City of Culver City, California

City Council Agenda Item Report

Meeting Date: 03/09/09	Item Number: PH-1
AGENDA ITEM: Discussion of an Update to the Comprehensive Financial Plan and Direction to Staff as Deemed Appropriate.	
Contact Person/Dept.: Jeff Muir, Chief Financial Officer	Phone Number: 310-253-5865
Fiscal Impact: Yes [X] No []	General Fund: Yes [X] No []
Public Hearing: [X] Action Item: []	Attachments: [X]
Public Notification: Master E-Mail Notification List (03/04/09); Culver City Employees Association, Culver City Management Group, Culver City Fire Management Group, Culver City Firefighters Local 1927, AFL-CIO, Culver City Police Officers Association, and Culver City Police Management Group on 03/05/09; Mail notice through USPS to Culver City Homeowners Associations, and Culver City Civic Organizations on 03/05/09..	
Department Approval: Jeff Muir (03/03/09)	City Attorney Approval: Carol Schwab (by H. Baker) (03/03/09)
Chief Financial Officer Approval: Jeff Muir (03/03/09)	City Manager Approval: Jerry B. Fulwood (03/05/09)

RECOMMENDATION:

Staff recommends the City Council receive an update of the Comprehensive Financial Plan (Plan), discuss the CFP, and direct staff as deemed appropriate.

BACKGROUND:

The Updated Plan being presented to the City Council tonight includes a fifteen-year forecast of revenues and expenditures. The projections are based on updated assumptions and new events that have occurred since the Plan was previously presented in January 2008. The Plan continues to show the trend of recurring expenditures out-pacing recurring revenues, as was presented in the last Plan. The current economic realities have only moved this problem closer and made the gap larger. The intent of the Plan is to provide a management tool that identifies short-and long-term financial issues. Based on the information provided in the Plan, financing options and funding strategies can be developed for City Council's consideration and possible implementation. The Plan is intended to serve as a working document and will be updated at least annually or more frequently as needed. This updated Plan utilizes some of the historical research originally done in preparation of the Plans presented to Council in 2007 and 2008. This data was combined with updated financial information from the Fiscal 2008-09 and Fiscal 2009-10 budget process, and mid-year adjusted financial information as of December 31, 2008.

The Plan was first introduced and presented to City Council on March 5, 2007. At that meeting, City Council directed staff to gather additional information on a number of the revenue enhancement options presented in the report. On June 18, 2007 staff presented the additional information to Council as requested. Due to the urgency of the issue, the City Council directed staff to pursue the option of modernizing the City's Utility User's Tax Ordinance to seek voters' support for maintaining and preserving the City's current UUT. In April 2008, Culver City voters overwhelming supported modernizing the City's UUT ordinance.

The City Council also directed staff to return with more information on the issues identified in the Plan that were faced by the Fire Department. In December 2007, the City Council was given a report addressing the current Fire Service level issue. The issue had re-surfaced as a result of the bankruptcy filing of Brotman Hospital which materialized after the Council had considered revenue enhancing options on June 18, 2007. At that time, the City Council directed staff to seek consulting services to investigate forming a Special Financing District to potentially fund a third paramedic rescue unit. A contract was awarded in January 2008, just as the economy began to contract. Staff did some preliminary analysis with the consultant, however, it was decided that, due to mitigating economic factors, it would be in the City's best interest to put formation of a Special Financing District on hold in favor of a more comprehensive solution to addressing the City's financial challenges, including cost recovery and recouping revenue. Since then, the economy has continued to contract, making a comprehensive approach even more imperative.

DISCUSSION:

The updated Plan being presented tonight includes adjusted budget information incorporating City Council approved actions for fiscal 2008-09 and detailed revenue and expenditure projections through fiscal 2023-24. It is important to note that forecasting five years is difficult in and of itself, and projections beyond that are staff's best estimate based on current and historical trends. This information was derived from historical trends for both revenues, which has been adjusted based on current economic trends, and expenditures, including remaining MOU negotiated items. The City has been able to balance revenues with expenditures over the last few years due to higher than anticipated ongoing revenues and some one-time revenues (including new development activity and land sale proceeds). Based on current information, the City will show a slight operational deficit in fiscal 2008-09, and is estimated to face an approximate $4 million deficit in fiscal 2009-10, which grows into the future.

The City has been diligent in ensuring that one-time revenues are only used to fund one-time expenditures. Due to the slowdown of development activity this fiscal year, it is doubtful the City will meet its one-time revenue projections, and steps should be developed to reduce or stop the purchases of one-time items, such as departmental supplies, unless an exception is authorized by the City Manager. It is also clear the underlying fundamental issue of recurring expenditures outpacing recurring revenues has not been solved and is a major issue facing the City. Lower than anticipated revenues in fiscal 2009-10 contribute to the gap next year, but even if the revenues were to grow at historical rates, expenditures would still outpace revenues. This projected deficit will continue to grow unless direct and decisive action is taken.

Preliminary figures show the General Fund Reserve as having a healthy balance through the remainder of Fiscal 2008-09. However, it is important to realize that a good portion of the reserve is a result of one-time revenue receipts (such as proceeds from new development activity), which have accumulated over time. This has enabled additional funding to be approved by City Council for significant capital improvement (one-time) projects, such as Fire Station #3 ($1,527,000) and the Public Safety Records Management System ($1,622,098), which otherwise might not have been funded.

Moving Forward

The City has been making positive progress through discussion and/or approved action on certain options and recommendations previously approved by City Council. These include:

- Placement of a measure on the April 2008 ballot that asked Culver City voters to approve modernizing the City's Utility User's Tax Ordinance, which passed overwhelmingly. The UUT currently generates revenue of approximately $14.5 million a year.
- Creation of a team of staff, including members of all six of the City's bargaining units, to evaluate the feasibility of various options for healthcare cost containment including researching various healthcare providers (in process and meeting with bargaining groups).
- Continuation of implementation of Best Management Practices throughout City Departments.

Current Economic Issues Facing the City

As with information presented in previous reports, the economy has been a major factor with regards to the City's financial issues. Culver City has not yet seen the slowdown in Property Tax revenues other cities and counties are experiencing, and if they are to be seen, they most likely will not occur until fiscal 2010-11. Projections included in the fifteen-year projections do include a slowdown in this tax category, though, over the next couple of years. Real Property Transfer Tax has also experienced a slowdown, especially due to a slowdown in turnover in the commercial real estate market. This category also anticipates low growth over the next couple of years.

For Culver City, sales tax is the major revenue issue facing the General Fund in the upcoming couple of fiscal years. On average, sales tax is over 20% of the General Fund. Over the past eighteen months, the drop in sales tax revenues has been significant, and fiscal 2009-10 will continue this trend. Not all of the decline is attributed to the lower than normal retail sales, but also to the loss of some major sales tax generators in the City, which include Albertson Oldsmobile, Karl Storz Endoscopy, Circuit City, and Hooman Automotive Group. Along with sales tax, these business losses contribute to a loss of business tax and utility tax revenue also.

Base sales tax revenues, as reported in the mid-year report, were adjusted down by approximately $1 million given actual receipts received through December 31, 2008. Given this information, along with the prior and new business closings, projections for fiscal year 2009-10 show an additional reduction in sales tax receipts. Westfield Shopping Mall should be completed in October 2009, and even with this completion and new Target, it will not be enough to raise sales tax estimates for the coming fiscal year.

The uncertainty of the State Budget has created concern, although with the approval of a Spending Plan and Budget in February, city and county general revenues were basically not touched. Schools and Transportation took the biggest hits, along with Redevelopment Agencies that also had funding taken from them this year. The State's Plan does rely on voter approval of some items in order for it to be completely fulfilled, and this will be known after the May 19, 2009 special election.

Staff continues to monitor state budget issues, and will keep City Council and Executive Management informed of any new information.

<u>Future (Long-term) Issues Facing the City</u>

In November 2007, the City Council approved a professional services contract with Aon Consulting to conduct an actuarial study to determine the City's outstanding unfunded OPEB retiree liability with regards to Governmental Accounting Standards Board (GASB) Statement No. 45 reporting. The primary purpose of this study was to determine the long-term costs of the City's medical insurance for retirees. The report was provided to the City and presented to the Budget & Finance Subcommittee. A presentation was given to the full City Council in May 2008. The report analyzed the cost to provide the benefits currently offered over the next thirty years, based on current active and retired employees, and using actuarial assumptions and trends.

As a start, the City Council approved setting aside $100,000 in the fiscal 2007-08 budget towards this unfunded liability until a study could be formally conducted. It should be noted that the approved $100,000 is only a mere fraction of the amount to fully fund the expected actuary-recommended contribution. The City currently funds this benefit on a pay-as-you-go basis, and the actual amount expended for Fiscal Year 2007-08 was $3.51 million. The report shows that this cost will continuously rise at a fairly significant rate, doubling from the current amount by 2017 and reaching almost $14 million per year at the end of the thirty years. If the City wanted to pre-fund this benefit today, it will need to invest $105 million with a 7.75% rate-of-return (similar to what CalPERS assumes for their portfolio), or $208 million if it earned 4% (the approximate earnings rate for the City's investment portfolio). If the City chooses to fund the benefit pursuant to GASB 45 over the thirty years, and deposits funds annually into an irrevocable trust fund, it will require $7.4 million annually in a trust earning 7.75% (lower earnings would require a higher amount). This means basically doubling the current amount the City pays.

While there is not a legal requirement to fund this amount, the problem is that in about ten years this is the amount the City will need to fund on a pay-as-you-go basis, and it will only go up from there. Additionally, the City will be required to report the difference between the Actuarially Required Contribution and what it actually funds beginning with the 2008-09 audited financial statements, which could affect the City's future credit rating and cost of borrowing.

Sufficient funding for deferred maintenance continues to be a struggle for many cities, including Culver City. For the past few fiscal years, the City Council was able to appropriate funding from the General Fund Fund Balance for one-time capital improvement projects, but a long-term plan to fund outstanding deferred maintenance continues to be in process. Two infrastructure studies were conducted last year (i.e. Facility Maintenance study and Park Facility Maintenance study) that identified how much the City will need to set-aside each year to enable it to meet future facility maintenance needs. It identified funding needs for routine maintenance, immediate repair needs, and an annual reserve cost to amortize large costs (i.e. roof replacement) over a number of years. By utilizing data from this study, funds were appropriated in the fiscal 2007-08 and 2008-09 Capital Improvement Budgets in the I & A Fund for some immediate repairs using available fund balance from the General Fund reserve. This study will again be used as a planning tool for the upcoming budget review.

<u>General Fund Scenarios in Updated Plan</u>

There are five financial scenarios included in the Plan for the General Fund. Four are scenarios showing potential forecasts based on different projections, and one (Scenario 5) is for illustrative purposes only. The scenarios are as follows:

Scenario 1 Summary

This scenario displays what staff believes to be the most realistic financial projection. It uses the adjusted budget information as of December 31, 2008, which includes all adjustments that have been made since July 1, 2008, including encumbrance carryovers, as the base information for fiscal 2008-09. Added to fiscal 2008-09 is the reduction of $1 million for the potential loss of the entire investment amount of the Lehman Brothers bond due to their bankruptcy in August 2008; potential savings from the "pull-back" measures implemented by the City Manager in October; and mid-year adjustments discussed in the mid-year report that include reductions in Sales Tax, Property Tax, and State VLF Fee.

Fiscal 2009-10 takes into account the continued downturn in the economy that is forecast to remain in place through the remainder of calendar 2009, and into the beginning of calendar 2010. Given information received in October and November from CalPERS, there is a very real possibility the City will see large increases in its retirement rates beginning in fiscal 2011-12. This projected increase has been included for all funds with personnel related costs, and is also included in all other scenarios. For the General Fund the estimated annual increase begins with an estimated $1.3 million hit in fiscal 2011-12.

It is important to note this Scenario does not include any funding towards the City's OPEB related funding needs, which amount to approximately $7 million annually for the General Fund.

The General Fund reserve remains above the 30% policy threshold through fiscal 2009-10 at approximately 34.5%, but fiscal 2010-11 sees it drop drastically to 27.0%. It continues to drop until it becomes negative in fiscal 2014-15. It is a goal of the City to maintain a general operating reserve of, at a minimum, 25% of projected General Fund operating expenditures for each fiscal year and an additional 5% emergency situations (excluding debt service, fund transfers, and encumbered funds). If the reserve were ever to fall below the 30% threshold, the City must implement measures to restore the reserve per City Council policy.

Scenario 2 Summary

Scenario 2 includes all information from Scenario 1, and adds one additional issue: the gradual annual funding set-aside for future related funding liability related to OPEB. The current study conducted by our consultants, AON, revealed the City had an unfunded liability of approximately $200 million related to retirement health benefits. Currently the City is on a pay-as-you-go basis for retiree health benefits, but sets nothing aside for future retiree medical liability. The identified amount that should be set-aside, above and beyond the pay-as-you-go amount, on an annual basis is $7 million. Scenario 2 shows the gradual set-aside starting at $1 million in 2009-10, $2 million in 2010-11, 4$ in 2011-12, $6 million in 2012-13, and then the full $7 million from fiscal 2013-14 forward.

The General Fund reserve percentage would be 33.4% in Fiscal 2009-10 with this additional set-aside, 23.6% in fiscal 2010-11, and 11.1% in fiscal 2011-12. Fiscal 2012-13 shows the General Fund going into negative territory.

Scenario 3 Summary

Scenario 3 includes the base information from prior scenarios for fiscal 2008-09. Beginning in fiscal 2009-10 it leaves revenues the same, increases the Excess Appropriation limit up to 96.5% and adds back the 3% CPI increase to operating and maintenance expenditures. These two adjustments, which were removed during the budget process last year for the approved fiscal 2009-10 budget, add back approximately $1 million to the overall expenditure amount. With this adjustment, the General Fund reserve percentage gets dangerously close to the required 30% threshold. The OPEB set-aside amount is also contained in this scenario.

Scenario 4 Summary

Scenario 4 includes various potential budget reduction options that could be used to help the City balance the budget over the next several fiscal years. Most of the items are one-time, short-term items that are meant to bridge the gap until fiscal 2011-12 when it is hoped the general economic conditions, not only locally but throughout the state, nation and world, will have improved. If no new revenue sources are introduced by fiscal 2011-12, the need for layoffs will be nearly certain.

Scenario 5 Summary

Scenario 5 is for illustrative purposes to show where the City's finances would stand if it budgeted at 100% of appropriations. It is clear the City has a ways to go before it will be able to cover the 100% of its budgeted recurring appropriations with budgeted recurring revenues.

OTHER FUND INFORMATION

Enterprise Funds-

Refuse Fund - Many of the same economic pressures constraining the General Fund are also impacting the Refuse Fund. Escalating personnel costs, fluctuating fuel prices, and the limited availability of raw materials, which has greatly increased the price of steel, are a few of the major issues placing pressure on the fund. This increase in steel has made new bins, replacement parts for older vehicles, and the purchase of new vehicles more expensive.

Local landfill capacity will be depleted over the next twenty years. As a result, disposal costs will increase dramatically in the future as the transition from local landfills to rail haul disposal to more distant locations occurs. The refuse fund expenditure projections take into account these projected disposal costs increases. In order to restore the financial health of the Refuse Fund, commercial and residential waste removal fees will need to be increased over the next few years. The revenue projections assume that there will be no increase in fiscal 2009-10, and an increase of approximately 4% per year for the next two fiscal years after that. If these revenue increases are realized and current expenditures stay within the anticipated growth forecast, then the Refuse Fund should continue to have a positive fund balance from 2009-10 on.

Transit Fund - The Transit Fund is also facing similar fiscal issues as the General Fund. Due to the ever-changing variables associated with these issues, it is difficult to realistically foresee more than two or three years into the future for certain funding sources, and even less in some cases. As was mentioned previously, the Transit Fund currently has a healthy reserve and would be able to stave off any unforeseen expenses that may occur in the very near future. It is clear, though, that beginning in fiscal 2010-11 a gap occurs between revenues and expenditures and needs to be addressed. Transit funding is one of the more volatile financing sources because it relies mainly on funding sources from other agencies, such as the federal and state government. Given the current events of the past year or two with funding being shifted or taken away, it is near impossible to predict what funds will still be available in future years. New revenue sources, fare increases, and service cuts will likely be considered in order to help the expenditures to meet revenues.

Sewer Fund – The Public Works Department is gearing up to do a full Sewer Capital Improvement Study in the coming months. Current analysis shows the Sewer Fund to be in good shape. There was no increase in sewer operating charge rates for fiscal 2008-09, and projections in the forecast do show slight increases beginning in fiscal 2010-11 to cover operating & maintenance cost increases. Further information will be presented on the Sewer Fund during the budget process when the capital project study is finalized.

Other Funds – Other City funds are operating well, and further information will be discussed during the upcoming budget process.

FISCAL ANALYSIS:

Included as an Appendix to the Comprehensive Financial Plan is a Long-Term Financial Options Summary report (Attachment 2). This report is a compilation of a number of revenue enhancement and cost reduction ideas that have been collected over the last few years from staff research and input from the bargaining units, City Council subcommittees, and various staff task forces and subcommittees that have been convened to discuss financial matters. There is a brief discussion for each option that provides a basic description of the option, the potential fiscal impact, and the process for implementing the option, if applicable. At the end of the report, there are also a few short-term cost reduction options identified by the Culver City Management Group (CCMG). The Chief Financial Officer would like to thank CCMG for providing some ideas in response to a request sent to all the bargaining groups in November 2008.

While implementing at least some of the options provided in the Financial Options Summary is imperative to the long term financial health of the City, the impact of implementing those options would not be realized for at least one year or more in most cases. Additionally, even though the long term impact of most of the options contained in that summary report are significant, the initial short term impact is relatively minor.

The City has a fundamental problem in that its ongoing revenues are not sufficient to support its ongoing costs based on current service levels, and required staffing. Even if and when the economy improves, the City still shows a structural deficit. While there are certainly some short-term solutions the City can implement to get through the next year, the City is at a crossroads where some difficult decisions must be made.

At this juncture, the City must focus on surviving in the short term without losing sight of the long term goals. Tough short term decisions must be made while, concurrently, strategies to address long term needs are developed. Staff will continue to work with the City Council Budget & Finance Subcommittee to develop the long term strategy and with the City Manager's Office to tackle the short term difficulties. Staff requests that the City Council carefully review the Long Term Financial Options Summary that is included as an Appendix to the Plan (beginning on page 129) and provide feedback to the CFO or colleagues on the Budget & Finance Subcommittee as soon as possible so that the process of developing a long-term strategy can begin. Many of these options will require substantial staff effort, and therefore it is important to have input on those items the City Council is supportive of.

There is no direct additional fiscal impact associated with the presentation of this staff report. If the City Council directs staff to bring back information related to options for revenue enhancements or cost reduction recommendations, there may be an associated fiscal impact at that time.

ATTACHMENTS:

1. Updated Comprehensive Financial Plan

MOTION:

That the City Council:

1. Receive and file the Updated Comprehensive Financial Master Plan; and
2. Direct staff as deemed appropriate.