PISMO BEACH COUNCIL AGENDA REPORT

SUBJECT/TITLE: **GENERAL FUND FIVE YEAR FORECAST: FY 2011-12 TO FY 2016-17**

EXECUTIVE SUMMARY:

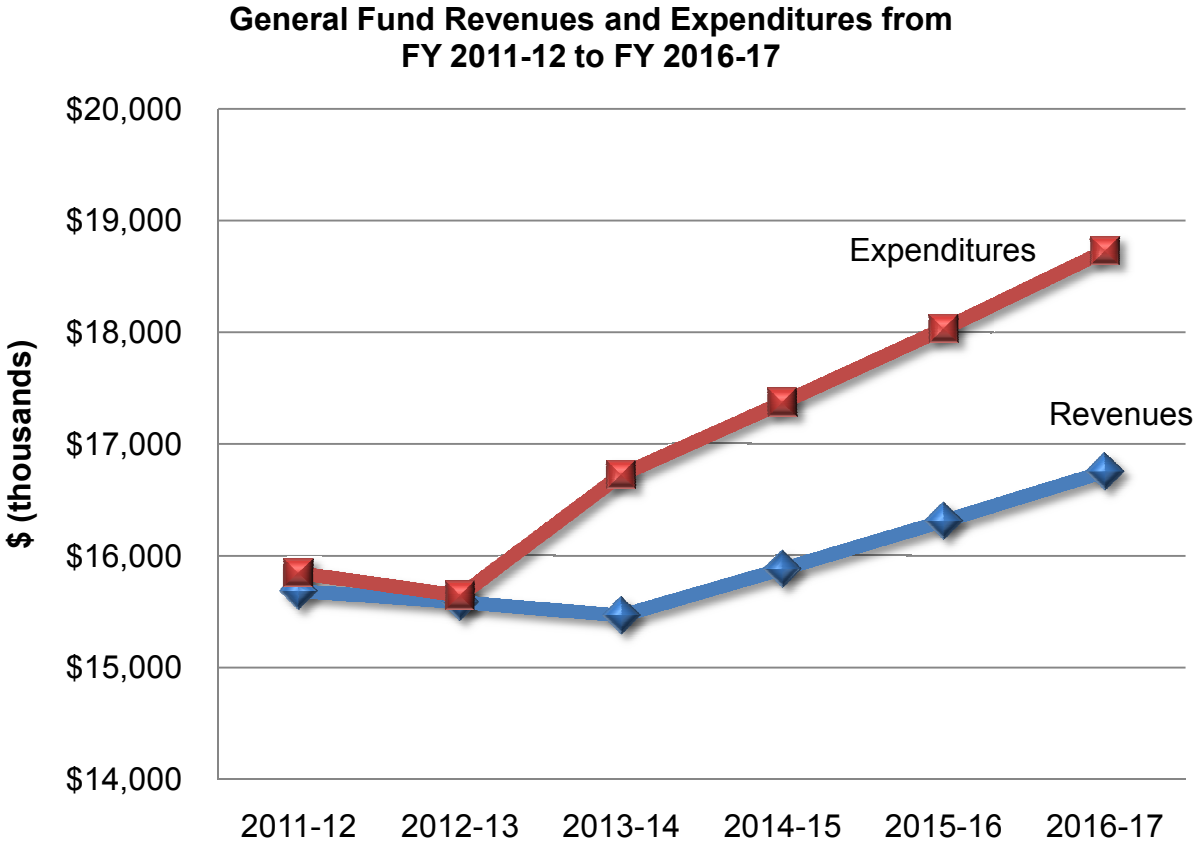
This report provides the Mayor and City Council with a Five Year forecast of the General Fund for Fiscal Years (FY) 2011-12 to FY 2016-17, assuming no changes to current policies and staffing levels.

As shown in the following table, this report projects ending General Fund unallocated fund balances of $2,182 thousand in FY 2011-12. Starting in FY 2012-13, the unallocated fund balance must cover the costs of capital projects and thus becomes the ending fund balance of $1,966 thousand in FY 2012-13, $538 thousand in FY 2013-14, which decreases over time to a projected $5,170 thousand fund balance deficit in FY 2016-17. These projections include the FY 2011-12 projections from the FY 2011-12 Nine Month General Fund Budget Status Report (Nine Month Report), the FY 2012-13 Adopted Budget, and future year known revenue and expenditure changes, as well as assumptions based on various economic factors. The primary factor for the widening gap between revenues and expenditures is due to the projected average revenue growth rate of 1.3% per year while expenditures are projected to increase by an average of 3.4% per year.

5 Year General Fund Projection FY 2011-12 to FY 2016-17
Fund Balance, Revenues, and Expenditures

		Fiscal Year					
	(in $ thousands)	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17
A	Fund Balance	$ 3,666	$ 2,672	$ 1,966	$ 538	$ (1,123)	$ (3,018)
a1	*Unallocated Fund Balance*	*2,344*	*2,182*	*1,966*	*538*	*(1,123)*	*(3,018)*
a2	*Capital Funds Carryforward*	*914*	*490*				
a3	*Purchase Orders Carryforward*	*191*					
a4	*GF Reserve Recognized*	*218*					
B	Revenues & Sources	$ 15,682	$ 15,583	$ 15,463	$ 15,880	$ 16,309	$ 16,751
C	Operating Expenditures	$ 15,844	$ 15,642	$ 16,723	$ 17,369	$ 18,030	$ 18,725
D=B - C	Net Operating Surplus / (Deficit)	$ (162)	$ (58)	$ (1,260)	$ (1,489)	$ (1,720)	$ (1,974)
E=a1+D	Ending Unallocated Fund Balance	$ 2,182	$ 2,124	$ 706	$ (951)	$ (2,843)	$ (4,992)
E	Capital Projects	$ 832	$ 648	$ 168	$ 172	$ 175	$ 179
F=A+D-E	Ending Fund Balance	$ 2,672	$ 1,966	$ 538	$ (1,123)	$ (3,018)	$ (5,170)

The following chart displays the widening gap between projected revenues and operating expenditures.



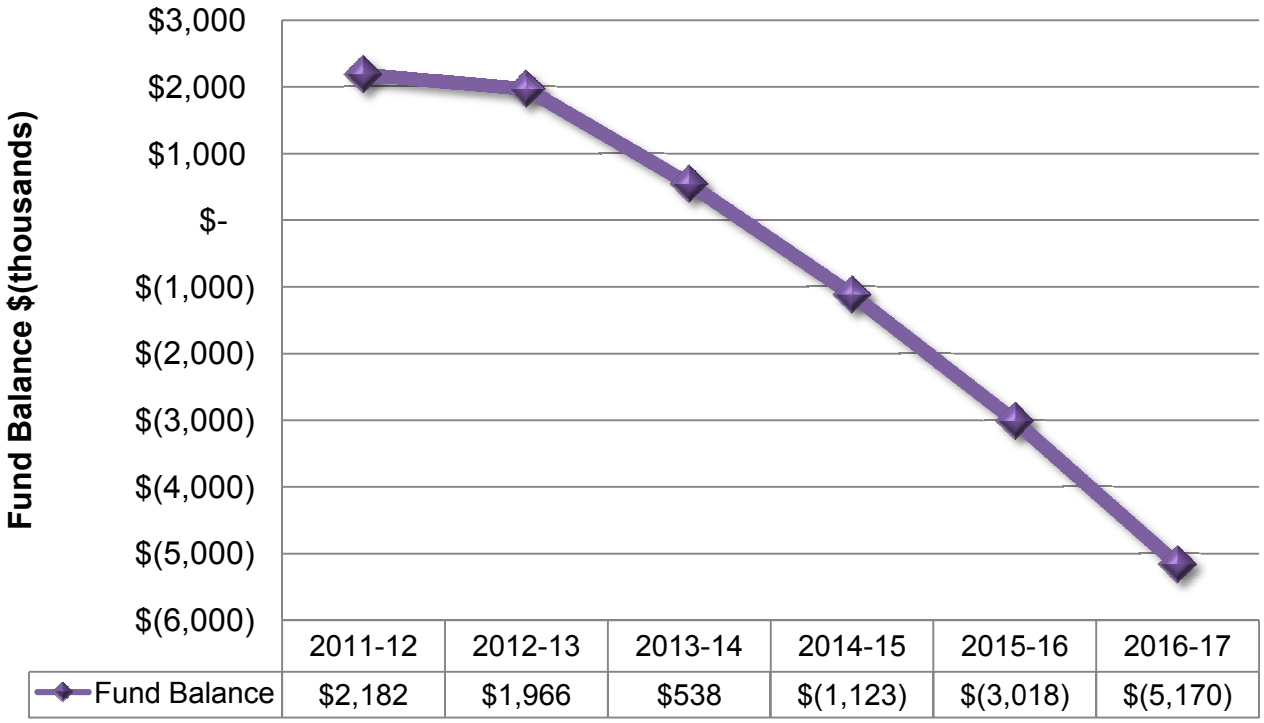
Fund Balance

The General Fund unallocated fund balance is a portion of the overall fund balance and represents just the amount of fund balance that is not committed for any specific purpose and may be used for various one-time projects. The ending unallocated fund balance is calculated as the beginning unallocated fund balance plus the net operating surplus or deficit.

Ending unallocated fund balance	=	Beginning unallocated fund balance	+ net operating surplus / (deficit)

The following chart displays the projected decreasing General Fund unallocated ending fund balance over time as rising costs continue to draw more on fund balance.

FY 2011-12 to FY 2016-17 Projected General Fund Ending Unallocated Fund Balance



	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17
Fund Balance	$2,182	$1,966	$538	$(1,123)	$(3,018)	$(5,170)

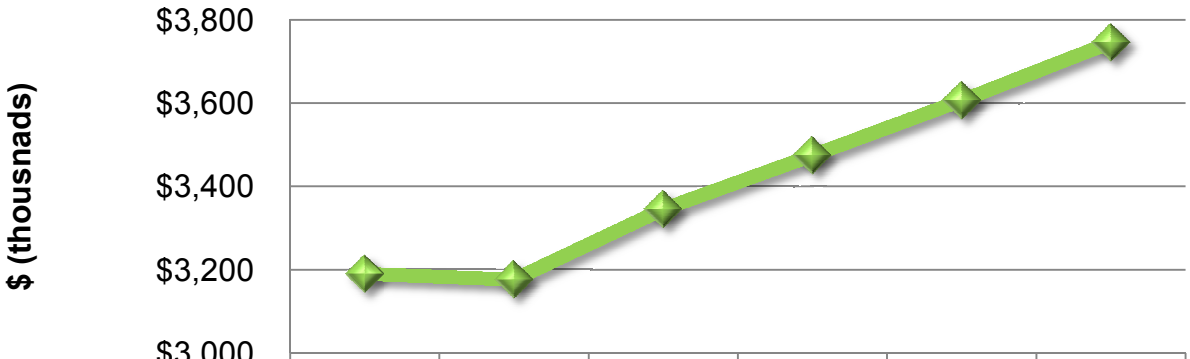
The revenues and expenditures in this report reflect projections, not budget or actual numbers. It shows what the City's General Fund would look like if we continued to receive revenues based on historical growth rates and spend based on historical spending rates. The widening gap between projected revenues and expenditures illustrates that budgets should be developed with a long-term outlook. Given the nation's slow recovery, the State's high unemployment and correspondingly fewer personal income tax revenues, and uncertainties of future revenues, expenditures, and resulting fund balances, it is prudent to continue to maintain thoughtful discipline in restraining costs.

While the projected shortfalls shown in the above table reflect the difference in projected revenues and expenditures over the next five years, Pismo Beach's Municipal Code requires that each year's budget be balanced. Balancing the budgets will require some combination of expenditure reductions and/or additional revenues. These projections assume no ongoing solutions are implemented. To the extent budgets are balanced with ongoing solutions, future shortfalls will decrease.

General Fund Reserve

The City adopted a Fiscal Policy that maintains a General Fund Reserve of 20% of budgeted annual operating expenditures. The FY 2011-2012 General Fund Reserve requirement is $3,189 thousand. Note that the FY 2011-12 and FY 2012-13 Reserve amount is equal to 20% of the Revised Budget operating expenditures, whereas the FY 2013-14 through FY 2016-17 is equal to 20% of projected actual operating expenditures.

General Fund Reserve (20% of total budgeted expenditures)



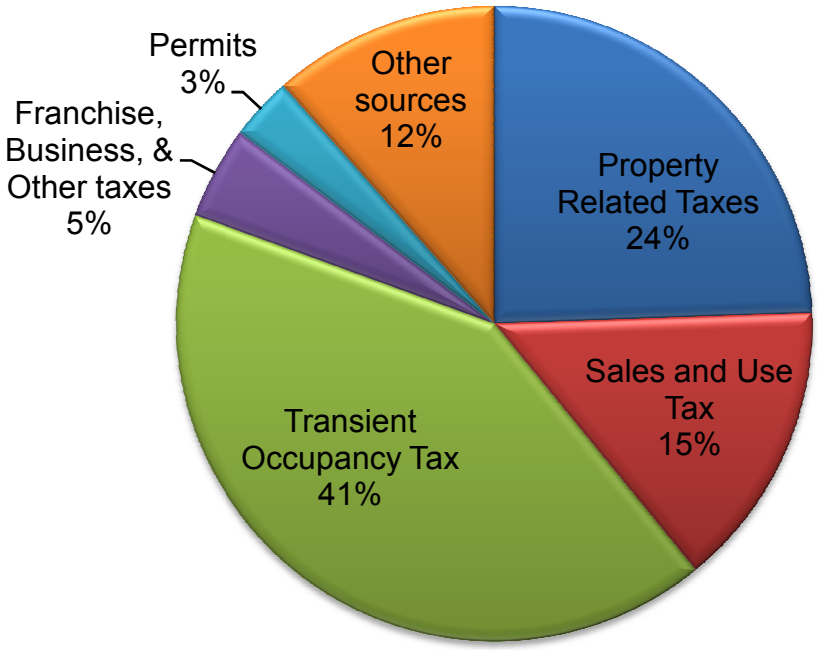
	2011-2012	2012-2013	2013-2014	2014-2015	2015-2016	2016-2017
GF RESERVE	$3,189	$3,176	$3,345	$3,474	$3,606	$3,745

Key Assumptions

Revenue assumptions

This report assumes that the economic recovery will continue at a pace of about 1.3% annual growth in revenues after taking into account adjustments for one-time items. The following table illustrates the mix of General Fund revenues by source for FY 2011-12. Since approximately 80% of General Fund Revenues consist of Property Tax, Transient Occupancy Tax (TOT), and Sales Tax revenues, this analysis focuses on these three revenue sources.

FY 2011-12 Projected Actual Revenues



- Property Related Taxes projected 2% annual growth: The FY 2011-12 property related tax projection is equal to the Nine Month Report projection. The FY 2012-13 property related taxes are equal to budget. Note that there is a one-time $351 thousand property tax revenues increase that is budgeted in FY 2012-13 to reflect the repayment of the State borrowing 8% of the City's property tax revenues. FY 2013-14 through FY 2016-17 property related tax revenues are projected to grow at a 2% rate.

  The four year historical average rate of growth of assessed values is approximately 2%, which is used for this forecast's five year projected rate of growth. The last four years represent assessed values after Pismo Beach residential housing prices peaked. There is still risk in residential property taxes for Proposition 8 assessed value reductions. A Proposition 8 reduction is a form of assessment relief that may be applied when a property's taxable value exceeds the current market value. Since 2008, the San Luis Obispo County Assessor has applied the Proposition 8

reductions to the City resulting in a 23% cumulative decline in assessed values for 932 parcels that were granted a value reduction. In 2008, the total decline was 10.5% for 232 parcels, and has slowed down to a 5.3% decline for 14 parcels in 2011. To translate these reductions into dollars, for FY 2011-12, the Proposition 8 reductions resulted in a $517 thousand reduction in property taxes.

In general, property related tax revenues are allocated to the City in December and April of each fiscal year and represents about 24% of the total General Fund revenue budget, or a projected $3,836 thousand in FY 2011-12. The two sources of property related tax revenues include:

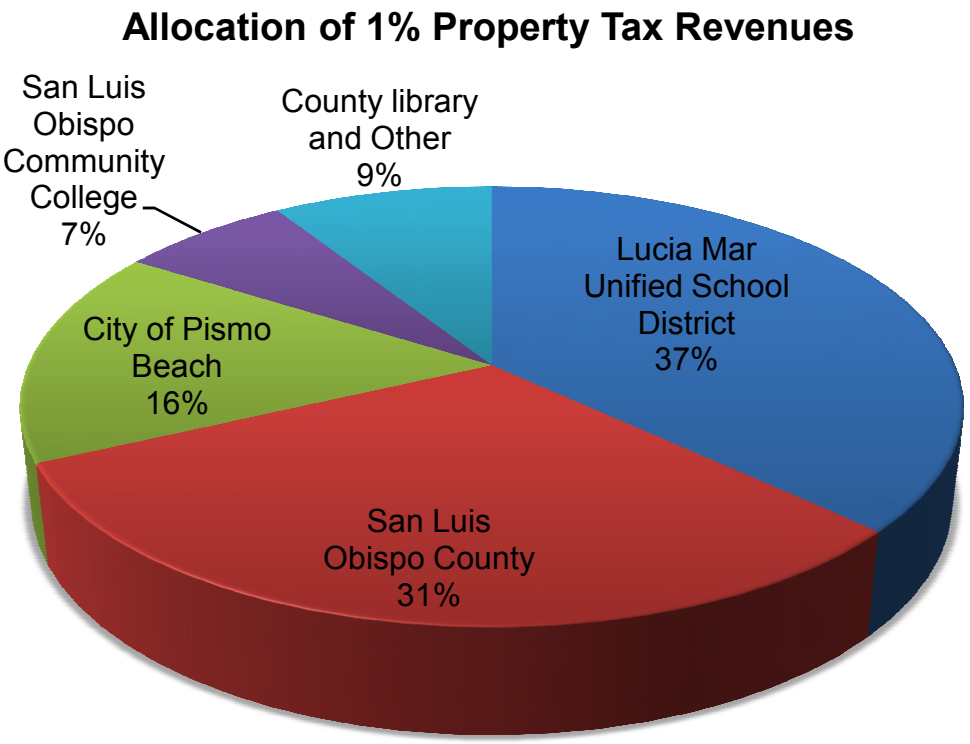
- Property Tax revenues: The largest share, or 20 % of the City's General Fund revenues, is property tax revenues. Property taxes are equivalent to 1% of assessed values.
- Property Tax In Lieu of Vehicle License Fees: The second source of property related tax revenues, or 4% of total General Fund revenues, is the Property Tax In Lieu of Vehicle License Fees. This revenue is a 1% tax on the market value of a registered vehicle.

Property Tax Revenues Assessed Value: Property taxes are equivalent to 1% of assessed values. The assessed value for most real property is the prior year's assessed value adjusted by the California Consumer Price Index, up to 2%. However, if there has been a change in ownership the new assessed value will be the market value of the property that changed ownership. New construction value is added to the property's prior base values. This new value is called the next taxable value. Approximately 82% of the City's property tax revenues are made up of residential net taxable value. Commercial net taxable value makes up 12%, leaving approximately 6% for other property categories such as vacant land.

Allocation of 1% property tax revenues to City's General Fund: The 1% property tax revenues collected by the County are allocated to the following:

- 37% goes to the Lucia Mar Unified School District,
- 31% goes to San Luis Obispo County,
- 16% goes to the City of Pismo Beach,
- 7% goes to the San Luis Obispo Community College, and
- 9% goes to the County library and various other purposes in the County.

The City of Pismo Beach's portion is further reduced by the State which shifts a percentage of these property taxes into a countywide Education Revenue Augmentation Fund (ERAF). This amount is calculated for each year and allows the County to distribute property taxes to schools. As a result, the City's General Fund receives property tax revenues equivalent to 0.13% (in FY 2011-12) of assessed values after accounting for the ERAF shift.



- Sales Tax projected 2% annual growth: For FY 2013-14 through FY 2016-17, sales tax revenues are projected to grow at a rate of 2% per year. The 7 year historical average of sales tax revenues is approximately 2%, and tends to follow the overall state of the economy and the California Department of Finance Consumer Price Index Los Angeles Recreation measure. This 2% rate of growth is used in this 5 year forecast.

  In general, the City is projected to receive $2,297 thousand of sales tax revenues, which represents about 15% of the City's General Fund revenues. There are three sources of sales tax revenues that the City receives.

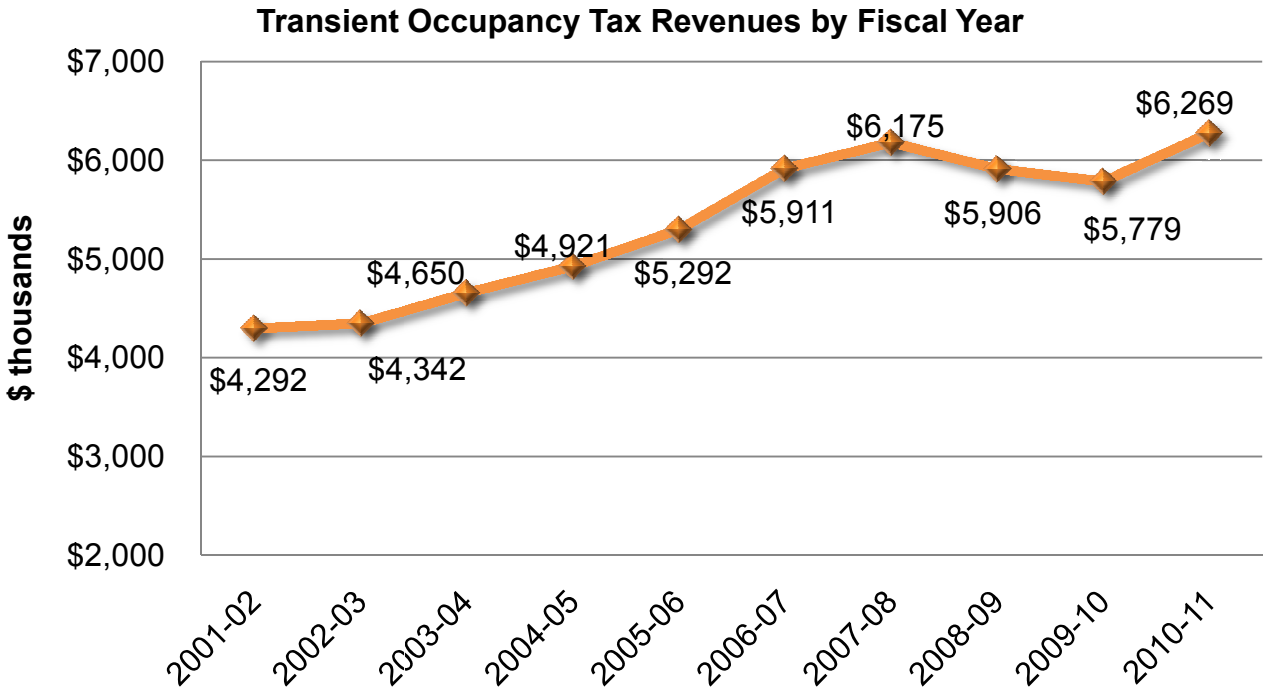
  - The largest share is the 0.75% Bradley Burns Uniform sales and use tax, and is projected to come in at $1,700 thousand in FY 2011-12. The City receives this sales tax monthly based on estimates made by the State, and is adjusted quarterly based on the actual sales tax revenues received.

  - The second largest share is the 0.25% sales and use tax that was confiscated by the State to guarantee State deficit bonds, and is backfilled with property tax revenues backfill from county property taxes each January or May per the State's "triple flip" borrowing plan. This 0.25% tax represents a projected $532 thousand in FY 2011-12.

- The third and smallest share of sales tax revenues is the 0.5% Public Safety Tax that provides revenues on the basis of the County's share of statewide taxable sales and then via a formula based on the amount of property tax lost to the previous state expropriations by ERAF. These revenues can only be used for specified public safety purposes. The City receives this sales tax monthly and represents a projected $65 thousand in FY 2011-12

The City also collects a 0.50% transaction tax on each sale transaction and is set to expire in FY 2014-15. These revenues may only be used for infrastructure projects and the revenues and expenditures are balance. These revenues are not included in this five year forecast.

- Transient Occupancy Tax (TOT) revenues projected level in FY 2012-13, then increase by 3.6% annually: The City is projected to receive about $6,500 million in TOT revenues in FY 2011-12, representing about 41% of the City's General Fund revenues. The FY 2012-13 projected actual revenues remains level to the current year's projections, then increases by 3.6% annually starting in FY 2013-14 based on the 5 year historical average rate of growth. The following table shows the TOT revenue growth for the past 10 fiscal years. Note that although the ten-year trend reflects a growth rate of 4.3%, the last 5 years only shows a 3.6% growth as there were declines in TOT revenues as recent as FY 2008-09 and FY 2009-10.

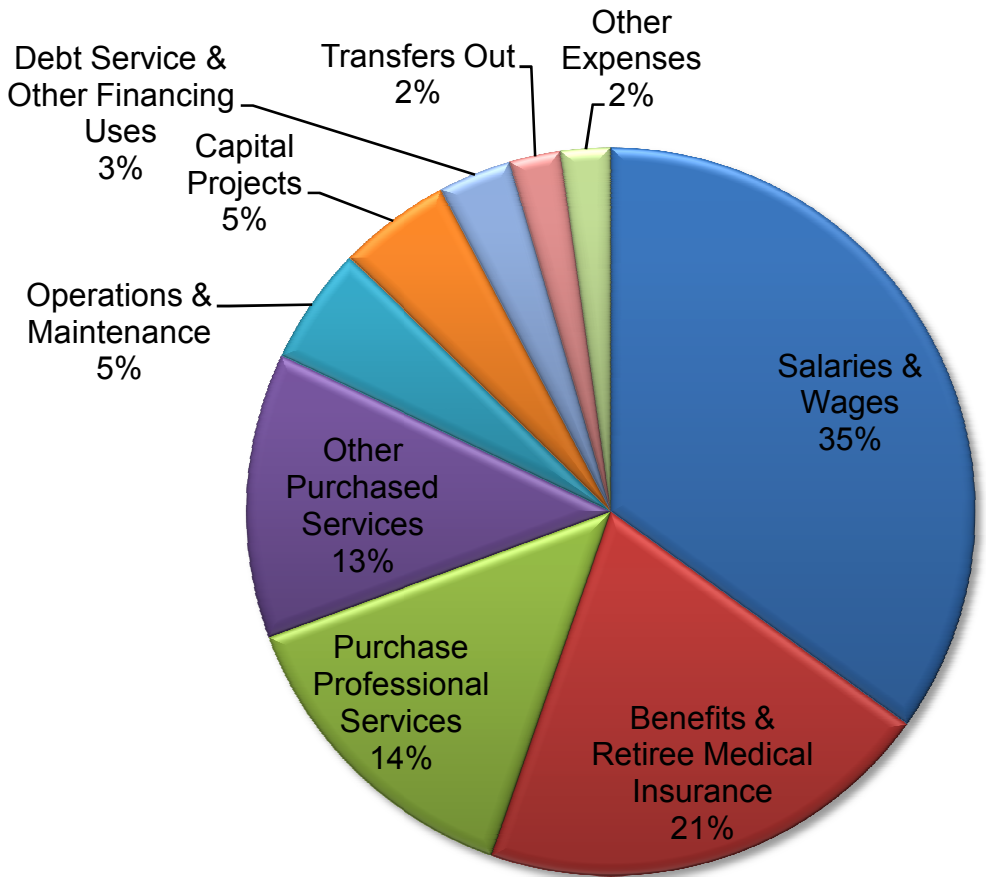


In general, TOT revenues are 10% of the rent charged by the operator for a person exercising occupancy for 30 consecutive calendar days or less, paid monthly to the City. These revenues tend to follow the California Department of Finance Leisure and Hospitality rate.

Expenditure assumptions

The expenditure projection assumes no major changes to policies, service levels, or the number of employees from the FY 2011-12 and FY 2012-13 budgeted levels, except for known one-time changes presented in the FY 2011-12 Six Month General Fund Budget Status Report or provided below. This report projects a 3.4% annual growth in expenditures after taking into account adjustments for one-time items. The following table illustrates the mix of General Fund expenditures by category for FY 2011-12. Salaries, wages, and benefits represent 56% of General Fund expenditures. Professional services and other purchased services represent 27% of General Fund expenditures. The professional services category includes the Cal Fire contract, legal services, auditor services, and other Department contracts. Other purchased services includes departmental professional service contracts, Conference & Visitors Bureau advertising and promotion costs and membership dues, California Joint Powers Insurance Authority costs, electricity, phone, garbage, travel, and training.

FY 2011-12 Projected Actual Expenditures



Expenditure projections reflect a 2.4% growth in FY 2012-13 and 2.6% in each year during FY 2013-14 through FY 2016-17, consistent with the CPI (California Department of Finance Los Angeles CPI-W for All Items), with exceptions as follows:

- Salaries & Wages: For FY 2012-13, salaries equal the Adopted Budget and known cost changes including:
  - $106 thousand savings from reorganizing the Public Works Department and deleting a position,
  - $48 thousand in savings from labor negotiated savings,
  - $33 thousand in additional costs for increasing the lifeguard pay schedule,
  - $21 thousand additional cost for no longer charging some salaries to the Redevelopment Agency since its dissolution, and
  - $7 thousand in additional costs to transfer the risk management task to the Human Resources Manager.

  Starting in FY 2013-14, salaries reflect a 4.4% growth rate from the previous year's projected actual costs based on the five year historical average rate of growth. In FY 2011-12, salaries represent 35% of General Fund expenditures, or $5,824 thousand.

- Benefits: For FY 2012-13, benefits equal the Adopted Budget and an additional $5 thousand for benefits related to the increase in lifeguard pay. Starting in FY 2013-14, benefits reflect a 5.5% growth rate based on the five year historical average, assume a projected 2% increase, or $75 thousand average annual increase, for California Public Employees Retirement System (CalPERS) miscellaneous employees (representing about 68% of General Fund budgeted salaries) and a projected 3% increase, or $80 thousand average annual increase, for CalPERS police officers (representing about 32% of General Fund budgeted salaries). Retiree Medical Insurance reflects projected Other Post Employment Benefit (OPEB) annual required contributions (June 30, 2011 GASB 45 Actuarial Valuation p. 20) In FY 2011-12, benefits and retiree medical insurance represents 21% of General Fund expenditures, or $3,400 thousand.

  The large increase in PERS costs is by far the greatest operating cost fiscal challenge facing the City at this time. This is largely due to the smaller rate of growth in PERS portfolio investment earnings as compared to the benefits that they provide. Based on the combined impact of investment losses and benefit increases, especially for sworn safety employees, employer contribution rates (as a percent of salaries) for police and miscellaneous employees are projected to increase. As mentioned above, CalPERS is already projecting rate increases beginning in FY 2013-14.

- Purchased professional services: For FY 2012-13, purchased professional services equal the Adopted Budget. Staring in FY 2013-14, these services reflect a 3.1% growth rate based on the California Department of Finance Economic Forecast for Professional & Business Services. In FY 2011-12, purchased professional services represents 14% of General Fund expenditures, or $2,347 thousand.

- CJPIA retrospective payment: The California Joint Powers Insurance Authority (CJPIA) retrospective payment of $1,229 thousand is spread into payments of $307 thousand in FY 2013-14 and $314 thousand in FY 2014-15 through FY 2016-17, which includes an estimated 2.25% fee starting. The CJPIA is the City's provider of risk management services, including insurance coverage for general liability, workers' compensation, and property insurance. The CJPIA calculates the annual net retrospective refund or additional payment due based on continued claim development for all prior years with open claims. The City's retrospective balance is currently $1,229 thousand. This is due either in full on July 1, 2013 or over two to six years with an annual fee beginning on July 1, 2014. Although the decision of how to pay this retrospective payment will ultimately be decided by the City Council, this report assumes the payment will be spread in four payments with CJPIA's preliminary estimated fee of 2.25% starting in FY 2014-15.

- Debt Service: Debt Service reflects the projected debt service schedule for the 2007 City Hall Refunding Bonds. In FY 2011-12, debt service and other financing sources represents 3% of General Fund expenditures, or $542 thousand.

- Capital Projects: Capital project expenditures reflect the projected flow of expenditures depending on the timing of various capital projects. In FY 2011-12, capital project expenditures represent 5% of General Fund expenditures, or $832 thousand.

Conclusion

- **Structural Imbalance**: There is a widening gap between projected revenues & expenditures.

- **Control Costs**: Things we can control are expenditures, where over half (56%) of all General Fund expenditures are salaries and benefits. These costs grow at a faster rate than any other expenditure even with flat staffing levels.

- **Review cost increases with long-term impact:** Any change in costs, especially permanent employee costs such additional positions or salary increases, must be considered with a long-term outlook. Permanent costs typically increase by COLA or CPI adjustments, benefit costs, or maintenance costs.

- **Efficiency measures now:** We should continue to become more efficient and also look at what other struggling cities are currently doing to reduce non-essential costs. In the next budget cycles, implement cost saving efficiency measures such as better technology to free up staff time to be more productive in other areas or reduce overtime.

Prepared by: Nadia Feeser, Administrative Services Director
Meeting Date: April 17, 2012