



DATE: February 19, 2008
TO: Mayor and City Council
FROM: Director of Finance and Internal Services
SUBJECT: Approval of Mid-year Budget Adjustments

RECOMMENDATION

That the Council reads and approves the Mid-Year Financial Report and the attached resolution amending the FY 2008 Operating Budget.

SUMMARY

This Mid-year Financial Report provides an overview of FY 2008 General Fund revenues, expenditures, and fund balance reserves projected through the remainder of this fiscal year. These projections are developed by reviewing the actual revenues and expenditures recorded through December 31, 2007, and analyzing current available financial assumptions, and other market trends.

The result of this analysis reflects a significant decline in revenue, which will increase the General Fund's use of reserves to approximately \$10.4 million for the year ended June 30, 2008 (FY 2008). Detailed financial assumptions are discussed below. Staff has proposed amendments to the FY 2008 budget in the attached resolution (Attachment A).

DISCUSSION

FY 2008 Summary of General Fund as of December 2007 and Projected Through June 2008

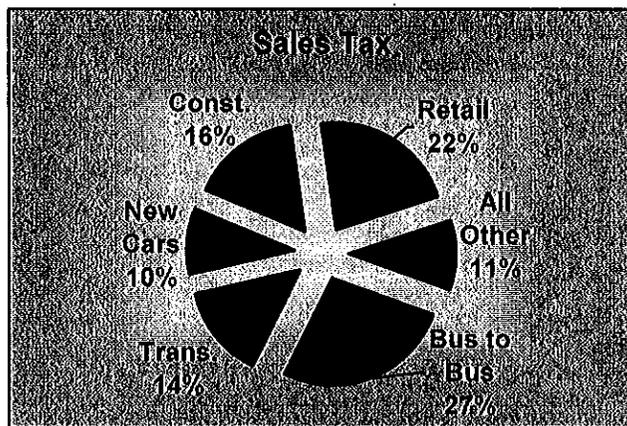
Adopted Budget - The FY 2008 General Fund Budget authorized a \$3.8 million use of reserves. The adopted budget incorporated economic factors, such as a softening of the housing market and reduced retail sales, into the revenue estimates. The adopted budget also incorporated estimates for the effect of the City-wide review of employee salaries. However, as noted below, economic conditions have been rapidly declining since August 2007, when the effects of the collapse of the sub-prime mortgage market began, therefore staff has proposed certain amendments to the budget.

Revenue - Revenue received through the first half of the current year is about 98% of the prior year at this same time, after removing \$1.46 million in state mandated reimbursements. When comparing revenue through December to the budget, about 90% of projected revenue has been received, or \$5,305,771 less than estimated. This shortfall in revenue is due primarily to the decline of sales tax, real property transfer tax, and development related revenues. The City's major revenue sources are discussed below:

- **Property Tax** – A significant portion of the property tax revenue is received semi-annually. The semi-annual secured property tax payments received in December came in on target, and general property tax revenue is projected to be slightly above the \$36.4 million budget estimate by year end. These projections include two additional components of property tax. 1) Property tax backfill from the State's trade of VLF is forwarded semi-annually from the County, per the requirements of the Triple Flip. The semi-annual payment came in above target. 2) Unsecured property tax is also received for the value of aircraft at the Hayward Airport. The additions in new aircraft have increased this revenue source.

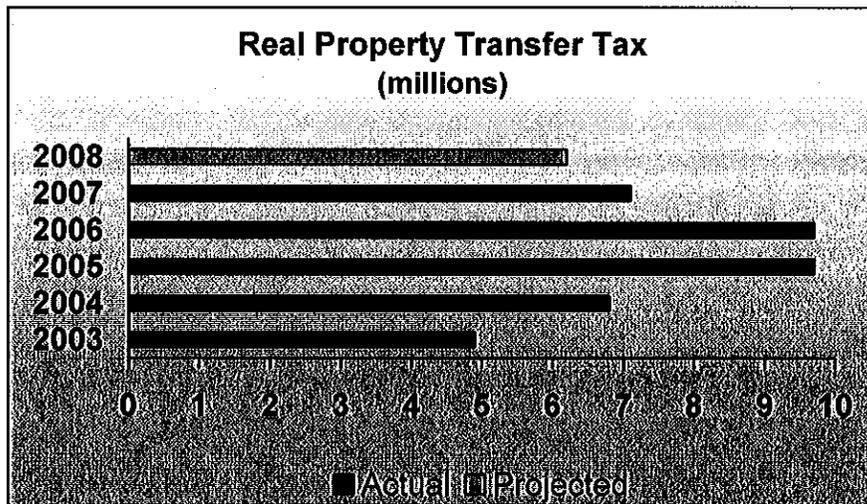
Staff is closely watching the effects of the housing and financial markets. In general, property owners request reassessments during periods when the housing markets encounter significant declines. Reassessments are processed by the County Assessor, and take a period of several months to process; therefore staff feels that the time delay will affect assessed valuation of properties in the next fiscal year if reassessments are granted. Staff is more concerned with possible delinquencies due to non-payment of property taxes. It is expected that when property owners are in the process of foreclosure, that they are also delinquent on payment of property taxes. Since foreclosure rates throughout the Bay Area have significantly increased, staff is working with the County to determine the effect on Hayward property taxes. After reviewing all the above factors, it is staff's expectation that property tax revenue will be greater than expected, and a budget adjustment to increase property tax by \$400,000 is proposed.

- **Sales Tax** – Sales tax was budgeted to grow by 5% this year, however, as of December this revenue has been flat. After receiving the payments through December, and analyzing local and State-wide trends, staff projects sales tax revenue to be 4% below target, or \$1.1 million below the \$30 million budget estimate.



Although the Hayward sales tax base is diverse (as reflected in the chart on the previous page), the concerns about consumer confidence, the reduction in new car sales, and the slow down in construction activity will all contribute to the decline in this revenue source. During the first quarter of this fiscal year, many business sectors experienced a decline in taxable sales, including the auto industry, construction related business, and retail that serves the housing and new construction markets, such as furniture stores. Department stores, the food related industries, business to business sales, and service stations showed single digit growth. Overall, the City is experiencing slightly greater declines in retail sales than the average of Alameda County cities and the Bay Area. This is likely due to new car sales and construction related sales making up 26% of our sales tax revenue. Staff expects that sales tax revenue will be approximately the same as the prior year, and therefore a budget adjustment to decrease sales tax by 4% or \$1.1 million is proposed.

- Real Property Transfer Tax** – The FY 2008 adopted budget includes \$8 million in annual revenue. However, the current year transfer tax revenue will be far below the prior year revenue due to the downturn in the housing market. Based on the revenue received so far this year, staff expects to receive approximately \$6.2 million, or \$1.8 million less than budgeted by year end. The chart below shows that over the past several years real property transfer tax has had significant growth and is now reflecting the reduction in residential housing turnover, thus continuing to demonstrate its highly volatile nature.

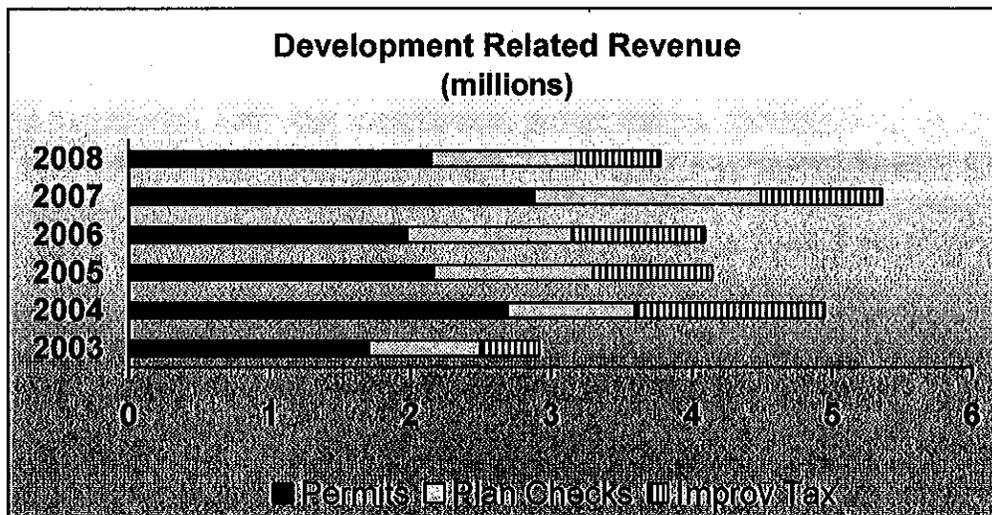


Based on the revenue received through December, the reduction in the turnover rate of residential properties and the overall real estate market crisis, a \$1.8 million reduction in real property transfer tax revenue is proposed.

- Development Related Fees – Development related revenues have been significantly effected due to the changes in the real estate and housing market, and staff expects revenue to be \$1.2 million less than budgeted.

| Development Related Revenue | Budget | Estimated Revenue | Proposed Adjustment |
|-----------------------------|-----------|-------------------|---------------------|
| Construction permits | 2,600,000 | 2,050,000 | <550,000> |
| Plan checking fees | 1,300,000 | 1,050,000 | <250,000> |
| Supp. improvement tax | 1,000,000 | 600,000 | <400,000> |
| Total | | | <1,200,000> |

The FY 2008 budget projected \$2.6 million for construction permits, \$1.3 million for plan check revenue, and \$1 million for the supplemental improvement tax; staff estimates revenue to be \$2.1 million, \$1 million and \$0.6 million, respectively. Revenue received through December is at 61% of the same period last year. The expectation is that development activity will continue to slow over the next six months. The chart below reflects the changes in development related revenues over the past six years. FY 2008 reflects the year end estimates, which will require a total amendment to the budget of \$1.2 million. If activity continues to flatten, a thorough review of program expenditures will be necessary to bring them inline with anticipated revenues.



- Other Revenue - Interest earned on General Fund investments is below expectation through December. Staff estimates that interest will be less than budgeted by year end due to the reduction in interest rates. Due to changes in the financial markets, the overall interest rate earned by the City's investment portfolio has decreased from 5.28% in July to 4.77% in January. The two-year T-bill rate has dropped 50% over the past 7 months, from 4.97% to a 2.48% monthly average.

The adopted FY 2008 budget projected \$932,000 in annual vehicle license fee revenue. The revenue through December is at 66% of prior year receipts. Staff estimates that this revenue

source will be below target. In general, new vehicle sales have been slipping for the past year due to increased gas prices and overall constrained consumer spending. With less new car sales, the fees paid to the State do not show significant growth.

Last year, within the first two months of the fiscal year the City received over \$1.46 million in State reimbursements for animal control services and other required services that were performed in prior years. Reimbursement of State mandated costs are controlled by the State and the Governor. The City has no control over the timing of the receipts. Fiscal year-to-date we have received \$161,469 and do not expect much more through the end of the year due to the State budget crisis. Staff is not proposing budget adjustments in these areas at this time.

Expenditures - Expenditures through the first half of the current year are approximately 110% of prior year at this same time. When comparing expenditures to the revised budget, approximately 100% of projected spending has occurred through December, reflecting that expenditure rates are on target.

Employee salaries and benefits represent 86% of the general fund expense. Two City unions are currently in contract negotiations (HAME, and Local 21). The HPOA, Local 1021, Local 1909, unrepresented employees, and Hayward Police Management contracts have recently been approved, with most of the retroactive salary increases included in the December numbers. Therefore, staff has estimated salary adjustment and retroactive payment for the groups that are currently completing the negotiations process. These salary adjustments are expected to be confirmed by March 2008. It is expected that the overall adjustment to employee services will exceed the budget, and therefore staff is proposing a budget adjustment to increase expenditures by 2% or \$2.1 million.

FISCAL IMPACT

The FY 2008 year end estimates for the General Fund are summarized in the resolution at Attachment A and General Fund Summary at Attachment B. The overall fiscal impact of the proposed budget adjustments add up to an additional \$5.575 million use of reserves, for a total of \$10.4 million. At the beginning of the 2008 fiscal year the General Fund reported reserves of \$23.5 million. The detailed breakdown of the General Fund reserves are outlined in Attachment C. After deducting the budgeted \$3.8 million, the additional appropriations of \$1 million, and the sum of the \$5.575 million proposed budget adjustments, the remaining fund balance is projected to be \$13.1 million. The remaining \$13.1 million is allocated as follows:

| | |
|-------------------------|----------------|
| Economic Uncertainty | \$ 7.0 |
| Liquidity | \$ 3.5 |
| Hotel Conference Center | \$ 1.1 |
| Public Safety | \$ 1.0 |
| Other Obligations | <u>\$ 0.5</u> |
| Total | \$13.1 million |

PUBLIC CONTACT

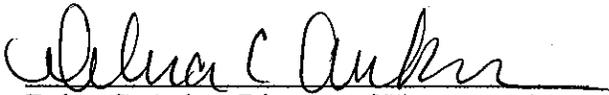
The City Council received a preliminary Budget Update on December 18, 2007. The Council Budget and Finance Committee meets monthly and discussed the proposed amendments at the January 23rd meeting. The Council also discussed the proposed adjustments at the January 29th

worksession. The City Manager has also presented information related to impacts of the City's budget to all city employees and employee unions.

NEXT STEPS

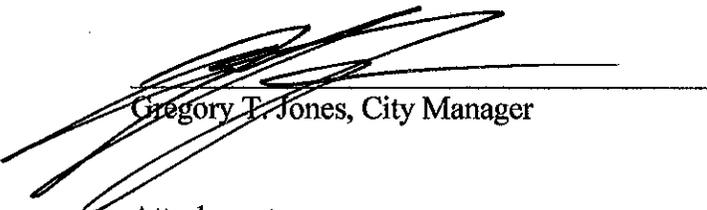
Staff will continue to monitor the financial health of the organization and provide monthly financial reports to Council.

Prepared by:



Debra C. Auken, Director of Finance and Internal Services

Approved by:



Gregory T. Jones, City Manager

Attachment:

A - Resolution

B - FY 2008 General Fund Summary, Revenue, June 30, 2008 Estimates

C - FY 2008 Mid-year Review General Fund Reserves

DRAFT

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HAYWARD CITY COUNCIL

RESOLUTION NO. 08-

Introduced by Council Member _____

RESOLUTION AMENDING RESOLUTION 07-079- APPROVING THE BUDGET OF THE CITY OF HAYWARD FOR FISCAL YEAR 2007-2008; ADOPTING APPROPRIATIONS FOR FISCAL YEAR 2007-2008

WHEREAS, the City Manager has submitted to the City Council of the City of Hayward mid-year estimates of revenues from all sources and estimates of expenditures required for the proper conduct of the activities of the City of Hayward for FY 2008 contained in those documents entitled "Mid-Year Budget Adjustments," dated February 19, 2008; and

WHEREAS, a public work session was held by the City Council of the City of Hayward on January 29, 2008, at which time all interested persons were afforded an opportunity to be heard on matters pertaining to the budget amendments recommended by the City Manager.

NOW, THEREFORE, BE IT RESOLVED by the City Council of the City of Hayward as follows:

1. GENERAL FUND MID-YEAR BUDGET AMENDMENTS:

Revenue

| | |
|----------------------------|--------------------|
| Property Tax | 400,000 |
| Sales Tax | (1,100,000) |
| Real Property Transfer Tax | (1,800,000) |
| Other Taxes | (400,000) |
| License & Permits | (550,000) |
| Fees & Service Charges | (250,000) |
| <i>Reduce Revenue By:</i> | <u>(3,700,000)</u> |

Expenditures

| | |
|-----------------------------|------------------|
| Employee Services | 1,819,134 |
| Charge/(Credit) from others | 280,866 |
| Capital Expense | (225,000) |
| <i>Increase Expense By:</i> | <u>1,875,000</u> |

2. The Director of Finance is hereby authorized and directed to distribute the above amendments to the various accounts of the City in accordance with generally accepted accounting principles and consistent with the purposes and objectives as outlined in the approved budget.
3. The FY 2008 appropriations and budget resolutions (Resolution 07-079) are hereby amended to reflect the above amendments.

IN COUNCIL, HAYWARD, CALIFORNIA _____

ADOPTED BY THE FOLLOWING VOTE:

AYES: COUNCIL MEMBERS:
MAYOR:

NOES: COUNCIL MEMBERS: None

ABSTAIN: COUNCIL MEMBERS:

ABSENT: COUNCIL MEMBERS:

ATTEST: _____
City Clerk of the City of Hayward

APPROVED AS TO FORM:

City Attorney of the City of Hayward

FY 2008 - General Fund Summary

June 30, 2008 Estimate

| | Current Year | | | | |
|----------------------------------|--------------------|---|------------------------|---------------------------|---------------------------|
| | Adopted | Revised | FY 08 EOY Projected | 08 EOY Est. vs. 08 Budget | |
| | Budget FY 2008 | Budget FY 2008 | | \$ Over/ (Under) | EOY Est as % of Budget |
| | (July 1, 2008) | (All changes from July 1 - Dec 31, 2007) | | | |
| Revenue | | | | | |
| 35% Property Tax | 36,410,000 | 36,410,000 | 36,810,000 | 400,000 | 101% |
| 20% Sales Tax | 30,030,000 | 30,030,000 | 28,930,000 | (1,100,000) | 96% |
| 8% Real Prop Trsfr Tax | 8,000,000 | 8,000,000 | 6,200,000 | (1,800,000) | 77% |
| 8% Franchise Tax | 8,347,550 | 8,347,550 | 8,347,550 | 0 | 100% |
| 6% Other Taxes | 6,530,000 | 6,530,000 | 6,130,000 | (400,000) | 94% |
| 4% License & Permits | 3,752,150 | 3,752,150 | 3,202,150 | (550,000) | 85% |
| 4% Other Revenue | 4,241,050 | 4,241,050 | 4,241,050 | 0 | 100% |
| 3% Fees & Service Charges | 3,179,809 | 3,179,809 | 2,929,809 | (250,000) | 92% |
| 3% From Other Agencies | 3,515,342 | 3,959,799 | 3,959,799 | 0 | 100% |
| 1% Fines & Forfeitures | 947,828 | 947,828 | 947,828 | 0 | 100% |
| 100% Total Revenues | 104,953,729 | 105,398,186 | 101,698,185 | (3,700,001) | 96% |
| Expenditures | | | | | |
| Salary and Benefits | 96,845,133 | 97,097,306 | 98,916,440 | 1,819,134 | 102% |
| Charge/(Credit) from others | (4,064,305) | (4,064,305) | (3,783,439) | 280,866 | 93% |
| 86% Net Employee Services | 92,780,828 | 93,033,001 | 95,133,001 | 2,100,000 | 102% |
| 4% Maintenance & Utilities | 4,138,202 | 4,159,672 | 4,159,672 | 0 | 100% |
| 10% Supplies and Services | 11,059,894 | 11,681,195 | 11,681,195 | 0 | 100% |
| 0% Capital Expense | 225,000 | 777,463 | 552,463 | (225,000) | 71% |
| | 15,422,896 | 16,618,330 | 16,393,330 | (225,000) | 271% |
| 100% Total Expenditures | 108,203,724 | 109,651,331 | 111,526,331 | 1,875,000 | 102% |
| Transfers | | | | | |
| Transfers in | 5,137,766 | 5,140,676 | 5,140,676 | 0 | 100% |
| Transfers out | (5,725,461) | (5,725,461) | (5,725,461) | 0 | 100% |
| Net Transfers | (587,695) | (584,785) | (584,785) | 0 | 100% |
| Difference | (3,837,690) | (4,837,930) | (10,412,931) | (5,575,001) | 215% |

**FY 2008 Mid-Year Review
General Fund Reserves**
(\$ in millions)

| | Adopted Budget | Revised Budget (Proposed) |
|---|---------------------------|--------------------------------------|
| General Fund Balances | | |
| Reserves: | | |
| Inventories | \$ 28 | |
| Encumbrances | 474 | |
| Liquidity | 3,500 | |
| Economic Uncertainty | 7,000 | |
| Public Safety | 1,000 | |
| Hotel Conference Center | 1,250 | |
| RDA Loan | 1,336 | |
| | <u>14,588</u> | |
| Total Reserved Fund Balance | | <u>14,588</u> |
| Unreserved Contingency | | <u>8,936</u> |
| Beginning Fund Balance at July 1, 2007 | \$ | <u>23,524</u> |

Use of General Fund Reserves

| | | |
|---|-------------------|-------------------------|
| Use of Reserves per Adopted Budget | | \$ 3,838 |
| Approved New Appropriations and Prior Obligations | | 1,000 |
| Use of Reserves Prior to Mid-year Adjustments | | <u>\$ 4,838</u> |
| Proposed Adjustments: | | |
| Reduction in Sales Tax | (1,100) | |
| Increase in Property Tax | 400 | |
| Reduction in Real Property Transfer Tax | (1,800) | |
| Development Related Revenue: | | |
| Decline in Construction Permits | (550) | |
| Decline in Plan Check Services | (250) | |
| Decline in supplemental improvement tax | (400) | |
| Increase in Employee Services Costs | (2,100) | |
| Decrease in Capital Outlay Spending | 225 | |
| Sub-total of Net Proposed Adjustments | <u>\$ (5,575)</u> | |
| Total Reserve Requirement | | <u>\$ 10,413</u> |

Proposed Use of Fund Balance Reserves

| | |
|-----------------------------------|-------------------------|
| Contingency | \$ 8,936 |
| RDA Reserve | 1,336 |
| Hotel/Conference Center | 141 |
| Authorized Use of Reserves | <u>\$ 10,413</u> |