



CITY OF HAYWARD
AGENDA REPORT

AGENDA DATE 03/01/05

AGENDA ITEM _____

WORK SESSION ITEM WS#2(3)

TO: Mayor and City Council
FROM: City Manager
SUBJECT: Development of 2005-06 Budget

RECOMMENDATION:

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

DISCUSSION:

This report is intended to provide the Council with a preliminary projection of revenues and expenditures for the General Fund for 2005-06 and to obtain Council direction to guide the preparation of the budget for next year. As in prior years, the recommended budget will be released in early May with work sessions beginning in late May followed by public hearings and adoption in June.

Attached for the Council's review is Schedule A, which presents General Fund revenues and expenditures for the Adjusted Budget 2004-05, staff's estimated budget for 2004-05 and projected figures for 2005-06.

As reported elsewhere, the 2004-05 budget recognized a revenue shortfall of approximately \$3.2 million. Based on staff's review of revenues and expenditures through December 31, it is estimated that the General Fund will end the year at a break even point. Staff has also developed estimates of revenues and expenditures for 2005-06. Based on certain assumptions applied to the 2004-05 revenues and expenditures staff is projecting that 2005-06 has a potential revenue short fall of approximately \$2.6 million. Obviously, the recommended budget that staff brings to Council will be balanced.

Fiscal Year 2005-06 Projections

Revenues:

Property Tax: This revenue source has 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 about 6% net growth. Taking a conservative view, staff is recommending that a net growth factor of 5% be used for 2005-06. Applying this growth factor would generate approximately \$20.7 million for 2005-06.

Unfortunately, the Governors budget continues to "raid" the City's property tax base. In addition to the permanent ERAF takeaways, 2005-06 reflects the second of two annual losses of \$1.9 million. The \$20.7 million reported for 2005-06 reflects this reduction. Consistent with the passage of Proposition 1A, this revenue returns to the City in 2006-07.

Sales Tax: Over the past three years, Sales Tax revenue has dropped from a high-water mark of \$34.4 million in 2000-01 to \$25.4 million in 2003-04. As has been discussed with Council, 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 September 30, 2004 shows that this major category has stopped its decline. Transportation, also a major economic category for Hayward, unfortunately suffered a decline in the third quarter. Other economic categories such as General Retail, Construction, etc, are flat or are showing only minor growth. The Northern California region experienced a growth rate of 3.7% for the third quarter. With this in mind, staff is estimating that sales tax revenue will grow by 3% for 2005-06. Based on the estimated actual for 2004-05 of \$26.5 million, this will increase the 2005-06 estimate to \$27.3 million, an increase of \$800,000.

A final concern with sales tax revenue has to do with adoption of Propositions 57 and 58 in March of last year. In brief, the local sales tax rate has been reduced from one percent to three quarters of one percent. The one quarter percent 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". Hayward has experienced it's first backfill payment and the State payments are basically in line with staff estimates.

Real Property Transfer Tax: This revenue source has shown strong growth for the past several years. As property values have increased and as the number of real estate sales has increased, this revenue source has grown. However, should the real estate market suffer a decline, as has happened in the past, this revenue will also decline. Staff is assuming that Hayward will experience the same level of activity for 2005-06 as is being seen for 2004-05, which is expected to generate revenue of approximately \$7 million. Allowing for a minor increase, staff is estimating \$7.2 million for 2005-06.

Vehicle License Fee (VLF): This revenue source has 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 back fill component is approximately the entire VLF budget as the VLF rate is now only .65% versus the prior rate of 2%. As with Sales Tax, Hayward has received its first backfill payment and it appears that State payments are consistent with staff's estimates.

VLF Gap Loan: The 2005-06 estimate also includes payment for VLF revenue that was "borrowed" by the State. The California 2003-04 budget borrowed three months of VLF backfill owed to local agencies. The State must repay the backfill amounts by August 15, 2006. As a result of recent legislation sponsored by the League of Cities, local agencies can "sell" their receivable from the state to a third party and receive funds earlier. A joint powers agency (California Communities) is being formed to issue bonds to purchase the receivables from cities and counties. The agency will purchase the VLF receivable from the local entity

at about 93% of the full amount. Then the full amount will be collected, by the joint powers agency, from the State at a later date. The difference between the purchase price and the ultimate collection will pay the cost of financing.

For Hayward the full amount borrowed by the State is about \$2.4 million. Staff recommends that Hayward participate in the financing of its receivable. If authorized by the Council, the City will receive approximately \$2.2 million in the 2005-06 fiscal year. Schedule A reflects the receipt of this amount in 2005-06.

Expenditures:

The single largest expenditure category for the City's 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 2005-06 reflects positions that were frozen with the adoption of the 2004-05 budget. For all units existing contractual obligations have been reflected in the budget estimate. In 2005-06 the only unit to receive a contractual increase is Fire. The 2005-06 estimate also includes current rate increases for retirement and other benefits. The other cost categories, Maintenance and Utilities, Supplies and Services and Capital Expenses are estimates at this point based on 2003-04 actual amounts.

Budget Approach for 2005-06

While no one likes to see a projected deficit, there is some good news with respect to the anticipated \$2.6 million revenue short fall. More specifically, I believe that this is something that can be addressed with the current resources of the City. To gain some perspective, the projected deficit represents about 3% of the General Fund revenue budget. Further the General Fund's Contingency fund balance is projected to be approximately \$5.6 million at the end of 2004-05. These funds have been set aside to address issues of this type and can be used to balance the budget for 2005-06.

Given that we are still early in the budget process and that adjustments can and will be made I am recommending the following guidelines with respect to directions to staff in developing the 2005-06 budget.

Revenue: Last year the City made several significant adjustments to several revenue categories. Consequently, except for mandated increases I am not recommending any material fee increases or new fees for the General Fund as contained in the City's Master Fee Schedule. Staff, however, will be bringing to Council a proposal to increase sewer and water rates in keeping with the policy of making adjustments, when necessary, every other year.

Expenditures: The single largest expenditure category is of course Employee Services. This category has seen increases in the past few years due to increases in PERS rates and medical benefits. The salary component, as a result of labor agreements, has remained almost unchanged. My direction to staff will be to maintain current staffing levels. This means that those positions frozen in 2004-05, are proposed to remain frozen next year. The exception to this is Fire, where Station 9 is assumed to resume operation.

Other expenditure categories are also being held at the current level. That is any program changes that might be approved must be done within the current budget. The significant disadvantage, but one that cannot be avoided with this approach, is that inflationary increases must be "absorbed", resulting in less funds being available to meet program needs.

Another program which saw a reduction last year is the Community Promotions budget. Historically, the City has provided funding to several local community groups that offer special programs and promotions that benefit Hayward residents. In 2003-04 this funding was \$180,000. For 2004-05 the funding level was reduced to \$150,000. I would recommend that funding remain at the \$150,000 level. .

Budget Issues for 2006-07

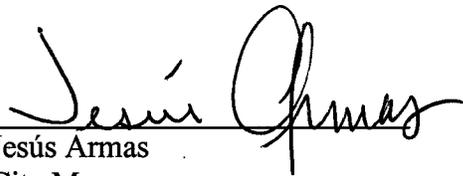
Council will remember that relatively recently staff prepared and submitted to the Council a two- year operating budget which was for the budget period 2001-2003. This practice was discontinued for the 2003-05 period because events, primarily at the state level, made it impractical to attempt a two-year budget. However, I am still very much in favor of a two-year budget, as there are significant advantages. I believe that we are approaching a period of relative economic stability and propose to reintroduce the two-year budget starting with the 2006-07 fiscal year.

Even though staff has not attempted to forecast 2006-07 at any level of detail, we have made some assumptions that are useful in assessing the trend of the General Fund's finances. For example, using growth factors of 5% and 3% respectively for property tax and sales tax and allowing some modest growth in other revenues staff is projecting total resources available in 2006-07 of approximately \$98.8 million. Also included in this revenue is receipt of \$1.9 million in property tax dollars that were withheld in 2004-05 and 2005-06. On the expenditure side, staff is estimating total costs of \$102.2 million. If these estimates hold true then there would be a revenue shortfall in 2006-07 of approximately \$3.4 million. On the expenditure side staff has adjusted for known increases for Employee Services and in other categories is assuming no change from the prior year. While this is a very rough estimate it does forecast continuing challenges. On the positive side, the magnitude of the potential shortfall is such that I believe the City will be able to respond in a manner that will not cause an abrupt change in the level and quality of City services.

Conclusion

To a large degree I believe the City's General Fund budget has stabilized. This is of course a relative term in an environment where the State continues to struggle with significant budget issues and government by proposition has become common place. Nonetheless, I do not see anything in the upcoming budget that will not allow the City to "hold the line" on services provided to our residents. I do not see the need for layoffs nor do I see the need to freeze additional positions. While a revenue shortfall is projected, it is not as overwhelming as some the City has faced in the past. We can still tighten the budget up and carefully review revenue estimates in the upcoming months. If we are able to make some gains in this regard I believe that it will be appropriate and responsible to recommend to Council to consider using

contingency fund to balance the budget. Staff looks forward to working with Council in developing the upcoming 2005-06 General Fund Operating Budget.



Jesús Armas
City Manager

Attachment

City of Hayward
 Mid-Year Budget Review
 Schedule of Revenues and Expenditures
 General Fund – 2004-05

Schedule A

	Adjusted Budget 2004-05	Estimated 2004-05	Projected 2005-06	Comments
REVENUES				
Property Tax	\$ 19,105	\$ 19,605	\$ 20,652	5% Net Growth Factor
Sales Tax	-	-	-	
Sales Tax Revenue	20,250	20,250	20,858	
State Backfill	6,250	6,250	6,437	
	<u>26,500</u>	<u>26,500</u>	<u>27,295</u>	3% Net Growth Factor
Real Property Transfer Tax	6,300	7,000	7,210	
Emergency Facilities Tax	1,700	1,700	1,700	
Supp. Bldg. Const. & Imp. Tax	1,200	1,200	1,200	
All Other Taxes	3,300	3,300	3,300	
Franchises	6,822	6,822	6,912	
Licenses and Permits	3,298	3,534	3,550	
Interest and Rents	851	411	577	
Fines and Forfeitures	887	1,668	1,159	
Vehicle License Fee	-	-	-	
VLF	8,400	1,383	2,875	VLF Loan payback, \$2.2 million
State Backfill	-	7,715	7,725	
	<u>8,400</u>	<u>9,098</u>	<u>10,600</u>	
All Other From Agencies	2,135	2,804	2,167	Reduced grant revenue
Fees and Service Charges	2,531	2,484	2,484	
Other Revenue	2,738	2,780	2,780	
	<u>2,738</u>	<u>2,780</u>	<u>2,780</u>	
Total Revenue	85,767	88,906	91,586	
Recurring Transfers In	4,965	4,965	4,965	
Encumbrances	-	-	-	
	<u>4,965</u>	<u>4,965</u>	<u>4,965</u>	
Total Resources	\$ 90,732	\$ 93,871	\$ 96,551	
EXPENDITURES				
Employee Services	79,066	79,066	83,894	Per computation
Maintenance and Utilities	3,894	3,894	4,146	Estimate based on 2003-04 actual
Supplies and Services	9,692	9,692	9,849	Estimate based on 2003-04 actual
Capital Expense	75	75	75	
Net Interdept. Charges (Credits)	(3,694)	(3,694)	(3,684)	Estimated
	<u>89,033</u>	<u>89,033</u>	<u>94,270</u>	
Operating Expenditures	89,033	89,033	94,270	
Recurring Transfers Out	4,869	4,869	4,870	
Total Expenditures	<u>93,902</u>	<u>93,902</u>	<u>99,140</u>	
Net Operating Revenue (Expenditure)	(3,170)	(31)	(2,589)	
Non-recurring Transfers In	-	-	-	
Non-recurring Transfers (Out)	-	-	-	
	<u>-</u>	<u>-</u>	<u>-</u>	
Net Revenue (Expenditure)	\$ (3,170)	\$ (31)	\$ (2,589)	