

## A HEARTY THANK YOU!

With the economic uncertainties of the past few years, budget work takes more and more time than in previous decades. The City's successful efforts to maneuver through this difficult period have been eased by the skills and knowledge of the Department Directors and members of the City's staff. For over two years, they have assisted the Finance Department in balancing our budgets and keeping the approved budgets on track after adoption by their frugality and thriftiness.

We all owe a thank you to James Walgren, J. Logan, Tuck Younis, Jim Gustafson, Brian McCarthy, Beverly Tucker, Dave Brees and Susan Kitchens.

Finance Director Russ Morreale and his team of Tracy Kwok, Sarina Revillar and Yuka Arai have provided the base information needed by the Departments and their budget preparing employees, have pulled the numbers together, balanced the revenues and expenses and counseled all of us as we trudged through the budgeting effort.

Our employees in the various Departments have reviewed the expenses and revenues of the past and applied their knowledge so that this cumulative series of numbers makes sense.

And to Jon Maginot and Yvonne Dupont, who refined the Issues and Options Policy Papers and prepared the cover for the Provisional Budget---thank you!

*“It”--- as “it” must be --- is balanced. In early winter, when he had first begun to assemble “it,” the Budgeteer had had a bit more wiggle room in drafting the financial plan than in the more recent years. He took delight in thinking of Mr. Gladstone’s comments in April 1881 before Parliament’s Ways and Means Committee as the economic hardship of that era was finally easing. “...at a period when the revenue is just beginning to recover from a serious recession, and, when important fiscal changes have been recently introduced, I have, I am afraid, a good deal to say.”*

*The Budgeteer, like the other permanent members of the staff Budget Team, had always enjoyed the compilation of this document, viewing it as a compass which indicates the goals and projects and directions of the Government rather than viewing it merely as a ledger or a balance sheet on operations. But as winter lapsed, he could sense the ebbing of new hope. The small wave of positive expectation that had seemed so promising with the advent of early spring appeared to be waning by mid-May. The “Shadow” began to reemerge at a most inopportune time, just as the document was being readied for publication. It was too late to turn back.*

*While the expenses were steely focused and concise, the revenues suddenly seemed to lack clarity as well as solid certainty. The small verve of hopeful anticipation originating from usually reliable sources of income seemed to become veiled, leaving the Budgeteer to wonder if the dreaded “second dip” or a European contagion would cast the Shadow upon this first season of recovery, causing chaos to the finely tuned transmittal text the Budget Team had so artfully assembled.*

*Yes, the projected revenue growth was modest, at least compared to the historical trend line of the past. And the Budget Team had once again conquered the established target for trimming organizational expenses. The commitments of the past would cascade into the next year and be satisfactorily addressed. The projects previously identified for construction and funded for this specific time were ready to commence once the calendar turned to the first day of July. The goal of 2009 established by the elected Mandarins of the community to grow the reserve safety net by 2014 to a more protective level was still on track. But...what if?*

## CITY MANAGER BUDGET MESSAGE

**Dear Mayor Casas, Members of the City Council and Citizens of Los Altos,**

Presented herein is the Budget for the City of Los Altos for 2010-11 which commences on 1 July. It is a financial plan in transition, for it reflects the changing economic news post the Great Recession, continues some past practices while wholly metamorphosing others. While this municipal organization has been able to continue fundamental services during the time of the recession, it must also be cognizant of how these efforts have been achieved. I can report to the City Council and our citizens that the financial plan presented herein is balanced without layoffs, furloughs or the use of reserves. With this Budget, our services will continue next year unimpeded by fiscal constriction.

The Budget accommodates the commitment the City entered into in 2007 with its Police Officers Association as well as the contractual obligation with the Santa Clara County Fire agency. Our citizens will see no adverse changes in the public safety operations of its municipality in the coming year.

Similar to one year ago, local governments throughout the State of California are expecting that the State will seek monies from the counties, cities and other local entities as the Legislature and Governor commence their annual sparring. The State's concluding actions, so distant from the closeness of our budget approval timing, could take the course of takeaways of subvention monies or the deferment of grants or other allocations. As such, the Budget continues in its direction to bolster its "rainy-day-funds" as a basis for maintaining fiscal stability for next year and over the long term.

The balancing of this budget is accomplished through efforts on both the expense and revenue sides of the budget equation. On the expense side, the Department Directors cost control efforts, following self-imposed reductions during the previous two years, is exemplary. A target of additional reductions in the Service and Supplies accounts of 2.5% was established early in the preparatory

cycle and achieved, following a 6.9% diminishment in 2008-9 and an expected savings of up to 7% in the current year.

Some revenues are expected to increase slightly during the year although Property Tax receipts, our largest income source, are estimated to be stagnant. We have implemented a long discussed City Council topic with this year's budget, the near complete elimination of General Fund subsidies to the Recreation Department.

## **THE HIGHLIGHTS**

The Operational Budget presented herein is "balanced" with revenues exceeding expenditures by nearly \$300,000, a small surplus compared to historical trends. This surplus is attributed to the inclusion of recreation revenue at full-cost recovery levels. Council is provided the opportunity in Issues and Options Policy Paper # VI to discuss the disposition of the excess collection in the context of full cost recovery efforts presented this year. General Fund expenditures are up 3% when compared to 2009-10, primarily due to increases in the Public Safety operations, and overall revenues are up 4%.

The Full Time Employee (FTE) count is constant at 130 although nine (9) positions remain vacant. This is an increase of two additional FTE positions from 2009-10 although the impact of the two vacancies are being mitigated with an increase in part-time employee hours. By leaving the nine (9) FTE positions unfilled, there is a savings of over \$900,000. Labor and benefit increases reflect a fulfillment of contractual and normal cost commitments only.

Departments reduced material and service costs by over 2.5% in this budget cycle and submitted equipment requests sparingly. General Fund contingency dollars were increased as a safety net given the reduction in line item costs made both this year and for the year ending.

Core General Fund tax revenues increase by nearly \$600,000 and are expected to return to 2007-08 actual collection levels although the Property Tax is anemic and the Sales Tax shows a modest decline from the current year. These increases are mostly attributed to a modest recovery in Hotel

Tax, a projected uptick in Utility Users Tax collection, and an adjustment of Property Tax to current year actual collected levels.

It is significant to note that the 2010-11 budget also includes an increase in Recreation programming fees to the level necessary to get close to achieving 100% direct cost recovery. The increases have been built into the proposed fee schedule included as part of Issues and Options Paper #VI, Fees, and include an adjustment for demand/price elasticity that will have to be evaluated as the 2010-11 year progresses. As ultimately adopted, this results in the addition of \$295,000 to General Fund Revenue, an amount that translates directly into the anticipated and projected surplus over and above an otherwise breakeven and balanced budget submittal.

As reported at the mid-year forecast, the largest percentage loss in revenue is with Interest and Rent. With interest rates still remaining at all time lows and with the loss of income from the rental of 230 First Street due to the demolition of the structure, the staff is forecasting a 55% decline in this revenue category or approximately \$458,000 primarily due to the dramatic drop in interest earnings rates. As approved in the prior year, staff has set into motion the process of building an investment portfolio that will be more defensively positioned in coming years as holdings become more diversified.

Recent revenue reports have shown a rise in Utility User Tax, Transient Occupancy and Business License collections. These improving trends, although modest, have been extended into next year.

With the advent of the new Waste Contract in 2010-11, franchise fees reflect an increase from 10 to 15%, or approximately \$200,000 for three quarters of the year. These additional revenues serve to offset General Fund costs for City facility waste services, a new addition to the Maintenance Services budget. Lastly, Planning and Building fee revenue are up 15% in anticipation of several significant developments in the coming year.

## RESERVES

Following the Council's approvals last budget cycle, this budget again moves ahead in strengthening operating reserves and maintains a guarded, proactive, and responsive posture to the current economic uncertainty.

**Fiscal Policy Reserve:** Last year, the Council established a goal of achieving a 20% operating reserve for the General Fund over the next five years. The Budget continues that steady march towards that goal using existing and excess reserves expected to be realized at year end 2009-10. At the end of the forthcoming year, we estimate that the General Fund Operating Reserve will be at 14.3%. Inclusive within this Reserve is the \$210,000 from the partial payoff last year of the PERS side fund.

**State Budget Stabilization Reserve:** The Budget continues the State Revenue Stabilization Reserve and increases the available funding to \$1,025,000, comparable to last year's level when State action emptied our designated pocket. Although we do not anticipate a Property Tax or Sales Tax shift/takeaway, as was the case last year, increasing this safety net reserve is necessary as the California's budget deficit balloons towards \$20 billion. Expectations at the current time point to the deferral of State Gas Tax and/or the cessation of grants and State mandated cost reimbursements as the next possible State move.

**Other Post Employee Benefits:** A new General Fund reserve is introduced with this year's budget prompted by the completion of the City's first Other Post Employee Benefits (OPEB) actuarial study performed in compliance with newly passed accounting standards. The City maintains post employment health care benefits at minimum levels as a required component of our participation in CALPERS - a benefit level that carries an implied current and long term liability. While the immediate funding of this benefit liability is not mandated, the establishment of a reserve is both prudent and fiscally responsible in line with recommendations by our auditors and by the Government Finance Officers Association (GFOA.) In the coming year, staff will evaluate funding options available in determining a formal plan of action. In the interim, our actuary has identified, and our financial statements will disclose, a future obligation of \$1.6 Million. Through the utilization of estimated year end unspent monies and a proposed 2010-11 budget allocation, we have placed

\$200,000 into this new fund reserve (OPEB) to begin to cover this obligation. We propose continuing allocations on an annual basis until the full liability is covered.

These important operating reserve balances are portrayed in chart form as follows:

GENERAL FUND RESERVES	Estimated Balance	
	June 30, 2011	% of Budget
- Fiscal Policy Reserve	\$3,936,228	14.3%
- State Budget Stabilization Reserve	1,025,000	3.7%
- OPEB	200,000	-
<b>Total</b>	<b>5,161,228</b>	

**Storm Water Fund:** The final Issues and Options Policy Paper which accompanied the 2009-10 Provisional Budget discussed financial warning lights- items of future concern. In that transmittal, I highlighted the reliance of the Storm Drain Fund, an enterprise entity, on General Fund transfers for its subsistence and noted that this subsidy could not continue due to anticipated needs once the Storm Drain Master Plan is completed and projects move towards implementation. In that paper I urged that an independent funding source for storm water expenses be pursued.

The year of reckoning is at hand. At the end of 2010-11, the expected balance remaining in the Storm Drain fund is less than \$25,000. With General Fund income sluggish, a sizeable transfer from the General Fund to the Storm Drain fund in 2011-12 will be needed, depriving other municipal services of growth or project implementation.

*The Budgeteer wondered how big...or small...should the subjects be when considered for an Issues and Options Policy Paper? Last year the number of important matters had been lengthy and he had crafted a dozen issues for contemplation by the Mandarins. But what was important going forward? It had always been his expectation that the Policy Papers would serve as the epicenter of discussion for the Mandarins, highlighting the most significant budgetary matters and freeing the electeds from spending time on those line items that showed only glacial change, if any, from year to year.*

*The Papers of last year had fortified much of the foundation from which the forthcoming year could build upon --- consolidation of funds, establishment of a new fund, setting a goal for reserves, PERS obligation pay downs. Harkening back to Gladstone, he echoed that an embryonic economic recovery might be underway and thus, the number of issues fewer than at the height of the recession. Some of the Papers were conscribed for consideration by activities and events arising from the soon to sunset year. The financial concerns for the future would once again be addressed in the valedictory paper.*

## **ISSUES AND OPTIONS POLICY PAPERS**

This year, the Council is presented seven (7) Policy Papers. These narratives describe policy matters which are addressed in the Budget either through inclusion or a recommendation for no funding. Some of the subject matters have been forwarded for budgetary discussion by the Council during the year---City Sponsored Events and Downtown Studies (Visioning, etc). One paper, on Deer Hollow Farm, has been thrust towards the City from outside parties eager for Los Altos to play a role in the continuation of activities at that venue. And, as is customary, the final Policy Paper casts a wide net to capture, in a singular place, the multitude of future financial impacts of significance which the organization will confront in the years ahead.

*It must have been so much easier back then, in June 1953, when the first group of electeds encountered the municipality's inaugural budget. The historical record shows the introduction of the proposal and its quick dispatch to early July at which time the plan is accepted as "a guide" until further consideration in the year. The Budgeteer contemplated what it must have been like in preparing the list of capital needs for the city's infancy. Sewers? Parks? Roads? Was there even a capital plan in that initial budgetary plan? As he reviewed the Budget Team's contemporary five-year capital proposal, he was impressed with the magnitude of effort the team was advocating. With nearly twelve million dollars in projects already authorized, the team was advancing additional proposals to address the spoken desires of the community's citizen boards, the Mandarins, as well as asset needs. With sixty-one open projects, the team was pushing for over twenty more, ranging from studies to new requirements from elsewhere to projects that had migrated their way up the plan's ladder over the years, reaching this apex year for action. Fiscal Year 2010-11 was to be the zenith year, for thereafter, the propellants to fuel the plan diminished. The impacts of the last few years of recession had starved the usual conduit of life support leaving the plan gasping for nourishment. The long arm of the Shadow had reached Los Altos. And while the magnitude of open projects to be completed would continue for some years, only a few annual efforts could be anticipated for consideration in budgetary epochs ahead.*

## **CAPITAL IMPROVEMENTS PROGRAM (CIP)**

Concurrent with the Council's consideration of the Budget is the review of its symbiotic partner, the Capital Improvements Program. With the Council's approval on 25 May appropriating the monies for the First Street Streetscape and Intersections project, the City currently has sixty-one (61) active projects. The plan presented for 2010-14 updates those efforts that will be undertaken over the next five years but also expands the list of unscheduled and unfunded projects.

For the first eight years of the first decade of the new millennium, the City transferred from the General Fund and the Utility Users Tax \$25 million to the CIP. This past year, 2009-10, we moved exactly 1% of that total, \$250,000, to the CIP at mid-year. The proposal before Council includes an additional allocation of \$200,000 originating from anticipated current year end monies. These past two years, the CIP has been internally self-funded with monies saved from one project being rotated for utilization elsewhere. This trend in CIP funding is a one of the matters of significance brought up in the "Financial Warning Lights" Issues and Options Papers included herein.

For 2010-11, twenty-three (22) projects migrate upwards on the five year list for the commencement of work in this, their climatic year. Nearly half of these projects are annual core needs, repeating themselves each year to keep the community functioning, safe, and preventing more costly outlays in later years. In 2011-12, sixteen (16) projects advance, ten (10) being annual. (Slurry sealing is a biennial activity.) The following year, fourteen (15) projects are identified, eleven (11) being annualized needs.

The budget contains \$5,194,500 in 2010-11 for new and annual citywide CIP projects of which 44% is for core annual efforts such as street work, sewer videoing and root foaming, and NTMP projects. A review of the 2009-10 CIP plan reveals that projects in 2010-11 were originally expected to exceed \$8 million. The drop to the \$5 million level noted above has everything to do with staff's 25 May recommendation to approve and appropriate the Downtown First Street Construction project, valued at \$3.3 Million and planned for 2010-11. To a lesser extent than was the case last year, some projects were re-positioned within the five year CIP term to allow for available resources and to focus on the projects already authorized. As projects have been pushed outward, some in the latter years have moved to "unscheduled" status and are presented on an un-prioritized basis.

Similar to 2009-10, the CIP's funding needs are addressed in Issues and Options Policy Paper # 7.

## **OTHER FUNDS**

In addition to the General Fund, the City maintains twenty-six (26) other funds, from the CIP and other capital funds, to the City's Enterprise Funds, to the State mandated Gas Tax Fund and the Municipal Code specified Park In-lieu Fund. Many of these funds adjust minimally throughout the years - the Debt Service Fund, various assessment district funds, the Estate Donation Fund. With actions brought to Council in 2009-10, a number of expired past debt assessment district funds were closed. Hence this grouping has dropped out of the budget. The following funds in the "other funds" group are worthy of Council's further attention.

The **Solid Waste Fund** has been reanalyzed this year in anticipation of an approved new ten-year contract effective September 2010. A review of this fund activity will reveal two notable differences. Revenue has been adjusted downward by nearly \$800,000, or 52%, reflective of the new contract structure requiring the hauler to directly pay disposal fees – a contract provision designed to eliminate the City's risk for such costs going forward. In the past contract, these fees and cost flowed through the City's accounts. Commensurately, the expenses side is over \$600,000.

The **Sewer Fund**, following the Council's adjustment of rates in 2008, is healthy even with active CIP projects totaling over \$5 Million and the addition of \$2.8 million in new 2010-11 capital projects. The Fund is expected to end 2010-11 with reserves of nearly \$2.2 Million as the City continues the implementation of the Sewer Master Plan. In 2010-11 a replacement line Vacuum truck valued at \$308,000 is proposed for purchase in recognition of the importance of this vital piece of maintenance equipment and the growing failures of our existing, aged truck. The Five year CIP includes a multi-year forecast of this fund which also displays the future viability of these operations.

The **Storm Drain Fund**, discussed above, remains a concern given the absence of a direct funding source and the unavoidable probability of increased costs in this area. As predicted last year, the fund balance for these operations ends the year nearly fully exhausted.

Projections for the **Park-In-Lieu Fund** have improved with the recognition of some exciting new development projects. We anticipate commencing the 2010-11 with an estimated beginning balance of \$1,335,000 and end the year with an available fund balance, after considering active projects on the books, of \$1,930,612. In 2010-11 the fund will benefit from over \$1.1 million in revenue, an amount higher than previously predicted. A review of the five year forecast of this fund, included in the CIP, displays that it can more than support the projects identified for these funds to date.

Transfers into the **Equipment Replacement Fund** for the forthcoming fiscal year are again proposed at maintenance levels only. At the 2009-10 mid-year review, Council seeded this fund with \$250,000 of prior year excess reserves to accommodate the purchase of deferred safety capital needs. The 2010-11 Budget proposes another \$100,000 transfer to keep a level fund balance in anticipation of a return to normalized funding when the economy ultimately rebounds. In 2010-11, expenditures in this fund include a replacement wood chipper for Maintenance Services at a cost of \$45,000 and over due replacement of our core domain servers at a cost of \$16,000.

A total of \$73,000 for additional Police Department purchases is placed in abeyance and no allocation is contained within the budget, awaiting a decision at mid-year based upon the City's budgetary performance at that time. This is identical to the timing for consideration with the current year's budget.

The **Real Property Proceeds Fund and the Community Facility Renewal Fund**, two other significant capital-related funds are note worthy. With last year's consolidation complete, the Real Property Proceeds Fund will end the 2010-11 year with a balance of nearly \$6.4 million having realized its final scheduled annual installment payment. The Community Facility Renewal Fund has maintained its balance of \$3.7 million.

The **Parking Permit Fund** is again the source of funding for the LAVA Downtown seasonal plantings and six sidewalk cleanings. Cost: \$21,000.

## **FARRAGOES**

This year's budget has a number of noteworthy adjustments from last year. Per the Council's decision and direction, the City's past practice of dispensing grant monies was curtailed except for

several allocations that Council, in August 2009, specifically said should continue. This results in a savings of \$35,000.

The Assistant City Manager's position and its accompanying expenses, previously allocated in the Executive's budget, has been transferred to the Human Resources Department.

The General Fund contains monies for five (5) new or on-going expenses:

The IT budget contains monies for the redesign of the City's webpage per the Council's conversation in February. Cost: \$30,000.

The second year of the phased replacement of personal computers is budgeted in IT, along with the continuing replacement of servers. Cost: \$37,000

The City Clerk's allocation includes \$44,000 for the November municipal election. Issues and Options Policy Paper # 1 discusses the timing of a bond election for the Community Center project. The Community Development Department is budgeted for a GIS upgrade and for a new map plotter. Cost: \$28,542.

The renewal of the contract with Acterra, which is working at Redwood Grove, is contained in the proposal at a cost of \$40,000.

The City Council's budget in the current year contained a \$50,000 contingency for unexpected matters which might arise during the year. This account was used sparsely in 2009-2010 and for the coming year, the account was reduced by \$25,000. On the other hand, the General Fund Contingency in Non-Departmental was increased by \$50,000 to address unplanned employee retirement costs and provide an increased safety net given the second year of general cost trimming.

With the approval of a new garbage franchise in March, the City now pays for the collection of waste at municipal facilities and from containers along rights of way at an estimated cost of \$190,000.

Other notable adjustments include: An increase of City facility sewer costs of nearly \$28,000 given the passage of restructured sewer rates in the prior year and an increase of \$75,000 in unemployment costs citywide given cost trends.

## **FINANCIAL WARNING LIGHTS**

Issues and Options Policy Paper # 7, the customary concluding document, takes a longer perspective than the single year snapshot contained in the Budget for 2010-2011. With known increases forecast for the City's PERS rates; with significant capital needs expected to be identified in the yet to be finalized Storm Drain Master Plan and no known source of funding other than the General Fund; with the CIP and Equipment Fund having been bypassed the past few years from the insertion of significant monies, there is much to explore and discuss.

In November 1940, during the battles of World War II, Churchill addressed the House of Commons and spoke "It is not given to human beings, happily for them, for otherwise life would be intolerable, to foresee or to predict to any large extent the unfolding course of events..." Contrary to Churchill's comment, we can foresee some of the issues the Council and the community will encounter in the next few years. Those matters are addressed in the Financial Warning Lights Policy Paper.

*And so, "it" was finished. The Shadow still loomed but whether it would strike soon, or later, or not at all, is unknown. Whether the Budget Team and the Budgeteer's expectations and estimations were accurate or off-target would not be known for another twelve months. They had tried, once again, to weave a public quilt that provided the community with its basic services, pursued the capital goals for a better tomorrow and created deeper safety nets should either the Shadow or the State or both strike once again.*

*The Budgeteer reflected on a writing by Tennyson he had read long ago about the passing of one year and the arrival of the succeeding one.*

*'Tis nearly twelve o'clock. Old Year, we'll dearly rue for you. What is it we can do for you?  
And a new face at the door, my friend, a new face at the door.'*

Mayor Casas and Members of the Council, on behalf of the Staff Budget Team, I am pleased to present to you the financial plan for Fiscal Year 2010-11. We seek your guidance as we again navigate through the financial uncertainty of our times and as all of us continue to set the course for the Los Altos of tomorrow.

Respectfully Submitted,

Douglas J. Schmitz  
City Manager

22 June 2010