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TO: City Council

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SUBJECT: Budget Message for City's Financial Plan: 2013/15 Operating Budget and 2013-2018 Five-Year Capital Improvement Program

INTRODUCTION

We are pleased to present the City's Financial Plan which includes the biennial 2013/15 Operating Budget and 2013-2018 Capital Improvement Program (CIP).

This document includes summaries of projected revenues, descriptions of services and/or projects and related expenditures, comparisons to prior fiscal year revenues and expenditures and future year forecasts.

DISCUSSION

Los Altos has a long history of prudent financial management and this two-year budget and capital plan continues that tradition. Core services are maintained while austere cost savings are planned in the short-term. The operating and capital budgets are balanced, do not require any borrowing of monies, and achieve the City Council's goal of a 20% General Fund reserve.

Trends and challenges

The past several years have been characterized by a significant and lingering economic downturn as well as impacts from actions taken at the State level, both of which have affected the financial climate in California cities. For Los Altos, the slow and gradual economic recovery has required deferring a number of staffing appointments to ensure long-term sustainability. Other key issues facing the City include:

Pension reform and outlook

A major concern revolves around CalPERS rates that are subject to double-digit increases over the next ten years beginning in 2015/16. In fact, staff has been advised that landmark changes are underway related to the pension fund pool in which the City participates. The cost-savings measures included in this operating budget are directed toward this very issue with the

corresponding recommendation to reserve funds for the inevitability of higher retirement rates and contributions. The City has been in the forefront of pension reform with the creation of a second-tier retirement benefit system, whereby new employees contribute the full amount of the employee share of the PERS rates. According to AB340, the State Pension Reform Act of 2013, employees hired as of January 1, 2013 and not previously employed by a government agency, or those employees who have had more than a six-month break in government service, have a lower retirement benefit than Tier 2 employees and also contribute their share of normal costs. Tier 1 City employees are currently contributing an increasing portion of the employee share of the PERS rates.

New accounting standards

Closely related to the matter of pension costs is the emergence of new accounting standards that require the recording of unfunded pension liabilities. In particular, the standard referred to as Government Accounting Standards Board (GASB) 68 will take effect in FY 2014/15. This topic is more than an administrative technicality given that it highlights long-term liabilities, which are not insignificant. As all cities implement this new reporting model, it will receive wide attention. Although this is not an immediate budget concern, it is certainly a major and material financial disclosure to acknowledge and communicate in future audits.

Aging Civic Facilities

The City's facilities are in considerable need of repair, upgrading and/or enlarging to meet immediate public service needs, building codes, energy efficiencies and technology infrastructure. The focus on immediate day-to-day fixes rather than comprehensive, long-term asset preservation has resulted in civic facilities that have exceeded their useful lives. To begin to address this issue, the CIP designates \$100,000 per year to cover interim basic repairs as larger scale improvements are planned and implemented.

Civic Center Revitalization

The need to either repair or replace a number of the Civic Center campus buildings and surrounding infrastructure is evident. One of the Council's 2013 priorities addresses this issue. Therefore, a new CIP project has been identified to support the Council's efforts to finalize a viable plan to redevelop the Civic Center facilities – specifically the Hillview Community Center, Police Station and City Hall.

Financial Warning Lights

Beyond the items noted above, the cost of health care is continuing to increase and evaluated on an annual basis.

Secondly, this is the initial year that storm water-related costs will need to be classified in the General Fund. The upcoming Storm Drain Master Plan should contemplate potential funding options to sustain service provision in this area without negatively impacting other City programs.

Additionally, the City has completed or is in the process of completing a variety of Master Plans (i.e., Parks, Bicycle, Pedestrian, Downtown Parking Management, Storm Drain, ADA Transition). While these documents are extremely useful, and in some cases required, it is important to recognize that

implementation of Master Plan strategies needs to be done over a multi-year, long-term period within available resources.

The City's overall Pavement Condition Index (PCI) has been slowly declining from a high of 82 in 2009 to the current 78. Although this trend is of concern, street pavements are generally in good condition, but will likely need future increased capital funding to flatten this downward trend. Additionally, the five-year CIP does not address the slow deterioration of public parking lots and neighborhood asphalt pathways. Increased funding will need to be identified in future budgets once the Downtown Parking Management and Pedestrian Master Plans are completed.

Last, but not least, the City continues to have a vested interest in controlling the long-term cost of Fire services provided through the County Fire District. This contract expires in 2016, and will require advance review and consideration since many of the same pension cost pressures and economic factors that cities face are similar for the Fire District.

Reserve Funds

The FY 2013/15 Operating Budget is an important milestone as it forecasts the achievement of the City's 20% General fund reserve balance goal. This, and other, key reserves follow:

<i>General Reserves</i>						
<i>Descriptions</i>	<i>June 30, 2012 Balance</i>	<i>Reclass/Use</i>	<i>12-13 Estimate</i>	<i>13-14 Proposed</i>	<i>14-15 Proposed</i>	<i>Proposed FY2014-2015 Balance</i>
Operating Fiscal Reserve	4,200,000	1,025,000	500,000	300,000	150,000	6,175,000
State Budget Stabilization Reserve	1,025,000	(1,025,000)	0	0	0	0
OPEB Reserve	400,000		350,000	100,000	0	850,000
PERS Reserve	100,000		(100,000)	450,000	150,000	600,000
Total	\$5,725,000	\$0	\$750,000	\$850,000	\$300,000	\$7,625,000

This biennial budget raises the OPEB reserves to \$850,000 and, most significantly, includes new PERS Reserve Fund monies totaling \$600,000 to counterbalance the anticipated pension rate increases in the near-term.

Other reserves include:

<i>Descriptions</i>	<i>June 30, 2012 Balance</i>	<i>Use</i>	<i>12-13 Estimate</i>	<i>13-14 Proposed</i>	<i>14-15 Proposed</i>	<i>Proposed FY2014-2015 Balance</i>
CIP Funding	6,378,055	(6,467,125)	250,000	150,000	350,000	660,930
Community Facility Renewal Fund	7,065,590	-	0	0	100,000	7,165,590
Real Property Proceeds Fund	6,910,870		444,430	2,744,400	66,600	10,166,300
In Lieu Park Fees	949,750	(432,000)	3,694,980	365,000	365,000	4,942,730
Total	\$21,304,265	(6,899,125)	\$4,389,410	\$3,259,400	\$881,600	\$22,935,550

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Revenues

General Fund

The biennial budget projects \$30 million in General Fund revenues made up mostly of general taxes and fees. The bulk of the City's tax dollars come from Property Tax (65%), Sales Tax (12%), Utility Users Tax (12%) and Hotel Tax (6%). These resources fund core City service operations including Public Safety, Maintenance, Recreation, Economic Development and General Government. Planning and Building costs are funded through development fees and charges. It is important to note that savings in the General Fund have traditionally been utilized to support the City's fixed assets and capital improvements needs such as streets, roadways, parks, pathways, traffic systems and parking lots.

Compared to the prior year budget, total General Fund 2013/14 revenue is estimated to increase by a modest 1.79% followed by a 2.74 % increase in 2014/15. This growth is primarily led by property tax increases of approximately 4% and 3% in years one and two of the biennial budget, respectively.

Sales tax trends have been moderate at best and adjusted downward for the retail interruption expected with the Safeway development on First Street as well as the loss of the Garden Supply Center, a commercial interest currently under construction as a residential and mixed-use development. Hotel Tax has performed extremely well with another double-digit year expected. Recreation also continues to grow its revenues as projected and Planning fees remain strong. To be fiscally prudent, however, revenue growth has been estimated conservatively.

Other Funds

Enterprise funds are stable and on track, especially with the recent adoption of the Sewer Master Plan. With the passage of that plan and related rate study, this budget has updated its revenue and capital needs projections ensuring the upkeep of a wastewater system that protects the health and welfare of the community for years to come.

Significant Development Proceeds

The recent receipt of development fee dollars can be applied to future City capital improvements. This biennial budget, including 2012/13 estimates, adds the following capital resources:

- \$4.3 million added to the Park In-Lieu Fees from major multi-unit developments on First Street, San Antonio Road and the El Camino Corridor
- \$2.7 million for the final installment of the sale of property on First and Main Street
- \$400K of a final contract installment on the sale of the Los Altos Sewer Plant

It should be noted that Park In-Lieu fees must be dedicated to new park and recreation-related land acquisitions or facility improvements. The funds from real property sales, both existing and those anticipated in this budget cycle, are without restriction and classified as dedicated to capital improvements.

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Expenditures

General Operations

Consisting mostly of tax dollars, City resources are applied to furthering the major goals of making Los Altos a safe, attractive and enjoyable place to live. Hence, the bulk of resources are applied to public safety, with 51% directed to the City's Police and Fire services. Another 19% is dedicated to general maintenance of City open spaces, roads, medians, sidewalks and traffic systems. Ten percent supports the City's urban planning guidelines and policies through Planning and Building activities while 7% is dedicated to quality of life standards in the offering of recreation programs and community events for residents of all ages. The remaining 13% is dedicated to support general government services including administration, policy, legal, finance, technology and human resources.

As a program-level budget document, the department section of the biennial budget provides a broad overview of core city functions and operations. These functions include Legislation & Administration, Finance & Technology, Human Resources, Public Safety, Community Development, Public Works and Recreation. In order to set aside additional reserve funds, City staff have identified only those cost increases necessary in scheduled salary and benefit costs, pension rates, increased fire services, professional services, and contract services. Equipment and new item requests were mostly deferred with the exception of core Police personnel safety equipment, safety radio communications systems and Police vehicle replacements. No other new vehicle or equipment requests are contemplated at this time.

The budget cycle brings with it a 5% increase, approximately \$300,000, in Fire contract costs making up the bulk of the second year increase in expenditures in Safety.

Staffing

What is notable in this budget cycle is the deferred hiring of five (5) additional positions beyond the existing seven within general operations. This brings the total deferred staff hiring total to 12 positions as a cost-savings measure given the current fiscal challenge areas noted previously in this report. It is important to recognize that with a nearly 10% reduction in the optimal staffing level, there will likely be impacts to the levels of services provided. It is anticipated that as the economy strengthens and revenue increases are realized, strategic hiring will be re-initiated.

The biennial operating budget and the Personnel Allocation Summary now reflect a Public Works Department comprised of Engineering Services and Maintenance Services. The fiscal resources for Engineering Services were transferred from Community Development to Public Works.

Other Funds

All other funds, as projected and proposed, are performing well. The Sewer Fund has been financially bolstered by the acceptance of the most recent Sewer Master Plan and Rate Study, ensuring sound maintenance and system sustainability in the near and long-term. Sewer Fund balances are projected to remain healthy and sustain a 25% reserve level if the recommended rates and charges are adopted beginning in FY 2013/14.

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As noted above, the City's various capital funds are benefitting from significant private development. The majority of these revenues can be expected to be utilized as the Council finalizes its approach for updating aging civic facilities. As material as the increases are, the full replacement of the City's Civic Center, as laid out in the Master Plan, cannot be achieved without public and/or external financing.

CAPITAL IMPROVEMENT PROJECTS

The five-year Capital Improvement Program identifies current and future capital projects and associated funding sources. The format and presentation of the CIP has been significantly updated and is now incorporated as part of this document. The first year of the five-year Program reflects projects that are proposed for funding; the future four years of projects are presented for planning purposes only.

The summaries provide a snapshot of each year. The project pages contain additional information about the individual projects within the new categories – Civic Facilities, Community Development, Transportation and Wastewater Systems.

It is intended to continue with two different CIP systems tracking until all the projects funded prior to FY 2013/14 are complete. Moving forward, Council will be provided a summary list of previously Funded Projects which remain active along with summaries of projects funded in FY 2013/14 and thereafter. The transition from the previous to the new CIP model will be accomplished over the next few years.

Over the five-year period 2013/14 - 2017/18, an annual average of \$3.6 million is planned in capital expenditures. A total of 21 projects are being recommended for 2013/14, with appropriations totaling \$4,107,830. Of these projects, seven are new with the remaining 14 projects being those identified in previous five-year CIP documents and/or are ongoing projects (i.e., Street Resurfacing, Sewer Root Foaming, and Neighborhood Traffic Management Program).

All City Commissions were involved in the review and discussion of potential Capital Improvement Program projects during March and April 2013. Those suggested projects not included in this five-year CIP will be noted during the staff presentation of this agenda item on June 4.

SUMMARY

The total 2013/14 budget, including all funds, is \$39,958,690, with \$29,739,350 in General Fund operating expenditures and \$4,107,830 in capital expenditures. Both budgets are fiscally prudent, providing adequate fund reserves and addressing the community's capital needs.

ACKNOWLEDGEMENTS

Many thanks go to the Departments and all Los Altos staff for their dedicated efforts in managing the City's resources effectively during difficult economic times while ensuring that Los Altos remains a great place to live and to raise a family.

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