



**CITY OF HAYWARD
AGENDA REPORT**

AGENDA DATE 04/13/04

AGENDA ITEM _____

WORK SESSION ITEM WS#2

TO: Mayor and City Council
FROM: City Manager
SUBJECT: Development of 2004-05 Budget

RECOMMENDATION:

It is recommended that the Council review and comment on this report.

DISCUSSION:

As the budget process for the next fiscal year is underway, this report is intended to review the financial status of the General Fund for the current year and to provide preliminary revenue and expenditure information for 2004-05. Attached for the Council's review is Schedule A, which sets out revenue and expenditure information for the General Fund for 2003-04 and 2004-05. In addition, staff is seeking preliminary direction with regard to expenditures for community promotion for 2004-05.

The recommended budget is scheduled to be released on May 11, 2004. Work sessions are tentatively planned for May 25 and 27 and June 1, followed by a public hearing on the budget on June 8 and adoption on June 22.

As shown in Schedule A, the adopted budget recognized a revenue shortfall of approximately \$7.5 million. In December, the Council was advised of a decline in Sales Tax revenue of \$2 million, and a State take away of \$1.9 million in VLF dollars. To respond to this shortfall, staff developed a series of cost cuts that brought the General Fund back into line with original estimates. These cost cutting measures were implemented for the balance of 2003-04, and allowed the General Fund to maintain spending levels in line with the adopted budget. Looking forward to the end of the current year, the Estimated Actual column shows revised estimates based on revenue and expenditure information through March 31, 2004. This column shows that the General Fund should end the year with a revenue shortfall of approximately \$6.2 million. While this is clearly an improvement, it still requires the use of contingency funds to balance the budget this year.

Fiscal Year 2004-05 Projections

The column labeled Projected Budget 2004-05 represents preliminary revenue and expenditure estimates for 2004-05. As can be seen from this schedule, the General Fund is facing a projected

deficit of approximately \$12.6 million. Clearly, the City cannot adopt a budget with a projected deficit of this magnitude. Staff has developed an approach for managing this potential shortfall which is discussed later in this report. Before doing so, it is appropriate to review the major assumptions used to estimate revenues and expenditures for 2004-05.

Property Tax, Sales Tax, Real Property Transfer Tax and Vehicle License Fees (VLF) are the four largest revenues sources for the City. In particular, Property Tax accounts for 24% of total revenues; Sales Tax is 31%; Real Property Transfer Tax is about 7%; and VLF equals 8%. Together, these categories total 70% of the General Fund's revenue base. Except for property tax revenue, the remaining three sources are considered highly volatile, meaning revenues go up or down based on the general state of the economy and can show marked variances in amounts collected over a short period of time. Consequently, in budgeting for future revenues, it is important to keep in mind that these three key revenue sources, which total nearly one-half of the of the City's revenue base, are at risk in terms of fluctuating in any given year.

Property tax revenues have shown consistent growth for the City over the years as a result of continued development and higher property values due to property turnover or sales. For the last two fiscal years, this category has averaged a little over 6% net growth. Taking a conservative view staff is recommending that a net growth factor of 5% be used for 2004-05. Applying this growth factor would generate approximately \$20.3 million for 2004-05. Unfortunately, the Governors budget, as it now stands, will reduce property tax revenue by some \$1.4 million, which will be used to support the Education Revenue Augmentation Fund, (ERAF). Taking this adjustment into account results in the new estimate for 2004-05 of \$18.9 million.

Over the past three years, sales tax revenue has dropped from a high-water mark of \$34.4 million in 2000-01 to \$25.8 million in 2002-03. As has been discussed with Council in other reports, the "Business to Business" component of the City's sales tax base accounts for a substantial portion of this decline. Information for the quarter ended December 31, 2003 is now available and shows that this major category has stopped its decline and in fact is showing some modest growth. Nonetheless, the non-business component of sales tax dollars is flat or showing only minor growth. With this in mind, staff is estimating that sales tax revenue will grow by only 3% for 2004-05. Based on estimated actual revenue for 2003-04 of \$25.8 million, sales tax revenue is estimated to increase by \$700,000 for 2004-05 to \$26.5 million.

A final concern with sales tax revenue has to do with adoption of Propositions 57 and 58 in March of this year. In brief, the local sales tax rate has been reduced from one percent to three quarters of one percent. The one-fourth has been diverted to the State and is pledged to repay State deficit-funding bonds. The State has pledged to "backfill" the one-quarter percent of sales tax to make local government "whole". How this will work in practice is yet to be determined. However, it is not unreasonable to assume that the "backfill" payments will come under scrutiny by the State as part of its budget balancing actions.

Real property transfer tax revenues have shown strong growth for the past several years. Based on the value of real estate transactions that take place in Hayward, this revenue has followed the growth of the real estate market. As property values have increased and as the number of real estate sales has increased this revenue source has too. However, should the real estate market

suffer a decline, particularly if interest rates increase, as has happened in the past, this revenue will also decline. Staff is assuming that Hayward will experience the same level of activity for 2004-05 as is being seen for 2003-04, which is expected to generate revenue of approximately \$6 million.

Vehicle license fee revenues have continued to grow based on the number of vehicle registrations and Hayward's population growth. Unfortunately, this revenue source also has a "backfill" component. That is, the State makes up the difference between the revenue that was generated by the previously higher rates and the lower current rates. This backfill component is approximately 66% of the amounts now being received by local government. Clearly, these backfill payments are at risk as the State struggles to balance its budget for 2004-05 and succeeding years.

On the expenditure side, the single largest expenditure category for the General Fund is Employee Services. This category represents approximately 88% of the General Fund's Operating Expenditures. Given the fact that the City is primarily a service provider, this is to be expected. The Employee Services estimate for 2004-05 reflects positions that were frozen with the adoption of the 2003-04 budget and also those positions that were put on hold at the 2003-04 mid-year budget review. Additionally, recently approved contracts with the Police and Fire labor units provide for no salary increases in 2004-05 and this is reflected in the 2004-05 estimate. For all other units, existing contractual obligations have been reflected in the budget estimate. The 2004-05 estimate also includes current rate increases for retirement and other benefits. The other cost categories are estimates at this point based on the unadjusted 2003-04 budget.

Of course, not reflected in the estimates above are any cost cutting measures that will come as a result of the work that is currently being done by staff.

Budget Approach for 2004-05

As indicated earlier, absent taking corrective action, available information indicates a deficit in the General Fund of approximately \$12.6 million for 2004-05. To address this challenge, staff proposes to rely on four measures: cost savings, contract adjustments, new revenue and use of contingencies.

On the cost side, I have asked department heads to prepare budget proposals reducing costs by 5%, 7% and 10%. In addition to meeting specific dollar targets, I have also instructed the departments to consider the impact of any proposed reductions and to look at cuts from a programmatic standpoint. That is, rather than reducing several programs to the point where none are effective, it may be preferable to cut an entire program to achieve the targeted costs savings. Further, because of the magnitude of the problem, we can no longer rely on the accident of timing with respect to vacancies to balance the budget. By looking at the issue from a programmatic or service perspective, we are better able to indicate which services can continue to be provided and which must be suspended until the economy improves.

As noted above, although the projected deficit can and should be addressed through some expenditure reductions, this will not be sufficient in and of itself. It will also be necessary to consider adjustment in fees. In this regard, staff is examining all fees and service charges authorized pursuant to the master fee schedule to determine if adjustments are in order. In some instances, some fees have remained static for many years and have not kept up with cost of services. Likely candidates for adjustment include development-processing fees, compliance with regulations governing hazardous material and some library fees. In addition, staff will explore revisions to the various franchise fees levied by the City in exchange for the use of public rights of way, an example of which is the franchise fee pertaining to refuse collection services.

Community Promotions Budget

An issue that I would like to bring to the Council's attention is the Community Promotions budget for 2004-05. Historically, the City has provided funding to several local community groups that offer special programs and promotions that benefit Hayward residents. For 2001-02, the funding level was \$173,703; for 2002-03 it was \$179,709; and for 2003-04 it was \$180,000. For 2003-04, fourteen organizations were funded for various programs and events.

The City has received Community Promotion applications for 2004-05 funding. There are 15 applications, which consist of 11 returning organizations requesting the same level of funding as 2003-04, one requesting a decrease in funding, one an increase and two new requests. The total requested is \$215,709.

The normal practice is for staff to review the applications and then present funding recommendations to the Council for its consideration. In order to develop such recommendations, it is important to know how much funding is available. Council direction is therefore requested in this respect.

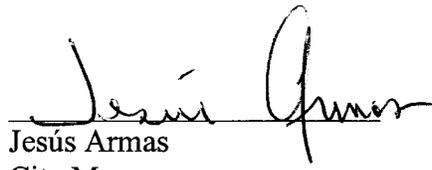
While the City is faced with a substantial budget shortfall, I do not recommend eliminating all funding for community promotion. Rather, I would suggest that the Council agree to continue earmarking funds for community activities, albeit at a reduced level.

As a starting point for discussion, I would suggest an overall funding level of \$150,000 for next year. Further, I would suggest that the City not entertain funding any new organizations or activities. Finally, because the suggested spending level represents a reduction, I would suggest that staff be directed to meet with current funding recipients to explore how best to maintain the essence of their offerings in light of lower funding. Based on this discussion, specific recommendations can then be developed for your review in May.

Conclusion

Preparing a General Fund budget for 2004-05 presents a significant challenge. Stagnate revenues coupled with rising pension and benefit costs have resulted in a projected deficit for 2004-05 that will take a toll on the level of city services that can be provided. To address this shortfall, several measures will be utilized. First, I believe that it is appropriate to use

contingency funds to address part of the shortfall. At the same time, I believe it is imperative that no other reserves, such as the Economic Uncertainty or Liquidity reserves, be used. Use of the contingency funds provides valuable time in which to implement ongoing corrections to the budget. In addition, I am recommending that Council consider new revenues. In several cases, revenue sources have not been adjusted and rates are out of date. Already reflected in the 2004-05 amounts are savings that have occurred due to the absence of salary increases for Fire and Police personnel. If these savings were not made available, the deficit we are facing would be even greater. Finally, the City must consider cost reductions to existing programs. Staff is working on developing recommendations to meet this goal with the least amount of impact to City services.


Jesús Armas
City Manager

Attachments

City of Hayward
Budget Projection
Schedule of Revenues and Expenditures
General Fund -- 2003-04 and 2004-05

Schedule A

(\$ in 000's)

	Adopted Budget 2003-04	Adjusted Budget 2003-04	Estimated Actual 2003-04	Projected Budget 2004-05
REVENUES				
Property Tax	\$ 19,344	19,344	19,344	18,900
Sales Tax	28,000	25,780	25,780	26,500
Real Property Transfer Tax	4,900	4,900	6,000	6,000
Emergency Facilities Tax	1,750	1,750	1,750	1,700
Supp. Bldg. Const. & Imp. Tax	800	800	1,500	1,200
All Other Taxes	3,525	3,525	3,525	3,300
Franchises	5,715	5,715	5,715	5,400
Licenses and Permits	2,080	2,080	2,900	2,900
Interest and Rents	851	851	851	851
Fines and Forfeitures	845	845	845	845
Vehicle License Fee	8,400	6,700	6,700	8,400
All Other From Agencies	2,324	2,324	2,324	1,824
Fees and Service Charges	2,224	2,224	2,500	2,500
Other Revenue	2,587	2,587	2,587	2,587
Total Revenue	83,345	79,425	82,321	82,907
Recurring Transfers In	4,592	4,592	4,592	4,592
Total Resources	87,937	84,017	86,913	87,499
EXPENDITURES				
Employee Services	79,100	77,091	78,700	85,030
Maintenance and Utilities	3,987	3,837	4,000	4,000
Supplies and Services	10,065	9,414	9,300	10,000
Capital Expense	125	125	125	125
Net Interdept. Charges (Credits)	(3,250)	(3,405)	(3,405)	(3,369)
Operating Expenditures	90,027	87,062	88,720	95,786
Recurring Transfers Out	5,444	4,246	4,353	4,353
Total Expenditures	95,471	91,308	93,073	100,139
Operating Revenue (Expenditure)	(7,534)	(7,291)	(6,160)	(12,640)
Non-recurring Transfers In	-	-	-	-
Non-recurring Transfers (Out)	-	-	-	-
Net Revenue (Expenditure)	\$ (7,534)	(7,291)	(6,160)	(12,640)

**City of Hayward
 Designated Fund Balances
 June 30, 2003 and Projected June 30, 2004**

	Actual Balance 6/30/2003	Estimated Actual 2003-04	Projected Balance 6/30/2004
Designated for:			
Economic uncertainty	7,000,000	-	7,000,000
Liquidity	3,500,000	-	3,500,000
Redevelopment Agency Loan	1,336,000	-	1,336,000
Public Employees Retirement System	1,000,000	(1,000,000)	-
Public Safety Radio System	2,250,000	-	2,250,000
Hotel/Conference Center	1,250,000	-	1,250,000
Contingencies	10,065,209	(5,160,000)*	4,905,209
Total Designated Fund Balance	26,401,209	(6,160,000)	20,241,209

* The adopted budget for 2003-04 provided for the use of \$6.5 million from this category as a budget balancing measure.