City of Emeryville
CALIFORNIA

MEMORANDUM

DATE: June 20, 2017

TO: Carolyn Lehr, City Manager

FROM: Susan Hsieh, Finance Director
Cindy Montero, Assistant City Manager

SUBJECT: Budget Planning Discussions FY 2017-18 and FY 2018-19

RECOMMENDATION

Staff recommends the City Council review and provide direction on expenditure reduction options in preparation of the FY 2017-18 and FY 2018-19 budgets.

BACKGROUND

During a fiscal workshop on March 13, 2017, City Council requested that staff adjust the two-year budget cycle to align with the City Council election cycle, and to return with a new two-year 2017-19 budget that reflects current financial projections as well as City Council values and service priorities. At this workshop the Council affirmed the City's commitment for sound financial management. These budget principles reflect best practices that are highly recommended by the Government Finance Officers Association.

City Budget Principles

1. *Current year expenditures should be supported by current year revenues. One-time revenues should not be used for ongoing costs, but should instead be used for necessary one-time expenditures or to strengthen fund reserves.*

2. *Fund balances should be maintained in all major operating funds that provide for unforeseen circumstances. The appropriate level of fund balance depends on the particular fund.*

3. *Unfunded liabilities should be identified and funded with surplus funds when they are available. Liabilities that are currently accruing should be funded currently.*

4. *When necessary, a strategy should be formulated and implemented to address potential impacts of the State budget and other State actions that may affect City revenues.*

5. *The operating costs of any planned capital improvement should be estimated in the planning stage, so that these amounts can be recognized and budgeted.*

At the June 6, 2017 City Council meeting, staff's presentation indicated that since the adoption of the fiscal year 2016-18 budget in June 2016, the City's revenue growth rate has softened and expenditure pressures have increased, prompting reconsideration of the City's budget objectives and discussion of sustainable levels of municipal services.

The City is facing emerging long-term financial conditions that are impacting the City's ability to balance its annual operating budget. Most notably, these changes include 1) the slowing of tax revenue growth as consumers evolve their buying habits; and 2) sharply increasing pension funding requirements from the CalPERS pension system due to lowering of investment income assumptions.

The five-year projection showed an increasing annual shortfall between expenditures and revenues, primarily due to the seven-year phase-in of new CalPERS pension funding requirements. Also during the June 6 Council meeting a third-party actuary provided the City Council with a second opinion, more precise projections, and funding options to address the City's burgeoning pension costs.

DISCUSSION

Purpose of City's Two-Year Budget

The primary purpose of the City's budget is to link what City Council wishes to accomplish for the community with the resources needed to accomplish that. The City's budget process does this by identifying major City goals and other important objectives, assigning responsible departments and staff to accomplish the work; and allocating resources for such services, programs and projects.

The purpose of this report is to provide City Council with an estimate of our budget gap, identify expenditure options to address the gap, and to seek guidance from the Council regarding the role of each option in balancing the budget. This direction tonight will assist staff in drafting a budget for Council consideration during budget hearings scheduled for July 11, and July 25, with the final adoption of the budget in September.

Budget Gap

Staff presented the General Fund 5-Year Financial Projections to the City Council on June 6, 2017. The Revenue and Expenditure projection schedules are attached to this staff report. The projected deficits for FY 17-18 and FY 18-19 are approximately $1.5 million and $3.2 million respectively. The projected revenue/expenditure gap will exceed $6 million by 2020-21. To balance the 2017-19 budget, current estimates indicate the City needs to achieve $4.7 million in cost savings. Staff is in the process of exploring options to raise revenues, and the City may not be able to implement significant revenue measures until fiscal year 2019-20 as tax measures require voter approval. The City should conduct a comprehensive analysis on potential revenue options to evaluate the impacts on residents and businesses. Costs for revenue consultants are included in the 2017-19 budget.

The attached table *Budget Balancing Chart* provides an overview of the budget gap, and options the Council will need to consider to create a balanced budget for the General Fund.

Cost Reduction Options

As stated earlier, staff is mindful that the current personnel and program cost structures, especially PERS benefits, are financially unsustainable. Additional cost reduction options are discussed below and in more detail on the *Budget Balancing Chart (*which will be distributed on June 20th).

Department Head 10% Reductions

At the beginning of the new two-year budget process, Department Heads were asked to first identify approximately 10% cuts to reduce the budget gap. Since this effort, the Senior Management team has worked closely with the Finance Department and the City Manager's office to identify feasible options to achieve a balanced budget for fiscal years (FY) 2017-18 and 2018-19.

Cost Reduction of Programs:

Emeryville Child Development Center (ECDC): The City is contemplating discontinuing the operation of the Child Development Center. It is staff's assessment that discontinuing the operation of the Child Development Center, by itself, could save approximately one million dollars annually.

Police Dispatch: The City is contemplating contracting out the operations of the Public Safety Dispatch function. The Dispatch function could save an additional 1.1 million dollars over the two fiscal years.

Reserves

The City's three top revenue sources are sale tax, hotel tax, and business license tax, and these revenues are susceptible to economic downturns or recessions. These revenue sources account for over 50% of the total General Fund revenues. To mitigate risk, the City has built up strong reserves over the years. These reserves can sustain cash flow while budget strategies are considered and implemented for long-term stability. The Fund Balance Reserves schedule is attached to this staff report.

Pension Reserve – The City has set aside a $13 million pension reserve that is available to invest or to buy down its CalPERS liability to reduce and stabilize future pension funding requirements. At the June 6th Council Meeting, the City's actuary recommended making one-time payments to CalPERS to pay down the City's unfunded liability to reduce future interest costs and investing funds in a Section 115 Trust. Staff reached out to CalPERS regarding payment options and potential savings and will report back to the Council when the information becomes available. Staff is also in the process of evaluating the establishment of a pension trust. The reserve can mitigate but not eliminate long-term pension cost increases.

Economic Contingency Reserve – The City's budget policy targets a 50% economic contingency reserve and currently holds $21 million in this reserve. The projected benchmark percent of expenditures fluctuates with the annual growth in expenditures. At $21 million, this reserve is currently projected to exceed the 50% target through 2018-19, but absent expenditure adjustment or additional funding, would drop to 45% of expenditures by 2020-21. Further, this reserve is intended to brace for tax revenue fluctuations that are inevitable during natural economic cycles, and would likely be partially drawn for this purpose sometime during the five-year projection period.

Unassigned Balance – With projected annual deficits, the unassigned fund balance is extinguished by June 2018. The cumulative operating deficits captured in this account then reach $15 million by 2020-21, further quantifying the unsustainable cost of current City services. To maintain its 50% economic contingency benchmark and avoid exhausting its reserves, the City must fairly quickly change financial direction to close this four-year cumulative $15 million gap between revenues and expenditures.

Staff will implement the proposed budget solutions according to the timeline approved by the Council. It is recommended that these changes be made in time to balance the 2017-19 budget. Otherwise, the City will have to draw into its reserves to sustain costs. With the anticipated increase in pension costs in the next several years, the City will be in a better financial position if the reserves are saved for later use.

COMMITTEE RECOMENDATION

Staff will be making a presentation to the Finance Committee for recommendations in June or early July and will present them to City Council in July.

STAFF COMMUNICATION WITH THE PUBLIC

None to date for this report.

CONCLUSION

Council should provide direction and make recommendations to balance the budget in order to place the City on a solid financial footing for the future. A draft of the

General Fund budget will be brought to Council on July 11 for further discussion and Council direction. A final budget will be brought to the City Council in September for approval.

PREPARDED BY: Susan Hsieh, Finance Director
Cindy Montero, Assistant City Manager

APPROVED AND FORWARDED TO THE
CITY COUNCIL OF THE CITY OF EMERYVILLE:

Carolyn Lehr

Carolyn Lehr, City Manager

ATTACHMENTS

1. Revenue, Expenditure, and Fund Balance Reserve Report
2. Services by Department