SAFER grant funds to offset increase in Fire Department personnel).
- General Fund cash flows assume all positions will be filled for the entire year. In actuality, positions will be held pending fund availability, possible SAFER grant funding in Fire, and normal turnover vacancies.
- CFD funds will begin to develop in 2004-05. No estimated revenue has been forecast at this time.
- Cal PERS investments returned 23.3% in 2003. Contribution rates are based on actual earning with a “lag” in impact. It is anticipated that City contribution rates will decrease beginning in 2006-07. No savings have been forecast at this time pending further analysis.
- The City authorized issuance of Pension Obligation Bonds (POB) in 2004 to stabilize the impact of the Public Safety PERS liability. Bonds are scheduled to be released in June. By issuing the bonds and securing a fixed cost on the liability, the City will realize annual contribution savings. This has not been forecast because the interest rates attached to the bonds will not be known until they are actually sold.
- The State Budget Impact Committee has recommended Council consideration of a ¼ % sales tax measure in November 2005. If successful, the City will be able to stabilize reserves while meeting

service delivery needs. No revenue has been anticipated in the forecast.

- The Public Facilities Financing Plan fees were increased in 2004 to recognize the increased cost of projects. Additional staff has been authorized to meet the timeframes for project production. Staffing increases for engineering and design were also addressed in the recently increased utility connection fees.
- Airport operations are being reviewed to maximize revenue potential. Rents and rates were adjusted in 2004, coincidental with the adoption of revised rules and regulations governing airport usage. Clean-up of the hazardous waste site is under permit review by regulators at the State Regional Water Quality Control Board.
- Airport land use sales remain constant as new Industrial uses locate in the South Industrial Airport Park. Revenues from the sales, which guarantee repayment of a HUD 108 loan, are exceeding expectations. Land cost has been favorably adjusted by the City Council to more accurately reflect market conditions. Retirement of the HUD 108 loan will remove covenants from the remaining property, and from CDBG allocations.
- Enterprise rates were adjusted in 2003 with annual increases to reflect the on-going cost of municipal services.
- The City joined a risk management Joint Powers Authority in 2003 to better control liability costs. While still self-insured, a higher degree of municipal risk management expertise was obtained. Once the City meets its deposited reserve requirement (3 years), savings will be realized assuming good risk management practices are adhered to, and claim costs and administration can be controlled.
- Workers Compensation reform should have some savings attached. At this time, it is not possible to forecast a dollar amount. However, because the City is self-insured with a large retention, actual savings may be inconsequential.

- Economic Development prospects and impacts from University of California create positive impacts for our future. While not specifically identifiable, our past history shows continued growth in retail sales and job production – both of which add positively to our outlook.
- The City Council has been active and participating in designing the future for Merced. The concerted teamwork has created visible results. Our community is recognized positively as a great place to live, work, and play in California.

Redevelopment

During FY 2003-04, State actions caused an ERAF shift from Redevelopment Agencies throughout California. In Merced, the Agency was required to send \$261,000 to offset State budget deficits. The proposed FY 2004-05 budget issued by the Governor calls for another shift of the same magnitude. However, there have been reports that after the May Revise, and after negotiations impacting all local government are complete, Redevelopment Agencies may suffer a more substantial loss. This could cause the Agency to shift Housing Set Aside monies on a short-term basis to cover the ERAF demand.

Bond proceeds on hand will allow the Agency to proceed with the Merced Center Project on the block across from the Civic Center. Proceeds will finance the parking structure needed to support the remaining development. Lease-Revenue Bonds may be required for buildings proposed to be lease-purchased by Merced County and Merced Community College. Private funding sources will finance the hotel.

New projects may find limited funding available.

Closing Remarks and Recommendation

Even amidst the trials and tribulations facing local government in California, we believe Merced has a bright future. We can identify problems and wring our hands; yet we can also identify and enumerate mitigating factors. Some

are clear, some are fuzzy. Nonetheless, Merced will stay the course and continue to be a special place.

After reviewing all of the revenue scenarios and expenditure versions, it is recommended that the City Council approve the Mid-Risk Revenue assumption with Expenditure Version 3. This provides for the construction and opening of Fire Station 55 with six employees, three CSO dispatchers, and six positions identified with “Other Funds” which includes two Information Services personnel, plus enterprise positions in Water, Wastewater, and Street Sweeping, with an internally funded position in Fleet. It is also recommended that staff have flexibility in determining whether three CSO Dispatchers, or a combination of CSO – Dispatchers and Police Patrol Assistants (not to exceed a cumulative increase of three positions) be filled. If SAFER grant funds are developed for the Fire positions, then staff will return to the City Council seeking authorization for the remaining CSO – Dispatcher and Police Patrol Assistant positions (a combined total of six).

This is certainly far more risky than waiting to see what may befall us. However, we have confidence that the benefit of this recommendation will outweigh the recognized risk.

It is further recommended, that once the State impact on local government is recognized, additional City Council review be given, and adjustments made as needed.²¹

On behalf of the staff and employees of the City of Merced, I am pleased to present this budget for FY 2004-05 to you for your favorable consideration.

Respectfully Submitted;

James G. Marshall
City Manager

²¹ Pursuant to the Charter, any budget amendment will require five affirmative votes.