City of Culver City, California

City Council Agenda Item Report

Meeting Date: 12/22/08	Item Number: A-1
AGENDA ITEM: Receive and File Financial Update Report from the Chief Financial Officer.	
Contact Person/Dept.: Jeff Muir, CFO	Phone Number: 310.253.6016
Fiscal Impact: Yes [X] No []	General Fund: Yes [X] No []
Public Hearing: [] Action Item: [X]	Attachments: []
Public Notification: Master E-Mail Notification List (12/17/08);	
Department Approval: Jeff Muir (12/15/08)	City Attorney Approval: Carol Schwab (by H. Baker) (12/16/08)
Fiscal Impact Review: Jeff Muir (12/15/08)	City Manager Approval: Jerry B. Fulwood (12/17/08)

RECOMMENDATION:

Staff recommends the City Council receive and file a Financial Update Report from the Chief Financial Officer related to current economic and financial conditions of the City.

BACKGROUND:

The current economic situation faced by local governments across California is starting to be felt more widely now as more and more businesses file for bankruptcy; the unemployment rate continues to climb; credit markets continue to fail; retail sales fall; and consumer confidence is down. Culver City is not immune from this situation, and has been able to weather the economic downturn rather well to date; but the upcoming months and the next several fiscal years will be a challenge for staff, the City Council and Culver City residents. Fortunately, Culver City is in better position to weather this economic downturn than many other cities. The following steps are currently being taken:

Fiscal ‘Pullback’ Measures

On October 13, 2008, the Chief Financial Officer gave a presentation to the City Council on the City’s economic and financial condition. At that time, it was stated the City needed to continue taking proactive steps to prepare it for continuing economic difficulties. The City Manager sent out a memo entitled “Fiscal ‘Pullback’ Measures” on October 22, 2008, with the following immediate steps to be taken:

- Implementation of an immediate hiring freeze, excluding Public Safety positions. All vacant positions will be reviewed on a case-by-case basis with the City Manager.
- Cessation of overtime, excluding Public Safety or emergency situations. All exceptions to be reviewed and approved by the City Manager.
- All Departments shall achieve a 25% budgetary savings in Training & Education, Conferences & Conventions, and Special Events & Meetings line items during the current fiscal year. Any exceptions must be discussed with and approved by the City Manager.
- Assessment of current usage of part-time and contract employees.
- Assessment of current usage of consultants.
- Review opportunities for increased efficiency in procurement and contracting.

Early indicators show that current vacancies are assisting the General Fund, and other affected funds, to maintain a relatively lower than anticipated expenditure percentage through the first four months of the fiscal year. Overtime is also showing a reduction since the "pullback" measures were implemented. Reports are in process for the assessment of current usage of consultants and part-time and contract employees. The results of these reports will be included in the mid-year review (currently scheduled for February 9, 2009). The 25% budgetary savings target is being tracked and departments will be notified if their numbers near the threshold.

Staff had initially anticipated bringing back an updated Comprehensive Financial Plan (CFP) in November with the results of the first quarter budget review. After thorough consideration of several factors, it was decided to wait and present the full CFP with the final Year-End 2007-08 Review with audited figures and Mid-Year Budget Review when more data on **actual revenues and expenditures** for fiscal 2008-09 would be available for analysis.

A first quarter budget review report was completed in October. Due to the lag in timing for receiving revenues[1], a significant downturn in revenues through September 2008 was not apparent. Although the economy has been slowing and contracting slightly since December 2007[2], the unprecedented economic volatility being experienced on a local, state, national, and international scale did not begin until the end of the first quarter (i.e. September) of fiscal 2008-09. Therefore, the second quarter of fiscal 2008-09 will have much more telling data as to how the economic conditions have changed, and how they are affecting Culver City.

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[1] Example: Actual sales taxes lag a full quarter, meaning revenues received in December are for the quarter ending September 30th

[2] The National Bureau of Economic Research, the organization charged with identifying the start and end to business cycles, declared that the U.S. entered a recessionary period beginning in December 2007.

State Update

The State has also gone through a much deeper fiscal struggle the last couple of months after its 85-day-late adoption of its fiscal 2008-09 budget. Just six weeks after adoption, the state was reporting an $11.2 billion dollar shortfall in fiscal 2008-09 that has now grown to $14.8 billion. It is also estimated that through the end of fiscal 2009-10 the state will be facing a deficit in excess of $40 billion. At this time there is still no word if the state will be taking any funds from cities, and staff remains diligent in its watch of any moves by the state in that direction. The Redevelopment Agency will be losing $2.26 million to the state in the form of an ERAF shift from the initial budget adoption, and Transportation will be losing $1 million in State Transportation Assistance (STA) funding. Both agencies face further funding takeaways for sure, although it is not known at this time exactly how much. The Legislative Analyst's Office has proposed making the Redevelopment Agency ERAF shift permanent (however the governor has not made this indication yet), and it is estimated Transportation may lose another $500,000 in STA funding for fiscal 2008-09. Further information will be received on this issue in January.

Investments

As the City Council is aware, the City holds a $1 million senior medium term note in Lehman Brothers that is seriously at risk due to the bankruptcy. At the bankruptcy court level, things are progressing at a glacial pace, likely because this is the biggest bankruptcy ever. Lehman was given another extension to prepare a revised creditors list, which should be ready by late January/early February, but that is assuming they make good progress on unraveling all of their swap deals to make a more accurate assessment of assets and liabilities.

In October, the City joined a working group of cities, counties and agencies in similar circumstances and has banded together with them to take action. Although $1 million is significant, the City is in a much better position than some other agencies that have a significantly higher amount at stake. Twelve entities to date are participating in the joint legal action, with total exposure of $33 million. Some of the more current actions taken by the group in the last month include:

- Working group works via e-mail and weekly conference call to keep updated on breaking events on Capitol Hill.
- Directed lobbying of the Secretary of the Treasury to see if the Troubled Asset Relief Program (TARP) can assist local government agencies in recovering funds invested in Lehman.
- Cities that have hired lobbyists (including us) have instructed those lobbyists to follow activities on Capitol Hill to determine if TARP or some new financial

relief package can include very direct language that covers local governments for their losses.
- Securities Investor Protection Corporation (SIPC) forms were mailed to entities the week of December 1; early deadline for most protection is January 30, 2009.
- Government Finance Officers Association (GFOA) agreed to put an article in their next newsletter regarding this issue.
- It is the consensus that the Obama Administration will be more accessible in listening and working through this situation than the current Administration, and strategies are being developed.

The next conference call of the working group is scheduled for December 17 in the afternoon, which is the day this report is finalized for the agenda and delivered to City Council. Any updated information that may come from this call will be reported to the Council during the oral presentation.

Input Requested from Bargaining Groups

A request was sent to the City's six bargaining units for their input with any revenue generating or cost cutting ideas. The Culver City Management Group submitted suggestions Monday, December 15, and staff will be reviewing these items during the next month. No other submissions were received as of the finalizing of this report.

DISCUSSION:

There is no getting around the fact that the city, state and nation are facing tough economic times to a degree that has not been seen in years. While the City has been very fortunate in the past several years to have been able to build a relatively healthy General Fund reserve, in part due to major development activity, it is going to be put to the test the next several years.

"Rolling" Two-Year Budget Process:

In fiscal 2007-08, the City adopted a two-year budget format process. It is not an ordinary two-year budget process, but what staff refers to as a "rolling" two-year budget process. The first of the two years is officially adopted, and the second year is approved. The next year when the second year becomes the first year of a two-year budget, it is fully reviewed again and then is adopted with the next fiscal (forecasted) year becoming the approved (i.e. 2007-08 Adopted & 2008-09 Approved Budget → 2008-09 Adopted & 2009-10 Approved → 2009-10 Adopted 2010-11 Approved, etc.).

In the upcoming budget process, the approved 2009-10 budget will be fully reviewed and reanalyzed before being adopted, and the "forecasted" fiscal 2010-11 budget will be approved. By actively engaging in this process, staff is able to get a considerably better fiscal picture of where the City will be at least a year out and the City Council is better able to allocate resources to meet the needs of the City, staff and its residents.

Although no one was able to predict the current economic catastrophe currently facing the nation, staff was able to note slight shortfalls during the last budget process thanks to this "rolling" two-year budget process and make changes accordingly. The City is now in a position, though, where additional significant adjustments need to be made. Staff has continually been monitoring the City's financial condition, and will be presenting recommended mid-year adjustments to the City Council for the fiscal 2008-09 budget.

Fiscal 2008-09 Outlook

The first quarter budget report submitted to the City Council in November showed General Fund revenues moderately in line with budgeted projections. Staff anticipates that second quarter results, especially for certain revenue receipts, will start showing the expected downturn in some revenue categories. However, since the real economic turmoil did not begin until late September and early October, the most significant downturns are expected to be seen in the third and fourth quarters (again, due to the lag in receipts in many revenue categories).. As mentioned previously, General Fund expenditures are much lower than anticipated, and were so even before the "Pullback" Measures memo submitted by the City Manager, mainly because of the high level of current vacancies. This will help offset some of the lower performing revenues and assist in the fiscal year ending within projections.

Estimated 2008-09 Mid-Year Adjustments

There are two specific revenue category adjustments that will be brought forward to the City Council during the mid-year budget review for the General Fund. They are in the Property Tax Category and the Sales Tax Category. The Property Tax is an adjustment to the initial projection received from our consultant, and will put us more in-line with what our property tax receipts should be through the end of the fiscal year. The discrepancy is primarily expected in the "County Pool" portion of property tax receipts, which, due to the large number of foreclosures and re-assessments to lower values throughout LA County, is much less than anticipated.

The sales tax adjustment is based on two factors: 1) an adjustment due to an overpayment in fiscal 2007-08 by the State for the Sales Tax In-lieu (triple-flip property tax shift), which means they will be deducting it from this year's payment; and 2) reduction in the base Sales Tax amount due to current reports from economic forecasts and preliminary sales reports from national retailers.

The current adopted sales tax amount for fiscal 2008-09 did take into account a downturn in receipts, specifically due to the renovation of Westfield Shopping Center and loss of some major sales tax contributors. The adopted budget amount is less than the adjusted budget for fiscal 2007-08, and less than the 2007-08 actual receipts. This foresight assisted the City in not taking as severe a hit as it could have given the current economic downturn.

Staff is anxiously awaiting the results of the sales tax "true-up" amount to be recorded for December 2008, which should be announced on December 17 or 18 by the California State Board of Equalization, too late to be included in this written report. This amount should assist staff in developing a better picture of where sales tax receipts are headed for this fiscal year and next. Estimated receipts are received the first two months of a quarter, with the third month being a "true-up" payment that reflects adjustments for actual receipts for a quarter. Unfortunately, we will not have the exact picture of the holiday season results until March 2009.

The Transportation Fund will note the $1 million State takeaway of State Transportation Assistance funds, and if any new adjustments are received between now and the time the mid-year report is brought to Council, those will also be included.

The Refuse Fund will be including slight revenue adjustments due to the decline in development activity currently being experienced in the city. These adjustments are not thought to affect the overall fund as expenditures are believed to not be fully expended by the end of the fiscal year.

The Redevelopment Agency will be making some minor positive adjustments to tax increment receipts (and related expenditures such as housing set aside and statutory pass through payments) based on the most current assessed value report received from the County in August. A budget adjustment will also be needed to appropriate the $2.26 million ERAF payment.

<u>Fiscal 2009-10 Outlook</u>

The outlook for fiscal 2009-10 is much different from the original one shown in the approved budget. The City's Approved Fiscal Year 2009-10 General Fund Budget was already facing an approximate $1 million deficit. This gap was closed by increasing the excess appropriations amount from 96.5% to 96.0%, and rolling back the 3% operating and maintenance CPI increase. These two techniques closed the gap, but did not fix the underlying deficit.

Current estimates, with the planned adjustments, show an additional $3 million gap between General Fund operating revenues and expenditures for fiscal 2009-10. These adjustments, specifically to revenues, are a direct result of the current economic downturn. This amount is a preliminary estimate and may decrease or increase based on results of continued analysis performed as staff moves through the upcoming "rolling" two-year budget process. The receipt and entry of actual revenues for October through December 2008 will also better assist staff in forecasting this amount.

The revenue categories that will be adjusted due to the economic downturn are sales tax, business tax, and transient occupancy tax. Property tax will be adjusted based on a new calculation from the adjusted 2008-09 projection, and fines and forfeitures will be adjusted due to a City Council approved increase to parking violation fines, which will be noted during the budget process.

Sales Tax

As mentioned above, the original fiscal 2008-09 sales tax projection was based on the anticipated renovation of the Westfield Shopping Center and loss of some major sales tax generators over the last year or two. The mid-year adjustment takes into account the much weaker economy and plummeting auto sales. Economic reports reviewed and received, along with conferences attended by staff, indicate that fiscal 2009-10 (especially in calendar 2009) will be much more severe for retail sales and auto sales. These factors will contribute to a recommended reduction to the projected base sales tax amount for fiscal 2009-10.

Business Tax

Business Tax is calculated on the gross sales amount of businesses, and basically mirrors sales tax in activity. Given the expected downturn in sales tax, there will also be a reduction in the projected business tax amount for fiscal 2009-10. This will be slightly offset by the business tax audit findings from the business tax audit being conducted during fiscal 2008-09. It is anticipated that non-compliant businesses will be discovered during the audit, thus adding to the on-going base business tax receipts and offsetting some of the downturn.

Transient Occupancy Tax

Current information relating to hotel occupancy rates is not encouraging, and a reduction in the approved fiscal 2009-10 projection will be recommended. Vacancy rates have increased significantly the past couple of months, and reports indicate this will continue through at least the first half of 2009. Airport travel through LAX is down, and in general people are not traveling as they were the past several years. Transient Occupancy Tax (TOT) receipts are up to a relatively respectable level, though, through October 2008, thanks in part to some of the major hotels in the city being fully open after renovations. This helps somewhat, but the overall affect of low vacancy rates is hitting the entire industry, not just Culver City. TOT receipts will start showing a notable reduction in coming months.

Known Adjustments to Expenditures

When forecasting the second year of the two-year budget, estimates some times must be used since actual data is not known. CalPERS sends estimated employer retirement rates to cities, which we use to calculate the retirement amounts for that year. These amounts can fluctuate slightly up or down from the actual rates. The City received the actual CalPERS employer retirement rates in October for fiscal 2009-10, which were higher than the estimated. This will increase the actual amount for retirement costs slightly for all funds and will be noted during the budget process. The dramatic losses in the stock market have severely affected CalPERS investment portfolio. Due to the ‘smoothing’ CalPERS implemented in the wake of the dot-com crash, the gains and losses in their portfolio are amortized over a longer time period and employer rates will not rise as dramatically as they would have under the old methodology. However, CalPERS recently informed client agencies that the estimated employer rates provided for 2010/11 would likely be increased by 2% to 4% of payroll if there is not a rapid recovery in the market.

Development Projects

New development activity within the City has not continued at the pace it has in previous years. This is a direct result of the current economic downturn, specifically in the credit markets as developers are unable to secure financing for their projects. Some of the larger developments in which one-time revenues were being projected in the budget for fiscal 2009-10 will most likely be pushed to future years. The funding from these larger projects is categorized as one-time funding and is not included in the “ongoing” revenue total that calculates the operating surplus/deficit amount for a fiscal year.

Conclusion

There are several additional factors that staff will be taking into consideration during the next month in preparation of the Mid-Year 2008-09 Financial Update, Comprehensive Financial Plan update, and Fiscal 2009-10 & 2010-11 Budget Process. The mid-year report will be extremely beneficial in enabling staff to make much clearer decisions for the upcoming budget process since more actual data will be available to analyze for the current fiscal year. This will also assist staff to better forecast for the Comprehensive Financial Plan update and include meaningful assumptions for the five- to fifteen-year outlook being presented.

FISCAL ANALYSIS:

There is no fiscal impact associated with this item. At this time, staff is scheduling to bring the Mid-Year 2008-09 Report, Comprehensive Financial Plan update, and Fiscal 2007-08 Final Year-end Report to City Council on February 9, 2009. Staff also plans to 'kick off' the 2009-10 budget preparation at the February 9th meeting, seeking City Council and public input on priorities and ideas for these fiscally challenging times.

MOTION:

That the City Council:

Receive and file this report.