



CITY OF HAYWARD
AGENDA REPORT

AGENDA DATE 05/22/07
AGENDA ITEM _____
WORK SESSION ITEM WS#2

TO: Mayor and City Council
FROM: City Manager
SUBJECT: Fiscal Year 2007-08 Budget

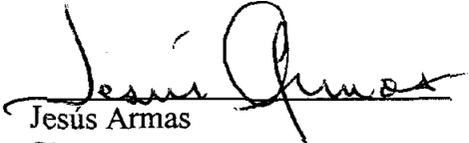
As noted in the budget message, it is necessary to utilize a portion of the contingency funds to assure that the budget is balanced for next year. Because recurring expenses are greater than recurring revenue for next year, staff cannot recommend incurring any new, on-going financial obligations. While there clearly is justification to provide additional staffing to respond to various community needs, there is insufficient income to enter into such obligations at this time. Additional staffing necessarily means incurring on-going financial obligations. While we would welcome the opportunity to recommend augmenting current staffing levels, fiscal realities indicate otherwise. Should the Council determine that additional staffing must be provided, it is left with a couple of choices: To reduce expenses elsewhere or incur the obligation with the knowledge that additional contingency funds must be earmarked to offset the increased costs.

It has been suggested that additional sworn police personnel are needed. While there is no dispute with this general assertion, adding a police officer requires an appropriation of \$150,000 per officer. Another area that has been mentioned as needing attention involves enforcement of various City regulations. Because this involves various code enforcement duties, this would be accomplished through the addition of personnel in our community preservation staffing. Each community preservation inspector results in an added cost of \$97,000 per year.

With the recent formation of the Keep Hayward Clean and Green Task Force, there will be a need to provide some level of funding to allow some of the initiatives that emerge from the work of the Task Force to be implemented. Since the Task Force has only been in existence a short period of time, it is still developing a complete list of activities it proposes to undertake in the upcoming fiscal year. Still, it would seem prudent to set aside a certain amount of funds for this purpose in FY 2007-08. To this end, it is recommended that the Council set aside \$50,000 to carry out the activities of the Task Force. At the same time, it is recommended that authorization to expend the funds be contingent on the presentation of a work program from the task force delineating how the funds will be utilized.

Another area that will need attention concerns the allocation of funds to support the City's participation in the 2-1-1 program. As of this writing, it remains unclear if the necessary funding will be provided by the County and the 14 cities in Alameda County to support this service. Because of the City's financial condition, staff cannot recommend earmarking funds for this purpose. Should the Council conclude otherwise, staff once again recommends allocating the

funds subject to the service provider being able to demonstrate that sufficient funding has been secured from private, public, or philanthropic sources to support this service. A deadline of January 1, 2008 is recommended.


Jesús Armas
City Manager

Attachment

May 15, 2007

Honorable Mayor and City Council:

In May 2006, staff presented to Council a two-year operating budget for the fiscal years of 2006-07 and 2007-08. This was the first two-year operating budget for some time and represented a positive step forward in the City's budgeting process.

A two-year operating budget yields a number of benefits, not the least of which is the ability to develop priorities over two years rather than a single-year period, which had been the norm in recent years. In addition, substantial staff time is saved with respect to the preparation of a budget in the second year. These two factors, alone, have made the two-year operating budget a success for Hayward

In keeping with the Charter provision for an annual budget, the budget ultimately approved by the Council in June 2006 applied only to FY 2006-07, with the second year considered a spending plan. Consistent with that second year spending plan, staff is now presenting Council with a recommended budget for the second year, FY 2007-08. As noted at the mid-year budget work session, Council is being asked to consider very few changes to the FY 2007-08 budget.

ECONOMIC CHANGES

Since Council considered the full two-year budget, the economy has softened, particularly in the areas of housing sales and construction. In addition, retail sales did not meet projections through the 2006 Holiday buying period. The price of gasoline held new car sales below expectations.

Despite these significant indicators, many economists believe that we will not see a major decline in the Bay Area economy over this next year. For the most part, the budget presented herewith is predicated on this assumption. City

revenues are assumed to remain relatively flat with some modest growth. This recommended budget continues to follow Council's policy of matching current year expenditures with current year income, but also relies on utilizing some part of contingency dollars in the following year.

As a result, I cannot recommend adding new positions even though it is clear that more staff and other resources would be helpful and are required to respond to the numerous priorities and program needs of the City.

OTHER FACTORS

Another major factor affecting this year's budget is that the City is involved in renewing or extending labor contracts for all bargaining units. These negotiations come on the heels of two years during which the City's bargaining units agreed to zero percent increases in order to assure that the City was able to sustain through leaner economic times.

In addition, 67 positions were frozen and remain frozen through this fiscal year. However, the demand for salary adjustments for the City's workforce cannot go unanswered if the City is to retain valued workers, compete for other qualified employees in the Bay Area marketplace, and honor agreements made with employee groups as part of holding salary costs steady over the last two years.

BUDGET OVERVIEW—2007-08

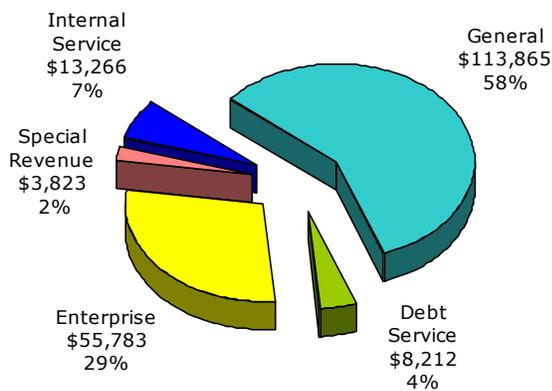
During this year's budget work session, the Council discussed the state of the City's financial condition and received input from staff and members of the community. At the conclusion of the work session, the Council provided direction to staff with regard to its priorities for the upcoming budget cycle.

A strong part of Council's discussion was the recognition that the City was in the second of a two-year budget, and is being challenged by a slowing economy. Therefore, it was important that the City move forward on the spending plan for this year as defined and

approved by Council in the FY 2006-08 Two-Year budget; and that the City not consider any new, major initiatives or recurring expenditures for the year.

The recommended 2007-08 operating budget is a balanced spending plan which totals \$194,949,000 for all funds. The following chart illustrates the composition of the City's operating budget by fund type.

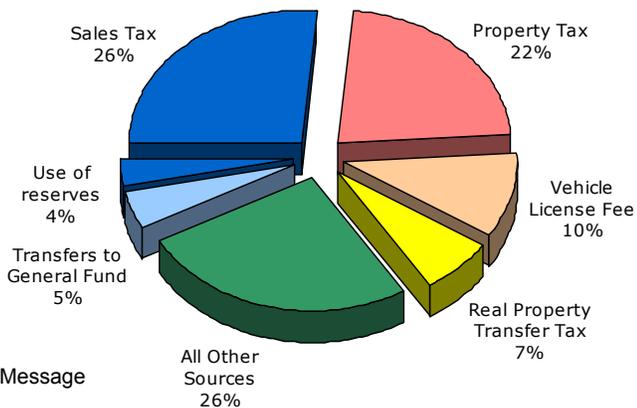
**City of Hayward Operating Budget—
All Funds
Total: \$195 Million
(\$'s in millions)**



This message focuses primarily on the General Fund, as this is where most City services are budgeted; and where Council has most discretion in setting priorities and spending levels.

**General Fund Revenue Estimates –
Sources of Funds**

**City of Hayward Operating Budget
General Fund Sources: \$113.9 million
(\$'s in millions)**



As can be seen from the preceding chart, General Fund revenues come from several sources, the most significant of which are Sales Tax and Property Tax. However, there are other important revenue sources for the General Fund such as the Real Property Transfer Tax and Vehicle License Fees.

Sales Tax. Sales tax revenue is estimated at about \$30 million for 2007-08, which represents a modest increase of approximately 5%, or \$1.43 million, over the 2006-07 estimate of \$28.6 million. This growth rate is cautious, but reasonable given the City's growing sales tax base and the sustaining local economy. In addition, the overall growth rate for the State for FY 2007-08 is projected at 5%, which further supports the projected growth. However, it will be important, as it is in any year, to carefully monitor this revenue source to determine if there are any signs of weakening. Should that become the case, staff will return to Council with recommendations at the earliest appropriate time.

Property Tax. Property Tax revenue is estimated at about \$25.7 million for 2007-08, which represents a modest increase of approximately 7%, or \$1.68 million, over the 2006-07 estimate of \$24 million. This revenue source continues to reflect both a stable although softening real estate market in terms of the number of sales as well as a market where values outpace inflation. New homes continue to enter the Hayward market as various housing developments are completed

As we all know, the real estate market, particularly the housing market, can change rapidly. However, as long as inflation in general and mortgage rates in particular, remain under control, staff sees moderate continued revenue growth. Also, it is important to note that the assessed value of Alameda County and of Hayward has reached a significant size, with Hayward's assessed valuation exceeding \$14 billion. As a consequence, there is stability to property tax revenue that dampens short-term market activity, positive or negative. A final caveat

of course is that the State does not tinker with the current property tax base. There is one additional revenue source that deserves special attention:

Real Property Transfer Tax: Real Property Transfer Tax is estimated to remain flat for FY 2007-08 at \$8 million. Over the years this revenue has become a major contributor to the City's revenue base and has exceeded \$9.7 million in previous years. However, the Real Property Transfer Tax revenue for FY 2006-07 is estimated to be \$8 million (or even less at year's end), which is short of projections by \$755,000, or 9%.

This revenue source is volatile and is a function of the number of residential sales (or property transactions) and the price at which property sells. As noted above, both of these categories are showing signs of weakening: fewer residential units are on the market, those that are offered for sale remain unsold for longer periods of time, and those that sell are doing so at slightly lower prices.

While new housing units continue to come online as discussed earlier, it should be noted that Real Property Transfer Tax revenue from the resale of existing units far out paces that which is generated by the sales of new units. Further, with the softening of the market, new housing prices are dropping.

Another variable in this volatile tax is the sale and transfer of commercial property. While a large commercial sale can positively impact this revenue to the City, commercial sales are both unpredictable and few and far between.

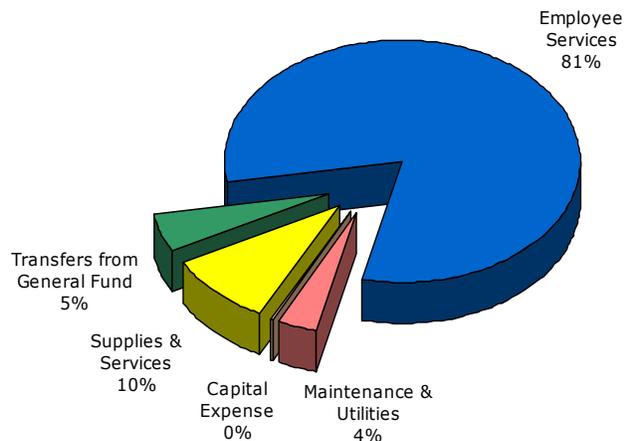
Expenditure Projections – Use of Funds

The overall effect of continued, sustained, flat-to-moderate revenue growth is that the City must use some contingency fund balance to fulfill contractual obligations with regard to salary adjustments and address other operating requirements.

While this maintains designated reserves in FY 2007-08, it does result in a 40% or \$3.8 million decline in the General Fund Contingency balance by the end of FY 2007-08.

The largest expenditure category for the General Fund is, of course, Employee Services. Given the fact that local government, including the City of Hayward, is a service provider, this is no surprise. Other expenditure categories include Maintenance and Utilities, Services and Supplies and Capital Expense. The relationship of these General Fund expenditure categories is as follows.

**City of Hayward Operating Budget
General Fund Operating Requirements:
\$113.9 million
(\$'s in millions)**



Employee Related Costs. Personnel salary and benefit expenses comprise approximately 81% of the City's General Fund operating costs, as shown above. For 2007-08, all negotiated salary and benefit increases, as well as those projected into the year, are factored into the expenditure assumptions.

Non-Personnel Expenditures. The other primary expenditure categories, Maintenance and Utilities, Supplies and Services, and Capital have been increased where necessary to meet contractual, mandated, or otherwise unavoidable costs and where the maintenance of service levels requires the acquisition of specific goods or services. In addition, within limited resources, the budget provides funds in selected departments to support efforts

directed toward meeting the Council's programmatic priorities for the next year.

HIGHLIGHTS

As Council is aware, the past few years have been extremely active ones, with the City entering into, completing, and beginning design of major land use and other projects. This work continues with many existing projects moving toward completion, and new projects being developed or proposed. The following are highlights of work staff is currently engaged in or that is coming forward to Council in this fiscal year:

- ◆ Mt. Eden Annexation – Phase II
- ◆ 238 Corridor Improvement Project
- ◆ 238 Land Use Study
- ◆ New Burbank Elementary School and Cannery Park Expansion Projects
- ◆ City Center Campus
- ◆ Cinema Place
- ◆ Conversion of City's phone system to Voice over Internet Protocol (VoIP)

CLOSING REMARKS

I believe that 2007-08 will be a challenging period for the City, and that the budget as presented has the necessary flexibility to survive any slight downturn in the economy. It is also a budget that recognizes the objectives that Council has identified.

The City's Executive team is now fully staffed and moving forward, productively engaged in the work to be accomplished. The Assistant City Manager, Community Development Director, and Finance Director were appointed and assumed their positions in FY 2006-07, joining the Human Resources Director, Library Director, and Public Works Director, who were all appointed in the preceding fiscal year.

While this is a significant step in assuring that the City continues to move forward with strong committed management, it is also of great significance since the Council

will face additional executive recruitments of a new City Manager and a new City Attorney in the first quarter of FY 2007-08. With the operational executives in place and working together, the Council can continue to rely on a well-managed, high performance organization.

In addition to continuing the positive momentum of the planned projects, Council will need to address the long-term financial health of the City. While we have a spending plan in place for this year, it is imperative that the Council determine a financial path for the City that contains expenditures within the bounds of expected revenues, and which does not rely significantly or regularly on the use of contingency fund balance.

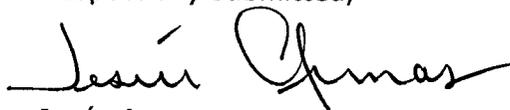
I strongly urge both Council and staff to enter into a constructive dialog with the City's residents and businesses to establish community priorities, define expected levels of service, and help assure that the City is delivering the services that matter most to the public. This may ultimately lead to a conversation about identifying new revenue sources for the community and its government.

ACKNOWLEDGEMENTS

I would be remiss if I did not acknowledge and thank all of the individuals who are instrumental in developing and producing this budget. The City of Hayward is fortunate to have a competent and dedicated staff and I extend my sincere thanks to those responsible for their efforts toward the completion of this budget.

As this constitutes the final budget that I will submit to the Council for its consideration, I close by stating that it was an honor to serve this organization and the residents of this community.

Respectfully submitted,



Jesús Armas
City Manager