

**REPORT TO THE
CITY COUNCIL**
City of Salinas, California

DATE: February 21, 2017

FROM: Matt N. Pressey, CPA, Finance Director

SUBJECT: **FY 2016-17 MID-YEAR BUDGET REVIEW AND
BUDGET ADJUSTMENTS**

RECOMMENDATION:

It is recommended that the City Council:

- 1) Accept the mid-year FY 2016-17 budget review report;
- 2) Accept the Salinas Financial Sustainability Plan Framework; and
- 3) Adopt a Resolution approving amendments to the FY 2016-17 operating and capital budgets for the City of Salinas.

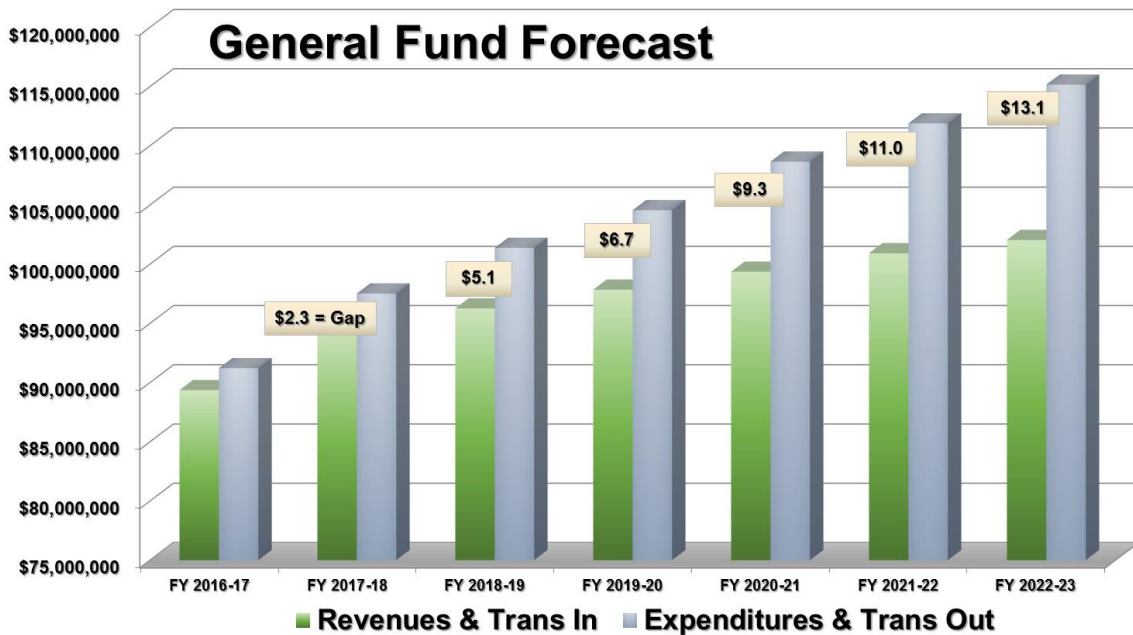
DISCUSSION:

Executive Summary

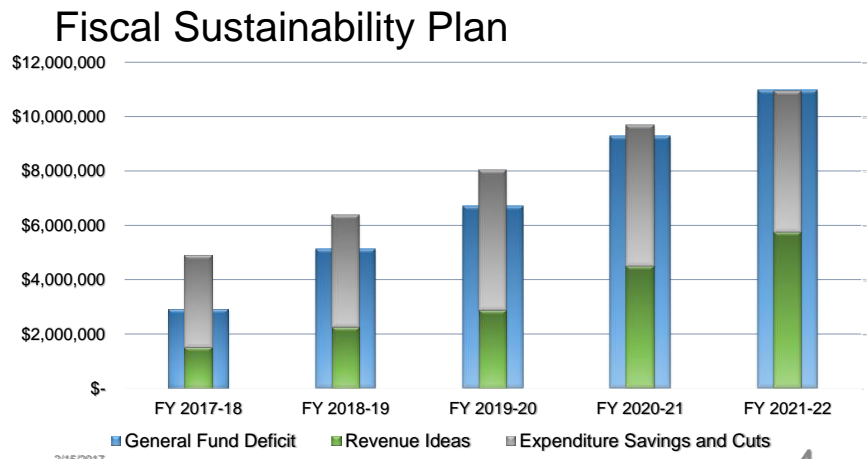
This mid-year budget review is more than a look at how the city is doing half way through the fiscal year compared to the adopted budget. It is more than the budget adjustments that are proposed. This mid-year review includes information that will help tackle a significant issue that the City has faced for many years, which is the structural deficit of the General Fund. The structural deficit has recently grown because of the Salinas Police Officers Association (SPOA) three year contract and from the recent CalPERS reduction in the discount rate that was approved December 21, 2016 by the PERS Board, with more changes expected next year. Projecting out 20 years, the cost drivers of salary, health care, and retirement exceed the future revenue. It is imperative that the City Council and City Staff understand this structural issue as we plan for the future and how we manage our resources.

Staff have put together the framework of a sustainability plan that will serve as a tool to eliminate the structural deficit. The plan identifies both short-term and long-term strategies to raise revenues, reduce expenditures and realign spending to higher priorities. Departments were asked to innovate how to eliminate the structural deficit. Some of the ideas have not been valued since it is still too preliminary, however, where realistic estimates could be made, dollar values were assigned over a five-year horizon. Twenty-five revenue generating ideas were identified that ranged from \$1,535,300 to \$6,296,000 over the next five years between FY 2017-18 and FY 21-22. Departments also came up with 85 expenditure reduction or savings ideas that totaled \$2,767,850 and \$4,632,850 over the same five years. The ideas vary in their impact. Each will require more detailed analysis and plans. However, with this framework, the City can begin to move forward toward a sustainable future.

The General Fund Forecast has been refreshed, which takes into consideration the existing operating programs and their full cost. It also refreshes the revenue forecasts with the most recent historic trends and information on new development and improvement of property and retail establishments.



With the refreshed General Fund Forecast, if the new revenue generating ideas and expenditure savings can be realized, the structural deficit for the next 5 years would be eliminated. The table and graph below summarize the results.



	FY 2017-18	FY 2018-19	FY 2019-20	FY 2020-21	FY 2021-22
General Fund Deficit	(2,901,700)	(5,113,600)	(6,713,100)	(9,294,900)	(10,966,200)
Revenue Ideas	1,525,300	2,260,100	2,887,400	4,521,000	5,761,000
Expenditure Savings and Cuts	3,387,850	4,117,850	5,142,850	5,167,850	5,167,850
	2,011,450	1,264,350	1,317,150	393,950	(37,350)

The key to success in eliminating the structural deficit will be in execution. All departments will need to work hard to implement the revenue generating and cost savings ideas. Furthermore, it is important to continue to control costs going forward, especially with CalPERS considering lowering the discount rate further. Staff will bring back the sustainability plan as part of the FY 2017-18 budget proposal.

Revenue

At mid-year, the General Fund revenues are coming in as expected with a few of the major sources projected to come in ahead of budget. As of December 31, 2016, the City received \$52,026,196, or 57% of the budget. As part of the mid-year review, staff is recommending increasing the estimated revenue by \$1,335,200.

	Adopted				Proposed
	Budget	Actual	Difference	% Rec.	Adjustments
Sales Tax	\$ 27,342,000	\$ 17,873,393	\$ 9,468,607	65%	\$ 486,800
Property Tax	28,500,100	16,180,430	12,319,670	57%	848,400
Utility Users Tax	12,494,000	6,234,159	6,259,841	50%	-
Franchise Fees	8,580,000	3,974,635	4,605,365	46%	-
Business License Tax	4,720,000	1,106,109	3,613,891	23%	-
All Other	9,923,400	6,657,470	3,265,930	67%	-
Total Revenue	\$ 91,559,500	\$ 52,026,196	\$ 39,533,304	57%	\$ 1,335,200

For a detailed revenue report of the above information, please see 5-Exhibit B.

Operating Expenditures

Operating Expenditures of the General Fund are under budget mid-way through the year. The General Fund total expenditures was \$42,325,563 as of December 31, 2016, or 46% spent. Mid-year adjustments to the operating budget totaled \$1,312,800 and are detailed in Exhibit A to this staff report.

	Adopted			%	Proposed
	Budget	Actual	Difference	Spent	Adjustments
Police	\$ 37,274,438	\$ 15,140,310	\$ 22,134,128	41%	\$ 100,000
Fire	18,232,737	9,315,651	8,917,086	51%	176,000
Public Works	9,856,374	4,075,152	5,781,222	41%	50,000
Library & Com. Serv.	848,913	336,201	512,712	40%	-
Community Dev.	4,590,216	1,663,992	2,926,224	36%	225,000
Administration	2,923,325	1,215,051	1,708,274	42%	370,000
Finance	4,268,340	1,830,445	2,437,895	43%	34,000
City Attorney	994,193	440,390	553,803	44%	100,000
City Council	238,310	116,430	121,880	49%	-
Non-Dep.	6,423,560	4,760,568	1,662,992	74%	295,000
Non-Dep.-Trans Out	6,082,800	3,431,373	2,651,427	56%	-
Total Operating Exp.	\$ 91,733,206	\$ 42,325,563	\$ 49,407,643	46%	\$ 1,350,000

Capital Improvement Program (CIP) Expenditures

The total CIP budget includes \$24,270,900 budgeted as part of the FY 2016-17 adopted budget and \$51,950,187 of projects in progress where the budget carries over year-to-year until completed. CIP expenditures totaled \$10,606,634 and encumbrances totaled \$12,732,567 as of December 31, 2016. Mid-year adjustments to the CIP budget totaled \$2,329,300 and are detailed in Exhibit A to this staff report.

CIP By Dept.	Budget	Actual	Encumb.	Difference	%	
					Spent & Enc.	Proposed Adjustments
Police	\$ 16,948,243	1,842,496	1,418,083	\$ 13,687,664	19%	\$ 80,000
Fire	3,650,171	1,013,736	1,143,726	\$ 1,492,709	59%	567,000
Public Works	46,200,837	6,287,727	8,264,770	\$ 31,648,340	31%	1,760,000
Library & Com. Serv.	5,818,775	736,833	944,339	\$ 4,137,603	29%	-
Community Dev.	2,476,215	323,958	843,664	\$ 1,308,593	47%	50,000
Administration	233,396	105,011	-	\$ 128,385	45%	50,000
Finance	893,450	296,873	117,985	\$ 478,592	46%	50,000
Total CIP	<u>\$76,221,087</u>	<u>\$ 10,606,634</u>	<u>\$ 12,732,567</u>	<u>\$ 52,881,886</u>	31%	<u>\$ 2,557,000</u>

Mid-Year CIP Adjustments by Funding Sources:	Proposed Adjustments
Measure X	\$ 1,445,000
Measure G	624,000
General Fund	438,000
Special Construction Fund	50,000
Total CIP Adjustments by Funding Source	<u>\$ 2,557,000</u>

Measure V – The Measure V Committee met on January 19, 2017. They reviewed the status of the FY 2016-17 operating and capital projects funded with Measure V. To date, there was a total of \$5,229,670 in operating expenditures spent and \$6,151,759 was collected in revenue. Please see the attached “9-Exhibit D for the December 31, 2016 Measure V Financial Report” for more details.

Measure G – The Measure G Committee met on January 26, 2017. They reviewed the status of the FY 2016-17 operating and capital projects funded with Measure G. To date, there was a total of \$8,941,445 spent and \$12,373,501 was collected in revenue. Please see the attached “7-Exhibit C - December 31, 2016 Measure G Financial Report” for more details.

Also included as an attachment to this report is the status of Measure G funded projects. The report is titled, “7-Exhibit C - December 31, 2016 Measure G Funded CIP Projects”. The Measure G funded capital project report shows \$4,363,042 spent, or 20% of the budget and \$10,691,033 spent life-to-date (LTD) as of December 31, 2016. The following table summarizes the Measure G funded CIP activity for the first six months of the year by department:

<u>Measure G CIP</u>					
	<u>FY 2016-17</u>				<u>Total (LTD)</u>
<u>Department</u>	<u>Budget</u>	<u>Actual Exp.</u>	<u>Balance</u>	<u>% Spent</u>	<u>Actual Exp.</u>
12 - Administration	\$ 175,896	\$ 97,308	\$ 78,588	55%	\$ 176,258
20 - Finance	461,065	194,710	266,356	42%	1,324,144
30 - Community Development	1,407,807	114,303	1,293,503	8%	513,578
40 - Police	10,576,268	788,407	9,787,861	7%	2,165,339
45 - Fire	2,347,101	810,689	1,536,412	35%	1,318,988
50 - Public Works	5,736,683	2,168,780	3,567,903	38%	4,863,481
55 - Community Services	1,569,601	188,845	1,380,757	12%	329,243
Total	<u>\$ 22,274,421</u>	<u>\$ 4,363,042</u>	<u>\$ 17,911,379</u>	<u>20%</u>	<u>\$ 10,691,033</u>

As mentioned above, the detailed list of Measure G funded CIP projects are included as an attachment to this report.

CalPERS Discount Rate Change

At the December 21, 2016, meeting, the CalPERS Board of Administration approved lowering the CalPERS discount rate assumption, the long-term rate of return, from 7.50 percent to 7.00 percent over the next three years. This will increase public agency employer contribution costs beginning in Fiscal Year 2018-19. On January 19, 2017, PERS issued Circular Letter 200-004-17 that provided more information that is summarized below. The phase-in of the discount rate change approved by the Board for the next three Fiscal Years is as follows:

Valuation Date	Fiscal Year for Required Contribution	Discount Rate
June 30, 2016	2018-19	7.375%
June 30, 2017	2019-20	7.250%
June 30, 2018	2020-21	7.000%

Lowering the discount rate means plans will see increases in both the normal costs (the cost of pension benefits accruing in one year for active members) and the accrued liabilities. These increases will result in higher required employer contributions.

The benefits of reducing the discount rate include:

- Strengthening long-term sustainability of the fund
- Reducing negative cash flows; additional contributions will help to offset the cost to pay pensions
- Reducing the long-term probability of funded ratios falling below undesirable levels
- Improving the likelihood of CalPERS investments earning our assumed rate of return
- Reducing the risk of contribution increases in the future from volatile investment markets

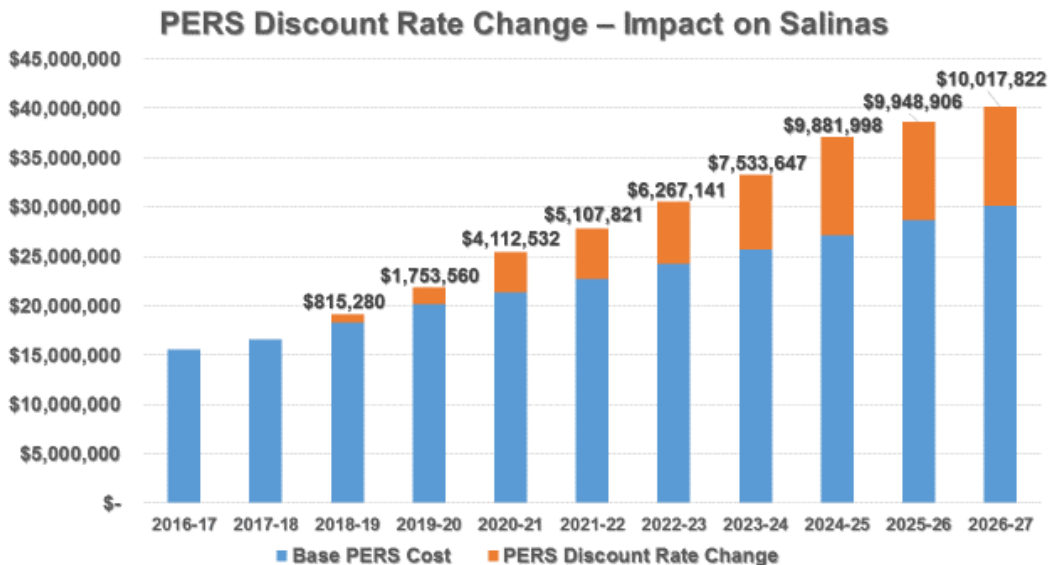
Results

Employer contribution increases as a result of the discount rate changes are estimated below by Normal Cost and required Unfunded Accrued Liability (UAL) payment.

Valuation Date	Fiscal Year Impact	Normal Cost		UAL Payments	
		Misc. Plans	Safety Plans	Misc. Plans	Safety Plans
June 30, 2016	2018-19	0.25% - 0.75%	0.5% - 1.25%	2% - 3%	2% - 3%
June 30, 2017	2019-20	0.5% - 1.5%	1.0% - 2.5%	4% - 6%	4% - 6%
June 30, 2018	2020-21	1.0% - 3.0%	2.0% - 5.0%	10% - 15%	10% - 15%
June 30, 2019	2021-22	1.0% - 3.0%	2.0% - 5.0%	15% - 20%	15% - 20%
June 30, 2020	2022-23	1.0% - 3.0%	2.0% - 5.0%	20% - 25%	20% - 25%
June 30, 2021	2023-24	1.0% - 3.0%	2.0% - 5.0%	25% - 30%	25% - 30%
June 30, 2022	2024-25	1.0% - 3.0%	2.0% - 5.0%	30% - 40%	30% - 40%

The changes to the Unfunded Accrued Liability (UAL) due to changes of actuarial assumptions are amortized over a fixed 20-year period with a 5-year ramp up at the beginning and a 5-year ramp down at the end of the amortization period. The 5-year ramp up means that the payments in the first four years of the amortization schedule are 20 percent, 40 percent, 60 percent and 80 percent of the ultimate payment, which begins in year five. The 5-year ramp down means that the reverse is true and the payments in the final four years are ramped down by the above percentages. A new ramp is established with each change to the discount rate. There will be three ramps established in the first three years. As a result of the 5-year ramp up and effective date of the increase, it will be seven years until the full impact of the discount rate change is completely phased in. The shaded rows above are the expected increases beyond the five year projection quoted in your June 30, 2015, valuation report.

PERS provided the above table as a tool to calculate broad estimates and indicated that it should only be used as a general guide. They indicated that the annual valuation report that will be released this summer will provide updated projections for our specific plans. Using the higher %'s, the following graph summarizes the impact to the City of Salinas:



Reserves

The City's Financial Policies provide that the City "strive" to maintain an eight (8%) percent General Fund Operating Reserve. Five (5%) percent of the reserve is required primarily for cash flow purposes. Reserves above the five (5%) percent level can be characterized more as "rainy day" funds to guard against economic uncertainties.

While a prudent reserve is certainly a worthy policy, it must be balanced with the fact that residents pay taxes for one purpose – to benefit from programs and services paid for with those taxes.

During the Great Recession, the FY 2009-10 Budget was balanced using \$9.4 million of General Fund/Measure V reserves. The use of reserves in both FY 2008-09 and FY 2009-10 was required to maintain services and were depleted to zero. Over the last four fiscal years using carryover funds and at the mid-year budget review, the City Council has approved replenishing the reserve with amounts each time. The reserves have grown and are now at \$8.5 million. As part of this FY 2016-17 mid-year review, staff is proposing to increase the General Fund reserves by \$1.0 million and bring the reserve to a new total of \$9,528,600, which would bring the General Fund reserve up to 8.0% and the total reserve for the General Fund, Measure G and V to 8.9% of operating expenditures. The Measure G reserve of \$1,760,000 is 8% of the 1st year estimated Measure G sales tax of \$22,000,000 and will function both as an operating reserve and a capital reserve. In addition to these reserves, the City has earmarked \$1,500,000 for the New York Life Retirement Reserve and \$500,000 as a structural deficit contingency reserve. As part of the mid-year, staff is proposing to increase them to \$2,500,000 and \$2,500,000, respectively. The \$2,500,000 is critical to helping manage the phase in of the sustainability plan.

Fund Balance Reserves:	<u>General Fund</u>	<u>Measure V</u>	<u>Measure G</u>	<u>Total</u>
Operating Reserve	\$ 5,830,000	\$ 938,600	\$ 1,760,000	\$ 8,528,600
Proposed Increase	<u>1,000,000</u>	<u>-</u>	<u>-</u>	<u>1,000,000</u>
Total Reserves	<u>\$ 6,830,000</u>	<u>\$ 938,600</u>	<u>\$ 1,760,000</u>	<u>\$ 9,528,600</u>

ISSUE:

Shall the City Council:

- 1) Accept the mid-year FY 2016-17 budget review report;
- 2) Accept the Salinas Financial Sustainability Plan Framework; and
- 3) Adopt a Resolution approving amendments to the FY 2016-17 operating and capital budgets including the changes to estimated revenue for the City of Salinas?

FISCAL IMPACT:

The FY 2016-17 mid-year adjustments are summarized below:

Available Fund Balance:	<u>General Fund</u>	<u>Measure V</u>	<u>Measure G</u>	<u>Total</u>
Beginning Avail. Fund Bal. (Carry-over)	\$ 4,740,076	\$ 2,721,126	\$ 87,337	\$ 7,548,539
Mid-Year Budget Adjustments:				
Revenue	1,335,200	300,000	1,000,000	2,635,200
Appropriations	(1,350,000)	-	-	(1,350,000)
CIP	(438,000)	-	(624,000)	(1,062,000)
Transfers	-	-	-	-
Decrease (Increase) Reserves	<u>(4,000,000)</u>	<u>-</u>	<u>-</u>	<u>(4,000,000)</u>
Ending Available Fund Balance 6/30/17	<u>\$ 287,276</u>	<u>\$ 3,021,126</u>	<u>\$ 463,337</u>	<u>\$ 3,771,739</u>

Mid-Year Budget Adjustments:	<u>Measure X</u>	Special		
		<u>Construction Fund</u>	<u>Asset Seizure</u>	<u>Parking Enterprise</u>
Revenue	\$ 1,445,000	\$ -	\$ -	\$ -
Appropriations	-	-	(5,000)	(75,000)
CIP	(1,445,000)	(50,000)	-	-

ALTERNATIVES:

Provide further direction to staff.

CITY COUNCIL GOALS:

The budget amendments support the five goals adopted by the City Council: 1) Economic Diversity and Prosperity; 2) Safe, Livable Community; 3) Excellent Infrastructure, 4) Quality of Life, and 5) Effective, Sustainable Government.

CONCLUSION:

City Council is asked to adopt the resolution amending the FY 2016-17 Annual Operating and Capital Budgets for the City of Salinas at its meeting on February 21, 2017. The recommended budget amendments are the result of a collaborative effort of all departments.

Back Up Pages:

- 2-Exhibit A – FY 2016-17 Mid-Year Budget Adjustments Detail*
- 3-Council Resolution - FY 2016-17 Mid-Year Budget Amendments*
- 4-Salinas Financial Sustainability Plan - 2017*
- 5-Exhibit B - December 31, 2016 Revenue Report*
- 6-Exhibit B - December 31, 2016 General Fund Expenditure Report*
- 7-Exhibit C - December 31, 2016 Measure G Financial Report*
- 8-Exhibit C - December 31, 2016 Measure G Funded CIP Projects*
- 9-Exhibit D - December 31, 2016 Measure V Financial Report*
- 10-Exhibit E - December 31, 2016 CIP Projects*

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