



TO: The Honorable Mayor and City Council
 FROM: James G. Marshall, City Manager
 SUBJECT: Proposed 2003-2004 Fiscal Year Budget
 DATE: May 7, 2003

INTRODUCTION

Today is May 7, 2003. I am specifically drawing your attention to this date because information contained in this budget message is relevant as of this date – but subject to change at any moment. On May 14, 2003, the Governor will issue the May Revise budget figures. It is upon the May Revise figures that the amended State budget for fiscal year 2003-04 will be developed. Accordingly, everything is in a state of flux.

As of May 7, four different budget proposals have been made to respond to the currently projected \$37 billion State budget deficit. Each one represents different potential local government impacts. These are summarized below.

<u>Budget Version</u>	<u>Impact in FY02-03</u>	<u>Impact in 03-04</u>
Governor Davis (Jan. 2003)	\$1.070 Billion	\$1.584 Billion
Senate Republican	\$289 Million	\$391 Million
Assembly Democrat*	\$94 Million	\$288 Million
Assembly Republican	\$9 Million	\$139 Million

*Note: Does not fully balance the State budget.

With total local government impact ranging from \$148 million to \$2.654 billion over the two-year period, it is needless to say that there will be an impact to the City of Merced—how much is impossible to forecast, however.

With the state budget situation as a backdrop, the recommended budget transmitted with this message makes the following assumptions:

1. All revenues due to the City of Merced from all sources will be received during fiscal year 02-03 and fiscal year 03-04.
2. All currently delivered core services will continue to be delivered during fiscal year 03-04.

The City will continue to grow in population (over 600 housing starts estimated during the 03-04 fiscal year) and, in sales tax revenues derived from increased retail sales. As always, revenue projections are conservative to avoid presenting an unrealistic expectation of available funding. If the City experiences significant losses from final state budget decisions, clearly the City Council will need to consider amending the proposed budget either prior to or after adoption.

CITY COUNCIL PRIORITIES

In February 2003, the City Council and staff met in adjourned session with consultant Bill Lewis to review goals established for 2002-03, and to establish priorities for fiscal year 2003-04. The City Council identified the following priorities:

- General Plan Update
- Water, Wastewater and Storm Drainage
- UC Merced
- Annexation
- Infrastructure
- Revenue Protection and Enhancement

In addition to these key priority areas, the Council identified over a dozen more issues to guide the staff in preparing department work plans for the coming year.

The proposed budget contains departmental goals and objectives. Following this Budget Message is a summary of City Council priorities tied to departmental objectives to provide the reader with an understanding of how the Council goals will be implemented. Departmental goals and objectives not directly keyed to City Council goals are usually operational and not necessarily policy-driven.

REVENUES--MUNICIPAL UTILITY RATES

During the 2002-03 fiscal year, the City Council approved rate increases for all municipal utilities. Rate increases were approved for water and sewer services effective in January 2003, January 2004, January 2005, January 2006, and January 2007.

Refuse collection and disposal rates were also approved with increases tied to the Consumer Price Index annually. Rates were also established during the 2002-03 fiscal year for new refuse-related services – curbside recycling and green waste. Both the recycling and green waste collection/composting programs were established to meet State landfill diversion requirements mandated under Assembly Bill 939. The curbside recycling and green waste programs were fully implemented during the last week of April 2003. At the time of the preparation of this budget message, it is too early to predict the amount of waste diverted from the landfill by these programs. However, the Council will be updated on a monthly basis once statistical data can be collected and established.

It is not anticipated that the Council will need to consider utility rate adjustments in 2003-04 unless:

1. The tipping fee at the landfill for disposal of solid waste and/or green waste is increased.
2. Legislation is enacted requiring the installation of water meters.
3. A capital component for expansion of wastewater treatment capacity is implemented and recovered through the sewer rate.

REVENUES--POTENTIAL ENHANCEMENTS

It is important to evaluate revenues collected for certain services against the cost of delivering those services. During the budget preparation process for fiscal year 2003-04, the following items for potential fee adjustment were identified:

Parking Enforcement – Currently, the parking enforcement program costs about \$311,000 to operate, with about \$239,000 in revenue produced. The shortfall needs to be addressed. Specifically, the administrative fee of \$10 charged for processing tickets where the violation has been remedied is insufficient to cover the direct costs.

Animal Control – The Animal Control program is required to ensure the health and safety of the community. Specifically, the program is designed to eliminate the spread of rabies. Rabies vaccinations are required in order to obtain a license for domestic animals. Currently, the animal control program costs over \$290,000 per year. Revenue returned is approximately \$45,500 per year. The administrative service associated with the licensing of animals is privatized to a third party service provider, who can provide the service at a lower cost than if delivering the same service with City personnel. The City Council may want to consider instituting both an aggressive licensing campaign and an increase in licensing fees.

Water Meters – Currently, public parks and public schools consume significant amounts of water. However, under the current Code provisions, schools and public parks are “flat rated,” and the City is not recapturing the cost for the water consumed by both parks and schools. It would be prudent to require parks and schools to install meters. Then, actual water consumed could be charged to the user. The City Council should seriously consider this matter during fiscal year 2003-04. Also, State legislation is currently pending which would require all flat-rated services to be metered. If this proposed legislation is successful, over half of the City’s current water services will need to be metered. The cost for this (estimated at more than \$7 million) will need to be borne by the consumer.

Environmental Control – Currently, under the City’s NPDES permit for wastewater, an Environmental Control program must be provided. The Environmental Control program monitors the content of wastewater from several industrial locations throughout the City. Monitoring the wastewater stream allows the City to require remedial action from specified wastewater generators to prevent the creation of wastewater characteristics in violation of the City’s permit to operate. The City receives about \$87,700 in revenue annually to cover the cost of inspections. However, with the increased need for groundwater monitoring, the Environmental Control program costs approximately \$478,000. While every resident of the City benefits from the Environmental Control program (protection of groundwater/drinking water supply), the City Council may want

to consider whether or not it is appropriate for the generators of high BOD streams to cover more of the program costs.

Airport – Currently, the General Fund contributes more than \$401,000 to the ongoing operations of the Airport. While the Airport provides a significant economic benefit potential to the community, the revenue returned from Airport operations is insufficient to cover the cost. Staff is currently reviewing all airport rules and regulations, including leases. A cost recovery component may also be desirable.

Refuse-Capital Recovery -- Cost recovery for refuse containers (new construction) is collected at the time of building permit issuance. Given the change in refuse collection practices (green waste, recycling, refuse), a fee adjustment will be required to recover the capital cost of new recycling and green waste containers.

While not required as a condition of adopting the recommended 2003-04 fiscal year budget, Council direction should be considered for mid-year review of the above listed items.

SERVICE DELIVERY—PROGRAM REALIGNMENTS

Traffic Impound Yard – The City of Merced had one of the highest rates of injury accidents in the State of California with vehicles operated by unlicensed drivers or drivers operating with suspended licenses. To protect the public at large, the Police Department, with the concurrence of the City Council, started an aggressive traffic enforcement program which included an impound yard. The impound yard was established to provide the mandatory 30-day storage for vehicles operated by unlicensed drivers, or drivers operating with a suspended license. Over time, the program has been modified to allow third party towing companies to provide vehicle storage. Accordingly, the facility acquired initially for the vehicle impound yard has now been converted to an evidence storage facility.

Fees recovered by the City under the targeted traffic impound program do not cover the costs of operating the property acquired. The property does not have to be dedicated to impound. Therefore, program funds which were in Fund 037 will now be directed into the City's General Fund to more accurately reflect the distribution of traffic impound duties and general police evidence storage functions.

Funds recovered through the targeted traffic impound program generally cover the expenses of the personnel associated with this program.

SERVICE DELIVERY--PROGRAM EXPANSION POSSIBILITIES

During 2003-04, even with the looming State budget deficit, there are opportunities for program expansion. The following two programs are currently awaiting responses from funding agencies:

1. Code Enforcement: Currently, the code enforcement program is funded from two sources – Community Development Block Grant and the City's General Fund. A grant application has been submitted to the State Department of Housing and Community Development for a code enforcement program grant which would allow the City to expand its program. Grant awards are expected to be released in late May or early June 2003. If the City is successful, a budget amendment appropriating the grant funds will be required.
2. Continuum of Care – The City of Merced, County of Merced, and Merced County Housing Authority have jointly supported the services of Merced County Association of Governments grant writing staff for the development of a continuum of care plan. A continuum of care plan addresses the needs of the homeless from emergency shelters to placement in affordable housing units. Grants are available through the Department of Housing and Urban Development for continuum of care programs once a plan has been approved. In May, a draft plan was submitted to HUD for review. Comments will be incorporated into a final plan which will be submitted for approval later this year.

If approved, the City and County will be able to apply for nearly one-half million dollars in funds to assist the homeless population. About \$23,000 has been set aside within the funds allocated for planning from the City's CDBG fund to complete the plan preparation process.

SERVICE DELIVERY--PROGRAMS AT RISK

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During the 2002-03 fiscal year, expanded after-school programming was offered through the City's Department of Parks and Community Services. Programs were offered at both City-owned facilities and on selected school sites.

The recommended 2003-04 fiscal year budget contains \$182,534 in after-school programs with no revenue offset. Previously, a County grant helped offset the cost of this program. The core program recommended provides for after-school programming at City sites only – Stephen Leonard Park, five days per week; McNamara Park, five days per week; and the central site on West 27th Street, five days per week. Not included are programs at Fremont Elementary School or the Family Service Center near Stowell Elementary School. Those programs have been deemed to be beyond core services.

The proposed program also terminates the noon program at Tenaya Middle School, and, an after-school program at Stowell Elementary School. The Stowell Elementary School program was determined to be very close to the Family Service Center, also not funded.

If the City Council wishes to allocate more than \$182,534, for after-school programming, action will need to be taken. Staff continues to work with the Merced City School District to seek funding contributions.

(Note: After-school programming should not be confused with the Youth Enrichment Program (YEP). The YEP is a program funded for preschoolers for families meeting certain income limitations. The YEP grant is received by the City. The program is implemented on school sites by personnel from the Merced City School District under contract to the City.)

The City Council has been reserving unrestricted program income from the housing program to establish a Youth Endowment Fund. Currently, there is approximately \$170,000 in the Youth Endowment Fund. It is anticipated that by the end of fiscal year 02-03, an additional \$40,000 will be available to be allocated into the Youth Endowment Fund. During fiscal year 03-04, approximately \$39,000 in additional unrestricted program income will be available to allocate to the Youth Endowment Fund. In total, approximately \$249,000 will be available in the Youth Endowment Fund if the Council continues to allocate Unrestricted Program Income. While the Council has considered guidelines for the expenditure of youth endowment funds, no specific criteria have been established. Accordingly, this could be a source of revenue to help offset after-school programming if desired by the City Council.

SERVICE DELIVERY--STAFFING

The Department Head Request version of the 2003-04 budget includes requests for 29 new full-time positions listed in the table below, plus a number of other personnel-related adjustments.

<u>Department</u>	<u>Position Requested</u>	<u>Number</u>	<u>Funding Source</u>
Fire	Fire Fighter	3	General Fund
Fire	Fire Engineer	3	General Fund
Fire	Fire Captain	3	General Fund
Fire	Fire Captain	3	General Fund
Police	Police Patrol Assistants	6	General Fund
Development Services	Supervising Plans Examiner	1	Building Permits
WWTP	Maintenance Electrician	1	Sewer Funds
WWTP	WWTP Operator Trainee	1	Sewer Funds
Refuse	Refuse Equipment Operator	2	Refuse
Fleet	Mechanic	1	Fleet/Internal
Parks	Maintenance Worker	1	General/Special
Information Systems	I.T. Director	1	Support Service/Internal
Information Systems	Network Systems Specialist	1	Support Service/Internal
Information Systems	Software Applications Support Analyst	1	Support Service/Internal
Information Systems	Secretary III	1	Support Service/Internal
Total		29	

Fire Department --Twelve new employees have been requested in the Fire Department. Nine of the employees would staff Station 55 – the new station proposed at the northeast corner of Paulson Avenue and Silverado. While capital funds are available to build the station, the potential State budget deficit makes hiring additional personnel a risky undertaking at this time. Once the State budget deficit is resolved, the City Council may wish to reconsider this item, particularly in light of pending PERS impacts discussed later in this message.

Three additional truck officers have been requested to provide “on-scene” supervision. Currently, the Fire Department operates two engines with two fire personnel per fire engine, and two engines with three personnel per fire engine. The Fire Department maintains two ladder trucks one of which is manned daily with two personnel (the other is in reserve status if needed). The additional three Fire Captains would allow one Fire Captain per shift to be added to the ladder truck for both manpower and field supervision. This is a safety item that the City Council should consider prior to funding additional personnel for Fire Station 55. It is recommended that attention should be given to adding three Fire Captains for the safety/supervision. The Council may wish to consider opening Station 55 with six personnel (two fire fighters per engine) rather than nine. This would allow Station 55 to be opened with backup engines/trucks coming from Station 53 located near the Merced Mall. The additional costs to open Station 55 with nine personnel is \$760,379 (not including gear). The additional cost of the three Fire Captains is \$272,206. The cost of manning Station 55 with nine personnel and creating three new captain positions is \$1,042,585.

Police Department--The Merced Police Department continues to operate with a ratio of 1.3 sworn personnel per 1,000 population. This ratio is fairly consistent with other departments of like size and configuration. The Police Department has requested six Police Patrol Assistants at a cost of \$350,000 (salary and fringe benefits). The Police Patrol Assistants would be deployed within the three divisions (North, Central, South) to respond to calls for service not requiring the attention of a sworn officer. Examples would be non-injury vehicle-related incidents, cold burglary [maybe a more civilian description here] reports, property-damage-only reports, etc. The Police Patrol Assistants would free up time for sworn officers to concentrate on directed patrol activities.

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Adding both sworn officers and civilian Police Patrol Assistant positions is desirable; the State budget deficit again stymies the ability to accurately forecast available funding. It makes no sense to consider adding new positions when the City Council may find itself having to reduce existing positions.

Inspection Services--The Building Inspections Division has requested the creation of a new Supervising Plans Examiner position. While the position would be funded from development activity, it seems prudent to evaluate the level of building permit activity 60-90 days after the beginning of the new fiscal year. If sufficient funds are not developed within the Inspection Division to cover the cost, then General Funds are required to augment the Development Services Department.

Wastewater Treatment Plant--A Maintenance Electrician position has been requested for the Wastewater Treatment Plant. This request will be deferred for six months to determine if the number of new connections to the plant are adequate to offset the cost of this position. The cost of this position was not included in the recent rate increase calculation.

A Wastewater Treatment Plant Operator Trainee position has been requested. Once again, this position was not included in the recent rate increase. Therefore, once sufficient revenues have been developed to support a new position, consideration will be given.

Refuse--Two Refuse Equipment Operator positions have been requested for commercial/roll-off service. Again, neither of the positions requested was included in the recent rate increase. With business expansion, additional revenue will develop which will ultimately fund a new position.

Fleet--A Mechanic position has been requested. Mechanic positions are internally funded across all department operations. Because a significant portion of the Fleet budget is funded through the General Fund (public safety, parks, streets), this position will not be funded this fiscal year.

Parks--A Park Worker position has been requested due to the increase in acreage resultant from new neighborhood park development. Because the new parks will develop over time, the position is not currently needed. Once it has been determined that sufficient acreage exists to require a new Park Worker; and, sufficient revenues are developed through maintenance districts or community facility special taxing districts to offset a reasonable portion of the cost, the position will be considered.

Information Services--As a result of the recently completed Information Systems Strategic Plan, organizational consensus exists for the need to add positions to support enhanced technology in the organization. The Strategic Plan recommends adding an Information Systems Director, Software Applications Support Analyst, and .25 FTE administrative support through reallocating existing staff effort. I am recommending that the Information Systems Director position be funded this fiscal year. Once that position has been filled, further consideration can be given to the other positions.

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<u>Department</u>	<u>Position Requested</u>	<u>Number</u>	<u>Funding Source</u>
Information Systems	I.T. Director	1	Support Service/Internal

There are a number of other personnel changes proposed in the budget as follows:

Finance Department--It is recommended that an Accountant III position be created (Management Supervisory) and an Accountant II position (Represented) be deleted. The Accountant III position is needed to provide additional supervision and control over Finance Department employees.

Development Services-Engineering--It has been recommended that an Engineering Tech IV be eliminated and a Capital Improvement Program Coordinator position be created. Currently, the City Manager's staff has been meeting with all department managers to more formally establish a Capital Improvement Program that reflects our current and future needs. Once the Capital Improvement Program has been established,

responsibilities for ongoing administration will be determined. At that time the reclassification request will be reconsidered.

Support Services--Risk Management--Currently, there are two Insurance Claims Specialists in the Risk Management Division of the Support Services Department. It has been requested to create an Insurance Technician position and an Insurance Coordinator position. These positions are responsible for resolving insurance claim issues within the scope of the Human Resources Division (health insurance, dental insurance, disability insurance, workers' compensation insurance claims, etc.); and, claims filed against the City under the City's liability program. The City is currently considering membership in the Central San Joaquin Valley Risk Management Authority. If the City is invited into membership, claims administration within the liability insurance program will change. In recognition of the different levels of expertise required across all insurance programs, it is recommended that the two title change/reclassifications be approved.

Support Services--Personnel--Currently, a Personnel Technician II within the Division of Support Services helps to administer the day-to-day functions of the department. However, the Personnel Tech II position is currently not involved in recruitment and testing. Given the increased activity in this area, it has been requested that a Personnel Technician III position be created to broaden the work-related responsibilities. This classification would be part of the career ladder. It is recommended that a Personnel Technician III position be added to the career ladder.

Support Services -- Records--Due to a retirement during the 2002-03 fiscal year, the Deputy City Clerk position is currently vacant. It is recommended that the position be eliminated and replaced with a Records Clerk position. Employees may be designated to serve as Deputy City Clerk by the City Manager/City Clerk.

Redevelopment/Economic Development-- It has been recommended that one Development Associate position (currently vacant) be eliminated from this department. Additional funds have been included in the Extra Help line item to assist the reduced staff with specific program applications as needed.

Finance-- As a result of the proposed Lock Box service offered through County Bank (contractual agreement currently in preparation for City Council consideration), a .5 temporary part-time Clerk position is recommended for elimination. This part-time position has been responsible for processing all payments received through the U.S. mail. The Lock Box service provided by County Bank will perform this service contractually.

Lao Family Grant-- During the 2002-03 fiscal year, the City received grant funds through the Merced Lao Family Inc. to train employees in custodial work, police community service work, park maintenance, and code enforcement. Once the grant funds have been exhausted, the positions will be eliminated because funding is not available to create full-time replacement positions.

SERVICE DELIVERY--WATER

Up until the 2003-04 fiscal year, much of the funding required for monitoring testing wells for PCE levels in the groundwater came from the settlement in the Fields case. Beginning fiscal year 2003-04, any and all costs associated with PCE monitoring, ongoing settlement discussions, and engineering reports and analysis required by the Central Valley Regional Water Quality Control Board will be borne by the City's Water Fund. You will note that \$35,000 has been included for ongoing groundwater monitoring and testing. Insurance policies in place as a result of the Fields settlement protect the City's drinking water supply. Therefore, if there is any change in the drinking water pumped from deep underground aquifers, proceeds from the insurance policy will provide appropriate remediation.

Water well sites have been identified as a prime candidate for terrorism by the Homeland Security Agency. The Water Department had requested funds for installing monitoring cameras at all well sites. No funds have been included in the recommended budget. However, staff has been advised to work with available Homeland Security grant funding opportunities to secure grant funds to cover the cost of enhanced security at the well sites.

SERVICE DELIVERY--TRANSIT

As a precursor to receiving local transportation (LTF) funds for street and road purposes, transit must be provided. Currently, transit is provided in Merced County through a Joint Powers Authority administered by

the Merced County Association of Governments. The Transit Authority contracts with Merced County for the operation of "The Bus." Merced County contracts with a third party operator for personnel to operate the equipment owned by the Transit Authority.

Under federal regulations, transit operations must be put out to bid every five years. Transit operations provided by Merced Transportation expire June 30, 2003. During the current fiscal year, MCAG, pursuant to the federal regulations, put transit operation services out to bid. Effective July 1, 2003, a new contractor will assume driver operations for the entire system – urban and rural. The new contractor is MV Transportation.

As a result of the reduced cost for urban transit services, the City will realize a slight increase in local transportation funds for street and road purposes this year. The increase is available because the MCAG Policy Board has made the required finding that, "There are no unmet transit needs which can reasonably be met."

During the 2004-05 fiscal year, a new formula will need to be established to govern the split of Federal funds for urban transit purposes. As a result of the 2000 Census, the City has been notified that the "urban" area no longer just includes the City of Merced. By federal definition, the urban area now includes the Cities of Merced and Atwater, and unincorporated communities including Winton, Ballico, Beachwood-Franklin, the McSwain area, and some unincorporated peripheral area around the City of Merced. To that end, the Cities of Merced and Atwater will need to meet with Merced County to negotiate the distribution of urban transit funds for services beginning in the 2004-05 fiscal year.

SERVICE DELIVERY--REDEVELOPMENT

During the 2002-03 fiscal year, redevelopment agencies in California were statutorily required to share tax increment revenues with the State Education Relief Augmentation Fund (ERAF). Due to the looming State deficit, different budget proposals impact redevelopment agencies to varying degrees.

In May 2003, the Merced Redevelopment Agency issued both current interest bonds and capital appreciation bonds for projects in Project Area 2. The Council further approved a Disposition and Development Agreement with the Merced Center Project for the block bounded by West 18th Street, West 19th Street, N Street and M Street. The Merced Center Project includes an office building for Merced County, an educational building for Merced College, a business class hotel, and a multiple story parking facility with ground floor retail. Debt service on the bonds and other outstanding debt is secured by tax increment.

To the extent that the State shifts available tax increment revenue to ERAF, the net remaining tax increment may be insufficient to meet the debt service. To that end, it has been anticipated that mandatory housing allocations would be deferred and the housing set-aside reserved for debt service payments. In future years, the housing program would be repaid any revenue deferred during the interim period.

This approach is being used by numerous redevelopment agencies throughout the State of California. Bond counsel, disclosure counsel, and financial advisors have consulted with and assisted the Redevelopment Agency in their actions. The Redevelopment Agency continues to be the primary economic development driver available to local government.

The City Council has also approved Disposition and Development Agreements for the reconstruction of the historically significant Bank of Italy (Mondo) building, and a new mixed use project involving office and 13 apartment units in the downtown area. Both projects are currently underway.

During 2002-03, the Main Street Beautification Project was completed. This project has extended the downtown theme from G Street to R Street.

WORKERS' COMPENSATION INSURANCE

The Workers' Compensation Insurance Program in California is again in turmoil. Many non-profit organizations and small businesses are finding themselves in a position of having to close their doors because they cannot afford to purchase workers' compensation insurance.

While the City of Merced does not have a bad experience rating, the City finds itself subject to prevailing market conditions. Currently, the City self-insures the first \$250,000 per occurrence. Excess insurance is purchased through the Local Agency Workers' Compensation Excess Insurance Program governed by a Joint Powers Agency (JPA). While it has not yet been confirmed, the JPA staff have recommended premium increases to the Board of Directors for consideration in June. Currently, if approved by the Board of Directors, the City of Merced would experience a 114 percent increase in workers' compensation insurance premium. The range of increases for cities in the \$250,000 self-insured level of the program are from 112 percent to 126 percent. The low end of the increase scale validates the City's safety programming efforts and reflects the City's good experience rating. The excess insurance premium is expected to cost approximately \$221,000. This cost is spread across all employees based on an internal formula recognizing risk and past departmental claims experience.

PERS – PUBLIC EMPLOYEES RETIREMENT SYSTEM

The City of Merced contracts with the California State Public Employees Retirement System (PERS) for retirement benefits. The City contracts for the administration of defined benefit plans for both Public Safety and Miscellaneous (non-safety, non-sworn) employees. Plan contributions fluctuate based on many contributing factors, including projected earnings.

PERS actuaries assume an 8.25 percent return on all investments. Clearly, investments in the last three years have not only not returned 8.25 percent, but have lost value in the corpus of contributions deposited. These losses, coupled with the failure to reach 8.25 percent return, drive the significant increased contributions. As a caution, if the investment market does not return 8.25 percent in future years, the estimated contributions included with this message will not be sufficient to meet retirement program costs.

Exhibit A reflects contractual retirement obligations for the City under existing Memoranda of Understanding with employee bargaining units. Public safety employees currently enjoy a 3 percent at age - 50 retirement benefit. The employer cost is actuarially determined. The employee cost is a flat rate. The sharing of the cost has been determined by previously negotiated Memoranda of Understanding.

You will note the significant increases in the actuarial rates for public safety. This is also caused by the reduced earnings of previously deposited contributions. The increase of approximately ten percent will cost the City an estimated \$800,000 annually—all from the General Fund.

Miscellaneous employees enjoy a 2 percent at age 55 benefit. Due to prior contributions earning high interest dividends during the late 1990's, sufficient funds were available on reserve at PERS to meet both the employer and employee contributions through the 2003-04 fiscal year. Beginning in 2004-05, however, it is anticipated that there will only be sufficient reserves to cover the actuarially determined employer contribution. Therefore, pursuant to previously negotiated Memoranda of Understanding, the City will be required to contribute the employee share of 7 percent from that date forward. That amount is approximately \$805,000 of which about thirty percent is General Fund. (The combined increase between Public Safety and Miscellaneous employees is \$1 million in General Funds.)

While the cost of the program has not increased, the significant losses suffered on investments during the 2001-02 and 2002-03 years have resulted in a termination of the City's "superfunding" status for Miscellaneous employees. Therefore, the City will need to cash flow an employee contribution which was not required during earlier budget years.

The increased cost of retirement benefits, coupled with potential State budget deficit impacts, play a major role in driving the City Manager's recommendation this year. If the City suffers significant losses from the State budget deficit, not only will the requests for additional personnel not be considered during the budget year, but existing personnel may need to be reduced. The City Council should remember that 82 percent of the City's General Funds are currently expended for public safety. Any and all hits on the City's revenue stream from the State will impact the City's General Fund. Therefore, public safety is at significant risk dependent upon State actions.

NEW TECHNOLOGY

INFORMATION SYSTEMS: During the 2002-03 fiscal year, an Information Technology Strategic Plan was developed and accepted by the City Council. The Strategic Plan prioritizes needed technology enhancements for both effectiveness and efficiency.

Over the last several years, significant improvements have been made in the City's technology which has allowed the delivery of a higher level of service to the citizens without increasing manpower.

Nonetheless, a management level position is needed in the organization to promote and coordinate existing and planned technology improvements. Currently, the City utilizes different platforms for different functions. This is by design and not by happenstance. Financial services programs, human resource programs, building inspection programs, and police programs are currently served from IBM AS/400 platforms – midrange computers. Most other functions in the organization are served from Windows-driven personal computer/server platforms. The City also operates a significant wireless data transmission network for both mobile units and permanent locations distant from the Civic Center. This includes SCADA data transmissions from various water wells, storm drain pumps, sewer lift stations, the wastewater treatment plant, and other automated remote locations. The City is also converting to water meters which can be read electronically to reduce the manpower needed for recording water consumption data.

While all of the above increases in the use of technology have been deliberate, managing such a varied system without the benefit of a dedicated professional is risky. Therefore, it has been recommended that a Director of Information Services position be included in the 2003-04 fiscal year budget. As previously noted, several other information system positions have been requested as recommended by the I.S. Strategic Plan; however, until such time as an I.S. Director is retained, the creation of the other recommended positions has been deferred.

AIR QUALITY: New technology applies to more than just the City's information services. New technology is one means of helping to improve environmental conditions. As air quality restrictions become more pronounced in the Central San Joaquin Valley, operators of large equipment, including the City, may find themselves needing to replace existing rolling stock with alternative fueled vehicles. Currently, through MCAG, the City of Merced has been supporting clean diesel technology for refuse vehicles, streetsweepers, transit buses, and other large equipment.

A review of the proposed vehicle replacement list for 2003-04 reveals an opportunity to replace four vehicles in the existing fleet with alternative clean air fuels. The City will replace two vehicles in the Water Department, one vehicle in the Fleet Division, and one vehicle in Facilities Maintenance with compressed natural gas – CNG fuel.

The City was also the recipient during fiscal year 2002-03 of two electric Gem cars. The electric vehicles have just been received from Merced County where the manufacturer outfitted the chassis with utility beds. During the next few weeks, the vehicles will be incorporated into the City's carpool for use by individual departments needing short-term, short-distance transportation.

WASTEWATER TREATMENT PLANT: Several new technologies are currently under construction at the City's wastewater treatment plant. Alternative fuels are also used in the standby generator where recaptured methane gas allows the City to operate a clean fuel generator to produce electricity for plant operations. This reduces the amount of commercial electricity purchased at the wastewater treatment plant; and, takes advantage of a clean air fuel which is a natural byproduct of waste.

The City has also started using a new product at the treatment plant to remove chlorine from the treated effluent prior to discharge. Previously, the City used sodium bisulfite to remove chlorine. Upon recommendation of the Central Valley Regional Water Quality Control Board, the City has switched to "Captor." By changing to this product, the City has been able to meet the chlorine-related discharge requirements contained in the City's NPDES permit. Due to the effectiveness of this product, the City has been returned to a quarterly monitoring as opposed to monthly monitoring of chlorine residual. While the unit cost of Captor is more than sodium bisulfite, the reduced testing costs make the product cost-efficient.

WATER: Elsewhere in this message the replacement of manual water meters with electronic water meters has been discussed. The electronic water meters emit a radio frequency which allows for the capturing of

water consumption data both rapidly and without recording error. All new homes and businesses constructed in the community are required to provide such meters.

CAPITAL PROJECTS

The Capital Improvement Program submitted with this budget continues to be refined. The refinements include the incorporation and integration of growth-related projects identified in the Public Facilities Financing Plan (PFFP).

Some capital project requests (either as professional service contracts, acquisitions, or capital projects) have not been recommended for approval this year. Projects rejected include:

1. \$130,000 in funding for proposed planning for expansion of the Public Works corporation yard. The City owns property across Grogan Avenue from the current corporation yard. While expansion is inevitable, initial planning should be deferred at this time.
2. Funds have also been removed from the Facilities Maintenance budget requested for the replacement of the sound system in the City Council Chambers, for the installation of robotic cameras for broadcasting City Council meetings from the Chambers, and for replacing the glass canopy over the entrance to the Civic Center. Once again, while desirable projects, they have been recommended for deferral.

FINANCING FUTURE GROWTH (CAPITAL AND SERVICES)

The City Council, during its goal-setting workshops, expressed an interest in finding methods to recapture the cost of new services to newly developing areas. To that end, the City Council entered into an agreement with Fieldman, Rolapp and Associates to develop a policy governing publicly financing developer installed improvements, and, cost recovery for municipal services.

The City has retained legal services through Fullbright and Jaworski to assist in developing a community facilities district through the Mello-Roos special tax process. On May 19, 2003, the City Council will be asked to retain the services of a special tax consultant to develop the appropriate methodologies for spreading the tax for the service portion of the community facilities district.

Staff will be recommending that all future developments be required to annex to a community facilities district (CFD) which will be established for both the construction of public improvements; and, for the delivery of services (public safety and services currently funded through maintenance districts). It appears that Bellevue Ranch developers will initiate the first CFD which is the basis for retaining the above-listed consultants. While all future developers may not require funding for the installation of public improvements, the City will require additional revenues to meet service needs created by new development. Therefore, it is anticipated that all new development will be required to annex into a CFD.

This is a departure from past practices. However, the City must poise itself to take advantage of any revenue-producing opportunity to cover service costs that can be negatively impacted by State actions.

Because this is a significant shift in both policy and practice, the City Council will need to support the team of staff and consultants to ensure successful implementation.

PUBLIC FACILITIES FINANCING PLAN: During the 2002-03 fiscal year, the City Council reviewed proposed changes to the Public Facilities Financing Plan and fee. The current schedule calls for City Council consideration of the amended fee after the adoption of the 2003-04 fiscal year budget. The increased fee is directly related to the increased cost of the projects identified in the financing plan. The increased fee is also resultant from a growth rate that is less than originally anticipated in the financing plan. A task force comprised of various interested stakeholders has met and recommended approval of the amended fees.

HUD 108 LOAN – SOUTH AIRPORT INDUSTRIAL PARK

The City Council will recall that funds were borrowed from the Department of Housing and Urban Development through their Section 108 loan program to complete needed infrastructure improvements for

economic development purposes at the South Airport Industrial Park. Debt service payments were pledged from income received from land sales at the South Airport Industrial Park resultant from the improvements. If insufficient land sales occurred to meet the annual debt service requirement, the City Council pledged HUD CDBG funds as security. To date, sufficient land sales have occurred to meet annual debt service requirements and no HUD CDBG funds have been used for debt service purposes.

Currently, the remaining debt balance on the HUD 108 loan is about \$1.5 million. Available sites remaining, if sold at today's pricing, would result in income of more than \$4.7 million. Because the land values are increasing, pricing recommendations are being formulated by the Economic Development Advisory Committee and Airport Authority to increase the unit acreage price by approximately 20 percent. This matter is currently scheduled for City Council consideration on May 19, 2003.

By borrowing the funds in advance of the land sales, the City Council has created tremendous economic development opportunities for small businesses which are currently occupying the South Airport Industrial Park.

WATER SYSTEM IMPROVEMENT BONDS/SEWER SYSTEM IMPROVEMENT BONDS

During 2002-03, the City Council approved water and sewer rate increases. The rate increases recognize the need for capital expenditures to maintain existing systems. The rates included a debt service component for borrowed funds needed to make the capital improvements. During the 2003-04 fiscal year, previously approved rates will be implemented which include debt service for funds generated from the sale of bonds. It is anticipated that the bonds will be sold in early 2004.

WASTEWATER TREATMENT PLANT EXPANSION

During fiscal year 2002-03, a \$13.8 million contract was awarded for Phase 3 improvements at the City's wastewater treatment facility. The improvements, upon completion, will provide a firm 10 million gallons per day treatment capacity. The improvements also provide some redundant capacity recognizing the age of many of the current treatment plant components.

As the City continues to grow, and given the lead time necessary to develop engineering plans and specifications, a decision will need to be made during fiscal year 2003-04 on expanded wastewater treatment capacity. The City Council has accepted a report prepared by ECO:LOGIC analyzing the North Merced sewer collection system capacity. The report also addresses alternative satellite plant treatment methodology as an alternative to expanding treatment plant capacity at the existing Gove Road facility.

It is prudent to begin engineering and design when a wastewater treatment plant exceeds 75 percent of its designed capacity. Upon completion of Phase 3 improvements, the City of Merced treatment plant will be functioning at 85 percent of its designed capacity. Therefore, direction will be required from the City Council, including identification of a funding source for this expansion. Ratepayers may very well find themselves in the position of having to include some form of bonded indebtedness for plant expansion in the sewer rate schedule.

Twenty thousand dollars (\$20,000) has been included in the Professional Services line item of the wastewater budget to engage a consultant to develop a funding plan for wastewater treatment expansion.

OUTSIDE AGENCY REQUESTS

On May 5, 2003, the City Council held a public hearing to consider the HUD Annual Plan for federal fiscal year 2003. The HUD Annual Plan outlines the anticipated expenditure of Community Development Block Grant (CDBG) funds and program income generated from the federal funds previously allocated (loan repayments).

During review of the Annual Plan, the City Council considered allocations of funds to several outside agencies. The funds requested exceeded the amount of funding available under the maximum 15 percent public services cap. Accordingly, the Council approved distribution of CDBG funds to the Merced Police Department and outside agencies as limited by the constraints of the program.

The City Council may wish to consider funding other programs. In past years, the City Council has funded the Community Action Network for Neighborhood Watch, graffiti abatement, and videotaping programs. Funds are currently included in the City Council budget for the videotaping of City Council meetings. However, funds have not been allocated for graffiti abatement and Neighborhood Watch. In past years, the City Council has allocated funds from the Local Law Enforcement Block Grant Program (\$10,000 to graffiti abatement and \$10,000 to Neighborhood Watch) and contributed \$45,000 of General Funds to graffiti abatement. (The General Funds replaced funds previously provided to MCAG through a grant from the Merced County Department of Health and Human Services for graffiti abatement.)

The City Council should give appropriate consideration to these programs.

FUTURE BUDGETS --LOCAL – LEAVE OUR COMMUNITY ASSETS LOCAL

The City Council, through the League of California Cities grassroots network, has authorized payroll deduction for LOCAL – Leave Our Community Assets Local. LOCAL has been effective to date in protecting local government assets in the State budget deficit foray.

The League, through LOCAL, is focusing its priorities in two specific areas:

1. Protecting local government revenues.
2. Protecting local control.

All proposed legislation upon which the League is taking a position is evaluated against these two criteria. If applicable, then the League Board of Directors will take a position on the pending legislation.

Efforts are also being made to develop a constitutional amendment to place a measure before voters that would protect local government revenue streams. To do so, the League, through LOCAL and ABC (Action for Better Cities), is building coalitions to ensure that when such a measure is placed on the ballot, it will be broadly supported by all of the competing interests for public funding.

The Honorable Mayor and City Council

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May 7, 2003

Throughout 2003-04, it will be important for the City Council to “keep its eyes on the ball” and take every action necessary to protect local government revenues. Failure to do so may very well cause a reduction in service delivery to the citizens of Merced.

Sincerely,

James G. Marshall
City Manager

JGM:nr

Attachment – Exhibit A