City Council Staff Report

December 19, 2017

ITEM

Staff Report: Fiscal Year 2017 and 1st Quarter Fiscal Year 2018 Budget Review

BACKGROUND

Consistent with the City of National City's Strategic Plan element of providing consistent financial updates, this report provides a review of the financial operating results of the City for fiscal year 2017 and a status report for the first quarter of fiscal year 2018.

Budgets are projections based on known and anticipated future revenues and expenditure obligations. Throughout the fiscal year, staff monitors and analyzes actual revenues and expenditures, develops projections, and provides periodic financial reports to the City Council, City Manager, and department directors. The totals presented herein for fiscal year 2017 are a summary of the actual revenues and expenditures, and their impact on fund balance, compared to the corresponding budgeted amounts for the year. However, as of the date of this report, the independent audit for fiscal year 2017 has not concluded. As a result, the actual amounts are subject to change should adjustments be necessary prior to closing the books for the period. The fiscal year 2018 first quarter data reflects revenue and expenditure totals for the period of July 1st through September 30th compared to the same period for the prior year.

DISCUSSION

<u>Fiscal Year 2017</u>

The fiscal year 2017 budget authorized a $5.4 million use of unassigned fund balance, $3.3 million of which represents a structural deficit. An additional use of $1.4 million was approved for mid-year adjustments. And appropriations totalling $4.2 million, which represent an approved use of fund balance, were carried forward from the previous fiscal year. But, although an overall use of $11.0 million of fund balance was authorized, a combination of overall cost savings and unanticipated revenues, including many of a one-time nature, resulted in an actual use of $1.7 million, leaving a total fund balance of $48.4 million. This remaining fund balance includes $2.9 million assigned for use on approved capital projects. These unspent capital projects funds have been carried forward for spending on the completion of those projects in the current and future fiscal years. The variances between budgeted and actual revenues and expenditures and the impacts on fund balance are summarized below.

It is important to note, the amounts in this report are subject to change until the annual audit of the City's financial records and comprehensive annual financial report (CAFR) have been completed.

Revenues

The City receives revenues from various sources, some of which, such as taxes and fees, provide unrestricted cash that may be used at the City's discretion. Other revenues are reserved for specified purposes, for example, grant funds received for capital projects. Actual revenues for fiscal year 2017, listed by source in the table below, were less than their combined budgeted total by approximately $0.9 million.

Fiscal Year-End Revenue Totals

Revenue Source	Actual (Estimated)	Adjusted Budget[1]	Variance
Sales & Use Tax	$ 18,078,608	$ 17,851,000	$ 227,608
District Transactions & Use Tax	11,044,638	10,877,000	167,638
Property Tax[2]	2,019,235	2,130,570	(111,335)
Property Tax in Lieu of VLF	5,936,618	5,902,223	34,395
Other Revenues	14,668,370	15,914,205	(1,245,835)
Total	**$ 51,747,469**	**$ 52,674,998**	**$ (927,529)**

[1] adopted budget, plus budget adjustments
[2] reflects reduction for property tax allocation to the Library and Parks Maintenance funds

The positive variances of $227,608 in sales & use tax revenue and $167,638 in district transactions & use tax ("Proposition 'D'") revenue resulted from growth in retail sales that exceeded expectations, especially in the categories of autos & transportation and business & industry. Property taxes for fiscal year 2017 were less than anticipated by $111,335. Staff uses the best information available to project these revenues at the time of budget development; however, these estimates are prepared in advance of the release of assessed values by the San Diego County Assessor in June and subsequent adjustments to those values. While actual property tax revenues exceeded the total for fiscal year 2016, they did not reach the amount budgeted for fiscal year 2017.

Property tax in lieu of VLF (vehicle license fee) revenue ended the year slightly above its budgeted amount. This revenue, which is tied directly to the annual reported change in assessed value, has consistently climbed over the past five years.

The "Other Revenues" category includes various accounts related to ongoing City operations, one-time events, and capital projects reimbursements. The negative variance of $1.2 million in this category is the net result of variances, both positive and negative, across multiple accounts. Significant components include the following unbudgeted or over-/under-realized revenues:

- $4.8 million in revenue was added to the budget mid-year as an offset to an equal amount of additional appropriations for the Westside Infill Transit Oriented Development ("WI-TOD") improvements capital project. In accordance with generally accepted accounting principles, it was determined that these revenues should be recognized as the project money is spent. Because only $0.1 million was spent as of the end of the fiscal year, only the same amount in revenue was recognized. The remaining $4.7 million was classified as deferred revenue and will be recognized as expenses are incurred;
- the unbudgeted receipt of $1.2 million in residual balance distributions from the Successor Agency;
- the unanticipated receipt of $0.2 million, the City's share of the proceeds from the sale of former Successor Agency-owned real property;
- an unanticipated payment of $0.5 million from the City of San Diego related to the termination of the Enterprise Zone program (The Council has approved an appropriation of $140,000 from unassigned fund balance in the current fiscal year for year 1 of the City's economic development program on the basis of the receipt of these funds.);
- unbudgeted overtime reimbursements of $0.4 million for the Fire Department strike team's participation in fighting various wildfires throughout the State;
- building permits revenues exceeding the budget by $0.2 million; and
- a positive variance in transient occupancy tax revenue of $0.2 million.

If the $4.7 million in under-realized revenue related to the WI-TOD project were to be excluded, however, "Other Revenues" would reflect a positive variance of $3.4 million and overall revenues would show as being greater than budgeted by $3.7 million.

Expenditures

As of June 30, 2017, General Fund expenditures totaled $52.0 million, $10.2 million less than the adjusted budget of $62.2 million. Expenditure variances are summarized by category in the table below. The most significant variance, $7.7 million, occurred in the capital projects category. This $7.7 million does not represent savings; rather, it is the sum of as yet unspent monies on specifically authorized capital projects, the largest single amount being $4.8 million for the WI-TOD park project. As is our usual practice, the unspent capital project appropriations have been carried over on a project-by-project basis to fiscal year 2018.

Fiscal Year-End Expenditure Totals

Expenditure Type	Actual (Estimated)	Adjusted Budget[1]	Variance
Personnel Services	$ 33,889,046	$ 35,502,108	$ 1,613,062
Maintenance & Operations	6,128,802	6,840,585	711,783
Capital Projects	4,273,918	11,994,981	7,721,063
Internal Service Charges	7,387,911	7,416,737	28,826
Other Expenditures	285,627	430,205	144,578
Total	**$ 51,965,303**	**$ 62,184,615**	**$ 10,219,312**

[1] adopted budget total, plus budget amendments, encumbrances, & capital projects appropriations carried forward from previous fiscal year(s)

The remaining $2.5 million of the variance is due to operational cost savings. Personnel cost savings primarily were due to vacant authorized positions in the City Manager's Office and Police Department and less-than-anticipated spending on compensation changes. Maintenance & Operations ("M&O") savings were realized in various accounts, particularly in Professional Services and Contract Services. The variance in "Other Expenditures" results from savings in the Refunds, Contributions, and Special Payments category, the largest of which occurred in the Fee Study, Westside Amortization, and Successor Agency Property Management accounts. (The fee study will be completed in fiscal year 2018 and at a cost significantly lower than originally budgeted.)

Transfers In/Out

While technically not revenues and expenditures (and, hence, not shown above), transfers in and out of the General Fund contribute to fund balance increases and decreases, respectively. Both transfers into and out of the General Fund equaled their budgeted totals.

Net Impact on Fund Balance

The table below combines the above revenue and expenditure tables and incorporates the transfers in and transfers out, to compare the adjusted budget's use of fund balance to the actual use. Actual fiscal year 2017 revenues, expenditures, and transfers resulted in an estimated decrease of $1.7 million in the overall fund balance of the General Fund, as compared to the adjusted budgeted usage of $11.0 million, a positive difference of $9.3 million. (Note: the adjusted budget's use of fund balance includes "unassigned" amounts anticipated to be used based on the adopted budget [$5.4 million] and mid-year budget adjustments [$1.4 million], as well as "assigned" amounts (see description below) for appropriations carried forward – primarily for capital projects – from the previous year [$4.2 million].)

Fund Balance Change – Actual vs Budget (Estimated)

	Actual	**Adjusted**	**Variance**
Revenues	$ 51,747,469	$ 52,674,998	$ (927,529)
Transfers In	519,672	519,672	-
Total Revenues & Transfers In	**$ 52,267,141**	**$ 53,194,670**	**$ (927,529)**
Expenditures	$ (51,965,303)	$ (62,184,615)	$10,219,312
Transfers Out	(1,972,835)	(1,972,835)	-
Total Expenditures & Transfers Out	**$ (53,938,138)**	**$ (64,157,450)**	**$10,219,312**
Fund Balance Gain/(Usage)	**$ (1,670,997)**	**$ (10,962,780)**	**$ 9,291,784**
Beginning Fund Balance	**$ 50,065,188**	**$ 50,065,188**	
Ending Fund Balance	**$ 48,394,190**	**$ 39,102,408**	**$ 9,291,783**

In accordance with Governmental Accounting Standards Board ("GASB") Statement Number 54, fund balance is classified based primarily on the extent to which its use of resources is constrained. The table below reflects the estimated changes in each category of fund balance within the General Fund from June 30, 2016 to June 30, 2017. The balances are dependent not only upon the results of operations, i.e., revenues and expenditures, but also upon changes in such things as liabilities accrued for employee benefits and unspent appropriations carried over to the succeeding fiscal year. As noted above, the amounts are subject to change until the City's financial statements for fiscal year 2017 have been completed and audited.

Components of Fund Balance (Estimated)

	FY 17	**FY 16**	**Change**
Nonspendable	$ 9,963,816	$ 10,766,098	$ (802,282)
Restricted	616,253	754,913	(138,660)
Committed	11,585,066	11,585,066	0
Assigned	14,325,682	14,792,381	(466,699)
Unassigned	11,903,275	12,166,730	(263,455)
Total	**$ 48,394,092**	**$ 50,065,188**	**$ (1,671,096)**

Summary of fund balance changes by category:

Nonspendable – fund balance representing assets which are not in spendable form. Included in the $10.8 million total fiscal year 2016 are real property assets with values totalling $5.8 million that were transferred to the City from the Successor Agency during fiscal year 2016 and a $4.9 million promissory note received in fiscal year 2014 for the sale of the previous Public Works site to the Housing Authority for the WI-TOD project. The $0.8 million decrease in the Nonspendable category is the result of the sale of the Palm Plaza site in fiscal year 2017.

Restricted – category with spending constraints stipulated either "externally" by the provider of the assets or by law. For the City, the primary purpose of this category is to reserve an amount of fund balance equivalent to the subsequent fiscal year's debt service requirement. The $0.1 million decrease is attributable to a decrease in debt service requirements.

Committed – total of resources which have internally imposed restrictions mandated by formal action of the City Council. This category comprises the City's $9.1 million Economic Contingency Reserve and the $2.5 million Facilities Maintenance Reserve and is unchanged from fiscal year 2016.

Assigned – assets constrained by the Council's intent that they be used for specific purposes but not meeting the more strict criteria for classification as restricted or committed. Of the $14.3 million total, approximately $11.0 million represents employee benefit liabilities and $3.3 million represents designated, but as yet unspent, amounts for capital projects ($2.9 million) and certain other items ($0.4 million) carried forward from the prior year. The difference between the $2.9 million of assigned fund balance attributable to unspent capital projects appropriations and the $7.7 million budgeted but not spent on capital projects noted earlier in this report is $4.8 million in appropriations for the WI-TOD project, which, due to accounting rules, does not result in the reservation of fund balance because it is offset with a corresponding revenue.

Unassigned – total of spendable amounts not allocated to the other fund balance categories and which is available for use at Council's discretion. Unassigned fund balance, which is estimated to have decreased by $0.3 million, benefitted not only from the operational savings and better than anticipated revenues discussed above, but also from a decrease in employee benefit liabilities and debt service requirements. This $0.3 million decrease compares favorably to the combined total ($6.8 million) of the fiscal year 2017 adopted budget's anticipated use of $5.4 million and additional mid-year approved uses totalling $1.4 million.

1st Quarter Fiscal Year 2018

The fiscal year 2018 adopted budget authorizes a use of General Fund unassigned fund balance of $4.5 million, including a structural deficit of $3.6 million. Since it is early in the fiscal year, the ability to project year-end revenue and expenditure totals and actual use of fund balance is limited. The most useful information at the end of the first quarter (July 1st through September 30th) is a comparison of the fiscal-year-to-date totals of the City's major revenue sources and expenditure categories for the period for the current and prior fiscal years. This information is summarized in the tables below.

Revenues

1st Quarter Revenue Comparison

Revenue Source	**FY 18**	**FY 17**
Sales & Use Tax	$ 1,722,627	$ 1,849,466
District Transactions & Use Tax	1,118,708	1,037,040
Property Tax	47,205	39,860
Property Tax in Lieu of VLF	-	-
Other Revenues	7,033,510	1,799,933
Total	**$ 9,922,050**	**$ 4,726,299**

The sales & use tax and district transactions & use tax revenue amounts shown are those distributed to the City by the State in September. Amounts received in July and August were accrued to fiscal year 2017. Payments for October and November have since been received, and each of those payments was higher than those received for the same months in the prior year.

Fiscal year 2018 property tax revenue is expected to slightly exceed that of fiscal year 2017, consistent with budgeted totals. While the revenue is low for both years, this is normal at this point of the year, as the largest portions of property tax revenues are typically received in December and April, corresponding to tax payment due dates.

Because the distribution of property tax in lieu of VLF revenue occurs in January and May, no allocation of this revenue was received in the first quarter of the current or previous fiscal year. However, having received information from the County regarding fiscal year 2018 distributions of property tax in lieu of VLF, staff can report that this revenue will be $6,393,152, $172,923 above budget.

The significant increase to other revenues compared to fiscal year 2017 is the receipt of unbudgeted bond proceeds of $5.4 million related to the cost of the Energy Services Agreement with Ameresco for the energy efficiency and renewable energy program.

Expenditures

1st Quarter Expenditure Comparison

Expenditure Type	**FY 18**	**FY 17**
Personnel Services	$ 10,481,185	$ 6,763,168
Maintenance & Operations (M&O)	949,311	556,407
Capital Projects	1,043,879	950,864
Internal Service Charges	2,007,806	1,834,436
Other Expenditures	53,698	63,818
Total	**$ 14,535,879**	**$ 10,168,693**

Personnel costs are higher than fiscal year 2017's at the same point, due to the one-time lump-sum prepayment of $4.9 million for the unfunded actuarial accrued liability ("UAAL") portion of the City's annual pension contribution. Effective beginning fiscal year 2018, CalPERS requires the UAAL contribution, whether prepaid or paid monthly, to be paid as a fixed dollar amount rather than as a percentage of payroll, the method by which monthly contributions had been calculated and paid previously. By choosing the annual prepayment option, the City will recognize a budgetary savings of $0.2 million. Setting aside retirement plan expenditures, all other personnel related expenditures for the first quarter were $0.4 million greater than the previous year's first quarter. Fiscal-year-to-date 2018 M&O expenditures are higher than for fiscal year 2017, principally due to the timing of the $0.5 million Police Facility lease payment. In previous fiscal years, the payment was made in the second quarter. For this fiscal year, the payment (which was the final payment) was made in July in order to facilitate the financing for the Energy Services Agreement with Ameresco. Absent the lease payment, M&O expenditures are below those for the first quarter of last fiscal year. Although cost savings are again likely in fiscal year 2018, the savings margin (actual vs budget) is likely to be smaller than in recent years due, in part, to budget tightening in various accounts.

Budgetary Outlook

The fiscal year 2018 planned use of General Fund unassigned fund balance is $4.5 million. However, based on the City's recent history, the actual use of fund balance is anticipated to be lower than this amount due to conservative revenue budgeting and prudent spending. The mid-year budget status report will include projections to year-end for revenues and expenditures and their combined impact on fund balance.

Conclusion

While the City's general fund experienced a decrease in fund balance in fiscal year 2017, it was to much less of an extent than was anticipated at the beginning of the year. This experience marks a change from past years, where, while the budget incorporated the use of fund balance as a funding source, conservative spending and better than anticipated revenues resulted in an *increase* in fund balance, particularly in the unassigned category.

Factors likely to affect fund balance in the future include the following:

- Actuarial adjustments by the California Public Retirement System (CalPERS) are expected to require increases in the City's employer contribution to employee pension funds into the foreseeable future. For fiscal year 2019, the City's contribution is estimated to increase over the fiscal year 2018 rate by 10.1%, from 27.462% of payroll to 30.235% of payroll, for miscellaneous employees and by 5.1%, from 48.005% of payroll to 50.472% of payroll, for public safety employees. These increases are currently estimated to accelerate pension contribution growth in the next fiscal year by an additional $1.4 million.

- An assessment of the City's deferred infrastructure, facilities maintenance, and historic and cultural assets needs was completed during the previous fiscal year and brought forward to the City Council as part of its February 28, 2017 pension, other post-employment benefit, and capital needs workshop. The cost to the General Fund to complete all of the recommended maintenance would be at least $30 million; therefore, staff is currently analyzing various options for scheduling and financing this cost and will develop recommendations for consideration by Council.

- It is anticipated that at least $1.8 million in annual appropriations will be necessary for streets and road improvement projects, to meet the "maintenance of effort" requirement for eligibility to receive all available funding from the San Diego Association of Governments (SANDAG) TransNet program and from the State in relation to the recently-passed Road Repair and Accountability Act.

- The City is currently in discussions with organizations regarding management of the National City Aquatic Center. While the annual cost of operation of the Aquatic Center is under negotiation, the cost for immediate equipment and infrastructure has been estimated to be $180,000.

- Equipment necessary for firefighting must be replaced periodically. Within the next five years, it is anticipated firefighter breathing equipment will require replacement at a cost of approximately $200,000 and station alerting hardware at approximately $125,000 for the City's three fire stations.

RECOMMENDATION

Accept and file this staff report.