MARYSVILLE CITY COUNCIL **AGENDA REPORT**

MEETING DATE:	February 17, 2015	**ITEM #**	**14**
SUBJECT:	**CITY MANAGER'S MID-YEAR REPORT AND BUDGET OUTLOOK FOR FISCAL YEAR 2015-2016**		
INITIATED OR REQUESTED BY:	☒ **Staff** ☐ **Council** ☐ **Other**	**PRESENTED FOR:**	☐ **Action** ☒ **Direction** ☒ **Information**
FISCAL IMPACT:	☐ **Yes** $ ☒ **No** ☐ **Unknown** Adm Svcs Director	**BUDGET AUTHORITY:**	☐ **Yes** ☐ **No** ☒ **Not Applicable**
ORIGINATED:	Administrative Services Department	**ATTACHMENT:**	☐ **Yes** pages
PREPARED BY:	Satwant S. Takhar	**CONCUR:**	City Manager

RECOMMENDED ACTION

Staff will make a presentation and take direction. No action required.

BACKGROUND

The defeat of Measure W at the November election eliminated the best, most immediate and long-term option for meeting the City's fiscal distress and restoring improved service levels to the community. Measure W would have provided funding to restore and maintain fiscal soundness, end furlough days to once again provide 5-day office hours each week to serve the public, offset major increases in the areas of workers' compensation insurance, general liability insurance, health insurance and CalPERS retirement costs. Measure W would have provided funding to rebuild financial reserves that have declined dramatically during the recession years and would have helped manage our long-term debt obligations related to the 2011 certificates of participation ranging from $482,000 to over $625,000 annually in later years. Financial recovery and, eventually, stability will be more difficult and uncertain as a result of the loss of that sales tax measure. Already, the City has seen its issuer rating downgraded from A3 to Baa1 by Moody's Investor Service as a result of the defeat of Measure W, ensuring that the City will have to pay more to borrow funds in the future. Moody's correctly pointed to the serious weaknesses the City faces as reasons for its action—(a) an exceptionally small tax base; (b) increasing lease (bond) payments and very limited revenue raising flexibility; (c) narrowing reserves and liquidity; and (d) limited capacity for making further budgetary reductions to meet the significant pressures on the City's operations posed by escalating debt payments. These are the same considerations that your staff has repeatedly pointed to in the past, and they cannot be avoided any longer. Financial recovery is the process of recognizing, arresting and reversing a pattern of financial decline. However, recovery is not just about stopping decline. The ultimate goal of financial recovery is to use the experience of the recovery process to make the City more resilient than it was before the distress occurred.
(Continued on page 2)

LEGAL REVIEW

N/A

(Continued from page 1)

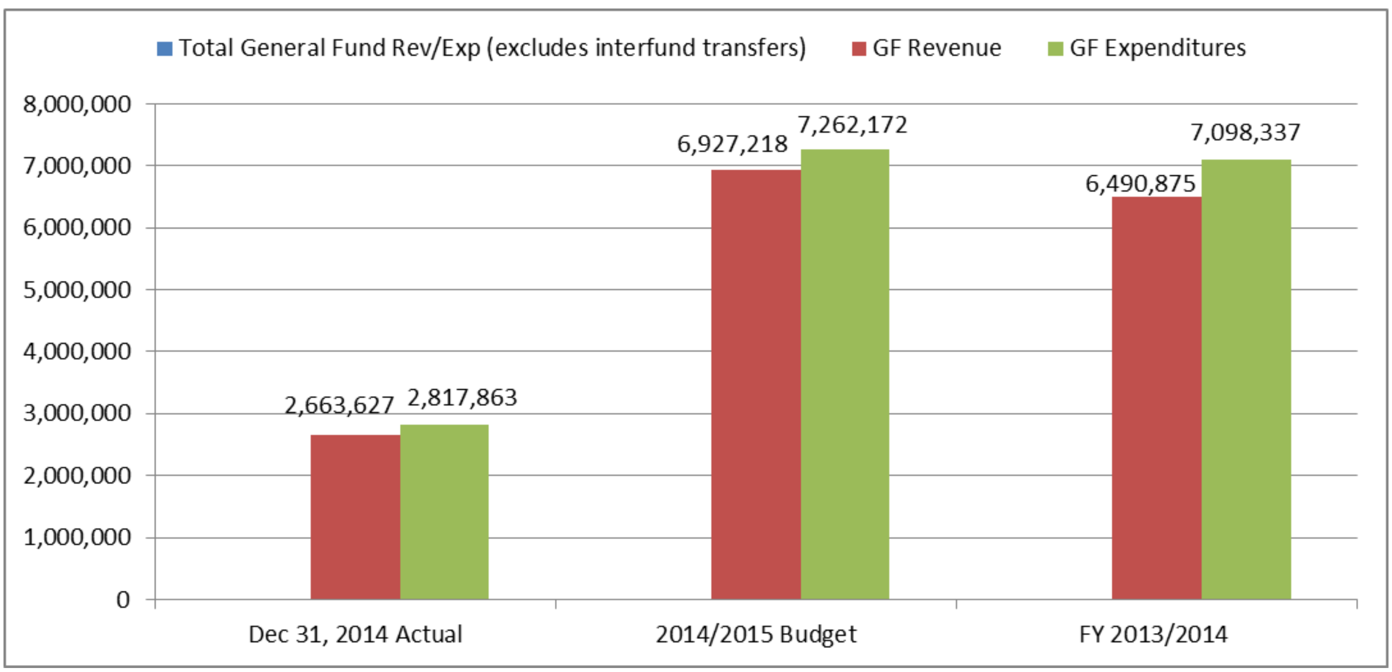
The first step in recovery is for the City Council and residents of the community recognizing that a real problem exists and gaining a thorough understanding of it—what revenues look like for the next year and the 3-5 years thereafter, where major expenditure pressures are coming from and the magnitude and nature of the overall problem. It requires an understanding of the extent to which the problem is structural versus cyclical. Will an economic recovery solve the problem or just lessen it? The City Council and City staff are leaders of the recovery process, but we must also recruit supporters into the recovery process to help others recognize the magnitude and duration of the problem and to inspire confidence in preparing fiscal first aid tactics for near-term and long-term fiscal relief. The second key element of recovery involves long-range strategies to help position the community to benefit from increased business investment opportunities, including retention/expansion of existing businesses and attraction of new ones.

The purpose of this report is to prepare the groundwork for the Fiscal Year 2015/2016 budget process by reviewing Fiscal Year 2014/2015 finances as of December 31, 2014, analyzing known increases that will significantly impact the 2015/2016 budget and looking at the most promising options to implement going forward.

ANALYSIS

Fiscal Year 2014/2015

The general fund revenue stream has been sluggish the first six months of the fiscal year, and as of December 31, 2014 actual general fund revenues received are approximately 37% of the budgeted amount ($2,663,627 actual vs. $6,927,218 budgeted). In contrast, general fund expenditures[1] appear to be outpacing revenues with approximately 39% of the budgeted amount ($2,817,863 vs. $7,262,172) spent. The graph below depicts those data, compared with the budgeted estimates for the current year, and the actual experience one year ago.



[1] Includes only the first quarter payment to CALFIRE for fire services.

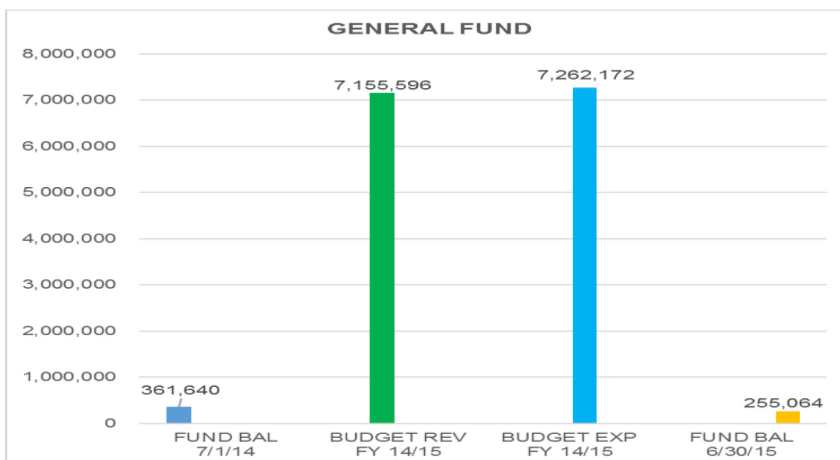
The first allocation of property taxes received in December was lower than expected due to the reassessment of property values that occurs throughout the year after the tax rolls are finalized. However, the in-lieu sales taxes were higher due to sales tax adjustments made by the State Board of Equalization; this is typical based on the timing of sales and use tax returns filed and paid by local businesses. The general sales tax increased based on improvements in certain sectors of the local economy. The overall increase over the previous period is approximately 1%, as follows:

Revenue Category	Actual July - Dec FY 2013-2014	Actual July - Dec 2014-2015	Dollar Increase/(Decrease)	Percentage Increase/Decrease
Property Tax	462,970	445,959	(17,011)	-3.7%
Property Tax In-Lieu of MVLF	404,507	405,937	1,430	0.4%
Property Tax In-Lieu of Sales Tax	243,713	258,845	15,132	6.2%
Sales Tax	531,720	548,689	16,969	3.2%
Total	**1,642,909**	**1,659,430**	**16,521**	**1.0%**

Sales tax revenues have the potential of coming in higher than budgeted in the current year because of improved sales activity overall, but any gains in sales tax revenue from the broader retail sector will be materially reduced the longer the trend of lower motor fuel prices continues. The table and accompanying pie chart on page 5 reflect that reality, continuing even into the upcoming fiscal year.

The General Fund unassigned fund balance as of June 30, 2014 was $429,535, which was $67,895 more than was anticipated at the time the FY 2014/2015 budget was adopted last summer. At the time of its adoption, the current year budget projected an ending fund balance of $255,064 as of June 30, 2015, resulting from the following estimates:

General Fund	Budget FY 2014/2015
Beginning Fund Balance	361,640
Revenue	6,927,218
Expenditures	7,262,172
Transfers In/(Out)	228,378
Ending Fund Balance	255,064

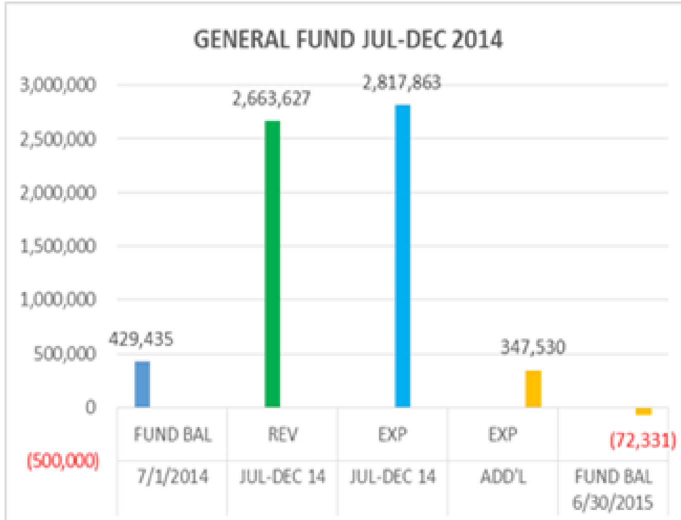


However, in the 7+ months since the start of the year, unanticipated cost increases in the areas of workers' compensation, general liability and CalPERS pension premiums have been incurred, in the following amounts:

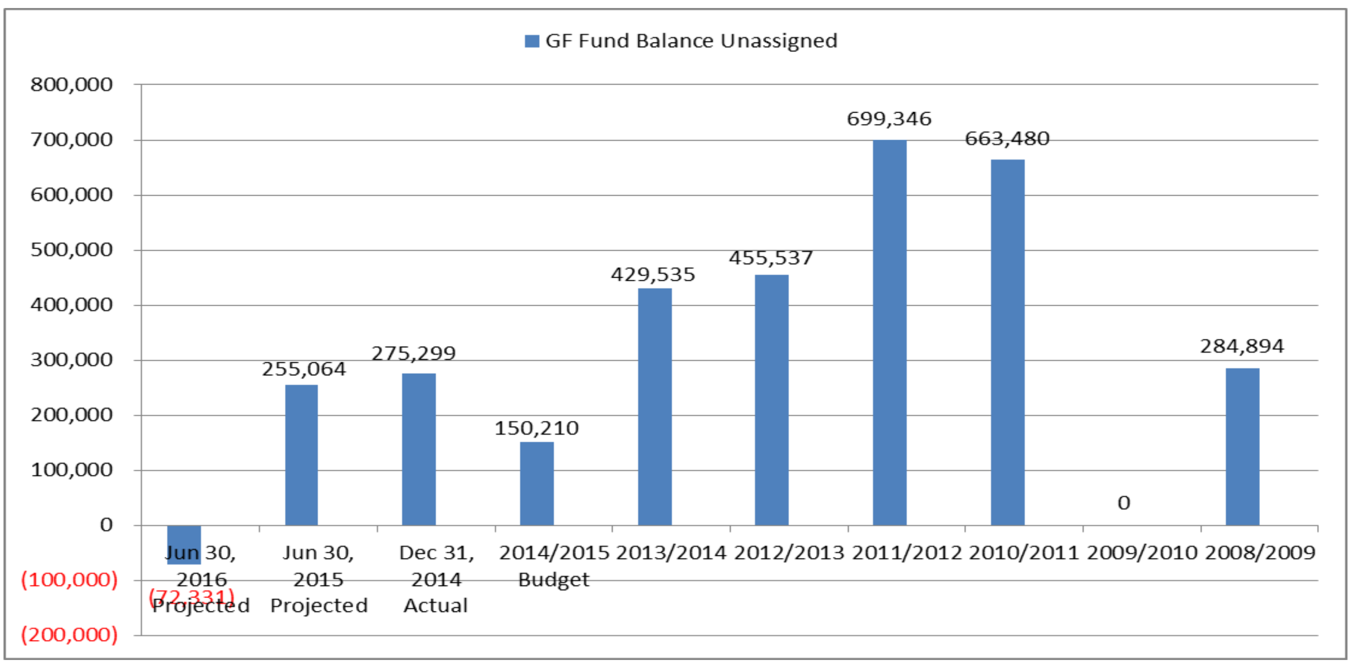
Workers' Compensation	83,000	136 % increase over previous year
General Liability	28,000	48 % increase over previous year
Calpers Pension Contributions	154,000	38% increase over previous year

These projected additional costs and unfunded liabilities of $265,000 (rounded), along with the write-off of bad debt and related allowance for doubtful accounts of approximately $82,530, further reduces the available fund balance by $347,530, an amount large enough to deplete the fund balance on hand unless current year expenditures come in lower and revenues come in higher than what has been budgeted.

General Fund	Actual July - Dec FY 2014/2015
Beginning Fund Balance	429,435
Revenue	2,663,627
Expenditures	(2,817,863)
Additional Unanticipated Expenditures	(265,000)
Write-Off Uncollectible Accounts (Bad Debt)	(82,530)
Ending Fund Balance	(72,331)



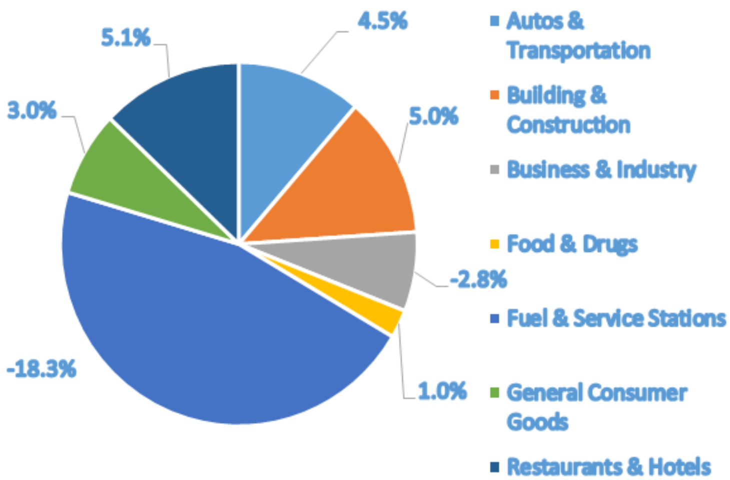
A summary of the unassigned general fund balance for the past several years shows how the fund balance has declined due to structural issues with deficit spending:



The CalPERS pension cost projections could be lowered if actual covered payroll is reduced due to vacancies and staff turnover, resulting in lower contributions to the pension plan. Similarly, an upcoming amendment to the Redflex agreement should help reduce expenditures under the contract with Redflex, but even that would only result in a revenue neutral condition where the City pays no more for the Redflex contract than the City receives in vehicle code fines from the citations issued. The best estimate of the general fund balance as of June 30, 2015 is approximately $255,064 but this is a very preliminary figure and will change according to more refined revenue/expenditure projections throughout the FY 2015/2016 budget development process.

Fiscal Year 2015/2016

Sales tax projections continue to show signs of an improving economy for Marysville, although not as fast as in urban areas around other parts of the State. Nevertheless, economic indicators point to improvement. Here are some sales tax projections for the coming fiscal year:



PROJECTED SALES TAX CHANGE	
Sales Tax Industry Group	**FY 2016**
Autos & Transportation	4.5%
Building & Construction	5.0%
Business & Industry	(2.8%)
Food & Drugs	1.0%
Fuel & Service Stations	(18.3%)
General Consumer Goods	3.0%
Restaurants & Hotels	5.1%
Total Overall	3.1%

Although the Business & Industry and Fuel & Service Stations sales projections are negative, the overall forecast for the remaining industry groups shows continued signs of modest improvement.

Offsetting these improvements are further cost increases projected for workers' compensation coverage, general casualty and liability insurance coverage, and CalPERS pension premiums for FY 2015/2016 over the FY 2014/2015 budget that will far exceed any projected revenue increases, as the following analysis shows:

Workers' Compensation Insurance Cost				
	Actual (1)	Actual (1)	Projected (2)	Projected (2)
	FY 2012-2013	FY 2013-2014	FY 2014-2015	FY 2015-2016
Premium (3)	221,885	216,705	298,221	332,678
Dividend	(95,551)	(75,557)	0	0
Assessment	0	0	34,457	34,457
Total	126,334	141,148	332,678	367,135
Projected Yearly Increase in Dollars		14,814	**191,530**	**34,457**
Projected Yearly Increase in Percentage		12%	**136%**	**10%**
Budget Appropriations			**249,825**	**249,825**
Projected Variance			**(82,853)**	**(117,310)**
Notes:	(1) Per Accounts Payable Records			
	(2) Per NCCSIF Projections			
	(3) Excludes Fire Dept			

General Liability Insurance Cost

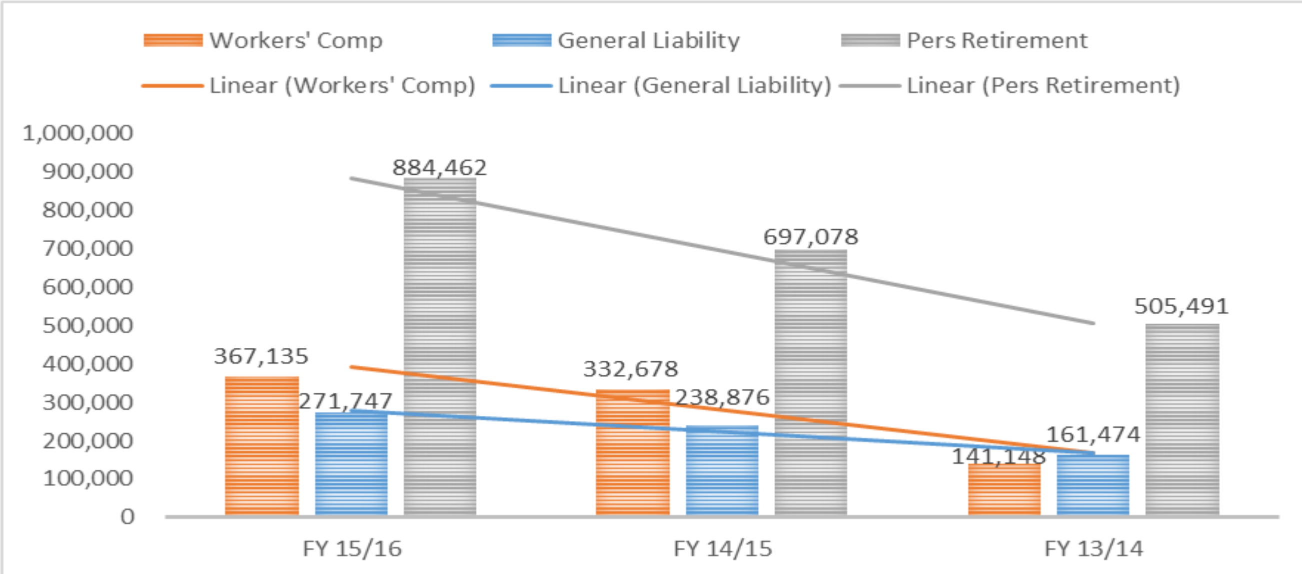
	Actual (1) FY 2012-2013	Actual (1) FY 2013-2014	Projected (2) FY 2014-2015	Projected (2) FY 2015-2016
Premium (3)	42,889	129,180	206,005	238,876
Dividend	0	0	0	0
Assessment	10,722	32,294	32,871	32,871
Total	53,611	161,474	238,876	271,747
Projected Yearly Increase in Dollars		107,863	**77,402**	**32,871**
Projected Yearly Increase in Percentage		201%	**48%**	**14%**
Budget Appropriations			**210,300**	**210,300**
Projected Variance			**(28,576)**	**(61,447)**
Notes:	(1) Per Accounts Payable Records			
	(2) Per NCCSIF Projections			
	(3) Excludes Fire Dept			

CalPERS Cost Summary

	Covered Payroll FY 2013-2014	Actual (1) FY 2013-2014 Rate	Actual (1) FY 2013-2014 Employer Cost	Projected (2) FY 2014-2015 Rate	Projected (2) FY 2014-2015 Employer Cost	Projected (2) FY 2015-2016 Rate	Projected (2) FY 2015-2016 Employer Cost
Safety Classic (3)	831,681	40.955	314,085	42.961	490,768	68.298	624,091
Safety PEPRA (3)	148,981	11.500	11,385	11.500	17,133	11.153	16,616
Misc. Tier 1	89,257	9.629	7,009	11.522	10,031	66.108	57,803
Misc. Tier 2	1,253,290	14.498	171,779	11.032	176,446	12.539	183,257
Misc. PEPRA	43,205	6.250	1,232	6.250	2,700	6.237	2,695
Total	2,366,414		505,491		697,078		884,462
Projected Yearly Increase in Dollars					**191,587**		**187,384**
Projected Yearly Increase in Percentage					**38%**		**27%**
Budget Appropriations					**543,171**		**543,171**
Projected Variance - Includes Amortization of Side Fund Costs					**(153,907)**		**(341,291)**
Notes:	(1) Per Calpers Payroll Reports						
	(2) Per Calpers Actuarial Valuation						
	(3) Safety Excludes Fire Dept						
	Police Safety Classic Pays 5% of Employer Cost - Total Rate 73.298%						
	Police Non-Sworn Classic Pays 5% of Employer Cost						

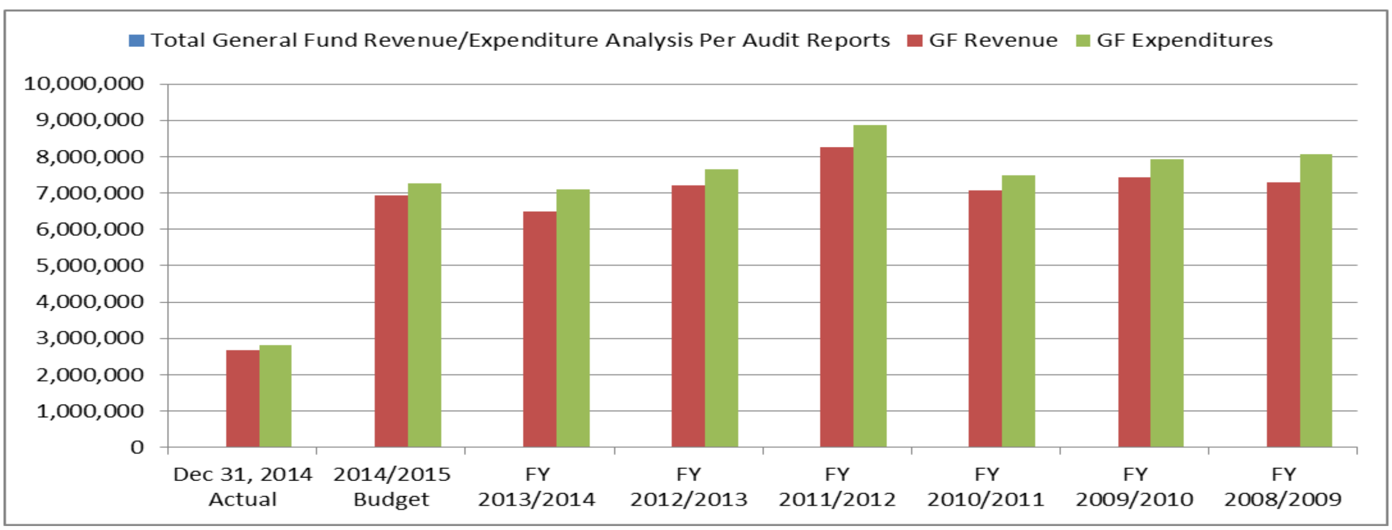
The chart at the top of the following page summarizes increases in these three program costs for the current and upcoming years, when compared with the preceding year.

These projected additional costs and unfunded liabilities of $520,000 are estimates based on available information at this time and will continue to be refined as we work through the budget process and updated information becomes available. However, as the trendlines indicate, serious efforts to address these unanticipated cost increases must be made. City staff continues working with Wuff Hansen financial consultants



on the possible CalPERS side fund refinancing to reduce the overall costs of the unfunded liability. This will depend greatly on whether we can refinance with a lower rate than the CalPERS discount rate of 7.5%. If the City is able to obtain a tax-exempt refinancing rate of 3.75%, as estimated by Wuff Hansen, this would result in a net savings to the City of approximately $199,000 over a seven year amortization period. As the chart above reveals, the projected CalPERS rates are increasing at a pace the City cannot sustain without a significant increase in revenues and/or reductions in payroll, thereby further degrading service levels.

Over the past several years, general fund expenditures have exceeded general fund revenues which has led to a near depletion of reserves on hand. If action is not taken to decrease general fund expenditures significantly along with a combination of revenue increases, the general fund reserves will most likely be depleted by December 31, 2015 and fiscal year ending June 30, 2016 will be in a negative position, even without accounting for the long-term debt obligations that will increase in the fall of 2016, further putting the general fund in a negative position.



Based on information available at this time, the comprehensive fiscal outlook for the City is not favorable unless serious steps are taken to attain fiscal solvency. We are pressed for time in making the necessary decisions and taking appropriate actions. We face an increasingly short time horizon to establish how increased debt obligations will be managed by the time they significantly increase in the fall of 2016, at the same time as we are confronted with rapidly rising pension and insurance costs.

On the positive side, there are options available to the City for developing new revenue sources and/or decreasing expenditures in order to provide fiscal first aid in the short term and some longer-term fiscal stabilization alternatives as well.

<u>Short-term action items (0-2 years)</u>:

- Develop an aggressive approach to grant funding opportunities traditionally funded by local resources. This could result in additional funds for improvement projects, pay for staff costs and take pressure off of limited local resources. These funding efforts could range from as little as a few thousand dollars on the low end to millions of dollars on the higher end. We caution, though, that most grants are competitive and cannot be relied on to drive a sustainable recovery.
- Implement a First Responder/EMT callout fee. This could generate tens of thousands of dollars or more per year to help offset public safety expenditures.
- Implement master schedule of fee updates and apply overhead rate to related fees. Unlike most of our surrounding jurisdictions, the City currently does not charge development impact fees (also known as AB1600 impact fees), thereby making the City an attractive place to conduct business for developers. In addition, the building permit and other fees for services appear to be very business friendly and could be updated and adjusted based on current practices with regards to fees charged and implementing a justifiable overhead rate as well. Depending on the number of transactions, this could result in thousands of dollars in cost recovery for the general fund.
- Renegotiate the existing contract for fire protection outside the city limits to ensure the cost of services provided are fair and equitable and not subsidized by the taxpayers of the City. The current budget estimates it costs approximately $167,300 to provide fire services to D-10/Hallwood in FY 13/14, which far exceeds the current contract amount of $105,000 paid to the City for that service.
- The current contract with the Gold Sox should be providing the City with $40,000 lease revenue annually, but as written, the agreement does not provide the City with any revenue and, in most years, actually costs the City general fund monies to help maintain the facility. Unless there is a big public benefit that can be quantified into revenue generation for the City, the current arrangement does not make sense in face of budget deficits the City is facing. All lessees and licensees of the City must be part of the fiscal recovery process. A renegotiation of the terms of the agreement will help the City realize the lease revenue payments it should receive and also provide an opportunity for the City to pursue grant funding based on the needed upgrades to the facility, which would decrease future maintenance costs. This would be a win-win situation for both the City and ball club that would result in facility upgrades, decreased maintenance costs to the ball club and increased revenue to the City.
- Plumas Lake golf course concession – review all options to determine if the current agreement or the property could be restructured to provide more benefits to the City via increased lease revenues or sales proceeds from development prospects. Current concession revenue of approximately $26,000 appears to be on the low side given the possible development prospects that could generate a greater revenue stream for the City to address much needed services and debt obligations.
- The existing Off Highway Vehicle (OHV) lease agreement, as well as all contracts for revenue generation and expenditure reduction should be reviewed for opportunities for the City to reduce expenditures and increase revenues. There is a possibility to increase revenues by $60,000 annually.
- Explore City/County/Other Public Agency partnership options for joint operations or other collaborations.

- Continue with current salary/benefit reductions commonly referred to as furlough Fridays, resulting in reduced service levels to residents.
- Explore further options for employee cost-sharing in the areas of health/dental/vision/long-term disability/life insurance. Savings to the City would vary by employee bargaining unit and are unknown at this time.
- Eliminate annual leave payout which would result in a cash savings of approximately $125,000 - $150,000 annually, but would constitute a growing balance sheet liability for future payment.
- Centralize purchasing of all goods/services in order to obtain lower costs for bulk purchases of services/supplies (i.e., piggyback on other public agency contracts for office supplies, chemicals, fuel, etc.). Potential savings of thousands of dollars a year based upon bulk purchasing contracts for items like office supplies, parts, etc., would be greater for items such as fuel, vehicle repairs, etc.
- Implement new financial software system capable of providing on-line/real-time financial information for the City's finances to better manage the financial capabilities of the City to adjust to outside factors that impact the revenues/expenditures of the City and affect the levels of services residents expect. The City must invest in its software system that tracks all revenues, expenditures, assets, liabilities, etc. in order to ensure there is a clear indication of available resources on a real-time basis. Staff will explore a system capable of providing the fiscal/financial tracking capabilities the City requires to meet current and future needs.
- Develop fair-share charges for professional engineering/accounting/administrative services provided to outside agencies (LAFCO, Levee Commission, etc.) which are currently absorbed by the City at no cost (it is common practice for public agencies to support the functions of other public agencies but are typically reimbursed for such services). Potential revenue of $15,000-$30,000 annually dependent on level of professional services requested or provided.
- Begin implementation of the Bounce Back economic development plan, streamlining the planning process in order for development projects to obtain entitlement approvals quickly and responsibly by updating the zoning code and development review/permitting processes. Re-invigorating a community is serious business and requires a serious, long-term commitment. The intended result will be future job creation, property and sales tax generation and continued success of new and existing businesses. Fiscal impact is positive but cannot be quantified at this time.

<u>Long-term exploration items (2-10 years)</u>

- Implement community facilities district (CFD) for police, fire, parks, street lighting operations. This would help offset general fund operational costs in future years and help rebuild the long-term financial stability of the City's General Fund.
- Implement park/landscaping special assessment for specific areas of the community, such as E Street improvements. This would help to upgrade and maintain the visual character of the corridor area and allow for the programming of gas tax revenues to much needed street rehabilitation projects in other areas of the City.
- Continue with Recology Franchise Fee increases beyond 2015 by adjustments of +2% in each of the next three years to bring the total franchise fee to 10% in 2018.
- Implementation of the Bounce Back economic development plan – streamlining the planning process in order for development projects to obtain entitlement approvals in a quick and responsible manner by updating the zoning code and permitting processes. Future job creation, property and sales tax generation and continued success of new and existing businesses. Fiscal impact is positive, but cannot be quantified at this time.

The actions described above are not all-inclusive/exclusive, but represent a starting point for discussions that will culminate in the Fiscal Year 2016 Budget next June. There must be a solution for fiscal recovery that is both short-term (0-2 years) and long-term (2-10 years) that accomplishes the sustained fiscal stability the City needs in order to provide essential services to the residents of the community, especially in the areas of public safety and city services, without at the same time compromising civic amenities like our park system and Ellis Lake, among others.

Long-Term Strategies for Building Tax Base

The City's immediate and near-term fiscal issues must be resolved at the earliest possible time in order to avoid either a default on debt obligations or an unacceptable further erosion of municipal services to the community. But without also pursuing a serious strategy for reinvigorating our local economy, the budgetary distress of the past few years will become a permanent and recurring feature of Marysville City government. The only way to avoid that is to relentlessly and intelligently pursue the encouragement of investment opportunities throughout the community. We do that by ensuring that we align our land-use planning and regulatory requirements with contemporary market preferences in concert with the soon-to-be released Bounce Back Plan.

But even before Bounce Back is released and its various implementation steps can be enacted, there are a number of important steps we can take to encourage investment and business expansion in the City. City Administration is proposing three highly significant actions for immediate consideration, primarily affecting the area west of Highway 70 from E Street to J Street and 1st Street to approximately 6th Street within the Medical Arts District:

1. Remove all existing land-use restrictions, effectively suspending zoning requirements in the defined area (shown on the map on the following page). This would eliminate all use permit requirements for uses which currently have such requirements. Residential requires only a minor use permit, and all other uses would be allowed by right. The intent here is to let the market, rather than the government, decide what the highest and best use of property is going to be in the 20± blocks surrounding the Rideout Regional Health Center. This will not only free property owners of any land-use limitations imposed on them, but should drive up property values in the process.
2. Remove all design review requirements for buildings and signs within that area, and introduce instead a suggested form-based code to encourage aesthetic continuity of new construction and repurposed existing buildings.
3. Eliminate on-site parking requirements for new uses of all existing buildings. New construction would still be required to provide on-site parking, or pay an equivalent in-lieu fee to permit the City to provide parking facilities somewhere within the boundaries of the target area.

Similar development incentives may also be appropriate in the mixed industrial/commercial area east of A Street from approximately 8th Street on the south to 14th Street on the north (see second map following the Medical Arts District map on the next page).

If the Council concurs with these important new business-development steps, the precise revisions to the Marysville Municipal Code to implement this policy will be returned at a later date for debate and adoption. But some foundation background is important to understanding the recommended steps. In arriving at these recommended steps, staff considered three broad regulatory categories that affect development: (a) building code regulations, (b) California Environmental Quality Act (CEQA) requirements, and (c) our own local planning regulations (zoning, signage and design review).

Building Code regulations are part of state law (California Code of Regulations, Title 24) and typically cover life-safety issues. As such, the City is unable to waive portions of the California Building Code (CBC) without incurring

MAP

MAP

the liability of reducing public safety provisions. Moreover, because the CBC is universal throughout the state, its requirements in Marysville are the same as they are anywhere else.

California Environmental Quality Act applies to all discretionary approvals or decisions regarding projects, and requires that, prior to these approvals being given, the project must be reviewed for compliance with the Act. Often, building maintenance, minor projects and smaller infill development come under one of the available exemptions to CEQA. Other projects must go through a process that includes, in successive steps, an Initial Study, a Negative Declaration or Mitigated Negative Declaration (i.e., a statement that the project will have no significant impact or, at least, no impact that cannot be mitigated easily), or finally, an Environmental Impact Report (EIR).[2] The text box at right show which situations trigger the mandatory CEQA review. One of the areas of potentially significant impact is in connection with historically significant resources. In Marysville, any building older than 50 years is considered historic, but not necessarily historically significant. If a building is listed on the National Historic Register or our local historic inventory or on the state inventory, it is presumed to be significant, and modifications to that structure trigger the more extensive CEQA review.

Description	CEQA Required?
Building permit	No
Zoning compliance	No
Design review	Yes
Use permit and variance	Yes

Zoning regulations include land-use regulations; physical regulations such as set-backs, lot coverage, parking, building height and others; signs and design review. At present, the exteriors of all buildings, including signs, are subject to design review. This is both unnecessary and contrary to the intent that only specifically identified, worthy structures within the Historic Preservation Overlay District would be subject to such review. It is important to understand that the design review process is often the single approval step that triggers the additional requirement for a CEQA review.

One other issue that occasionally arises is the requirement for on-site parking for an existing building, where a new use proposed for the building increases the number of occupants and, therefore, the parking demand created by that new use. Where there is not sufficient space on the building site to accommodate the required additional parking, the developer often seeks a variance to the parking requirement of the Zoning Code. For many of the existing buildings within the Medical Arts District, there is no available area on the property for additional parking. This poses an impediment to increased development, and is the reason for the proposed policy amendment for a blanket waiver of parking requirements for existing buildings. In practice, no responsible developer would invest large sums of money in a project without providing for adequate parking on his own, even without zoning requirements, to ensure that his customers can find convenient parking near by. The success of his business depends on his customers being able to get to his business in the first place.

[2] Two recent projects that required a full EIR were the Rideout Hospital expansion and the Washington Square retail commercial project.