



Agenda Item # _____

Staff Report

City of Manhattan Beach

TO: Honorable Mayor Aldinger and Members of the City Council

THROUGH: Geoff Dolan, City Manager

FROM: Bruce Moe, Finance Director
Henry Mitzner, Controller

DATE: February 5, 2008

SUBJECT: Consideration of FY 2007-2008 Mid-Year Budget Review

RECOMMENDATION:

Staff recommends that the City Council receive and file this report.

FISCAL IMPLICATION:

As we review the mid year results, and begin the budgeting process for FY 2008-2009, the City remains in good financial condition. For FY 2007-2008, General Fund revenues are projected to exceed budget estimates at year end by approximately \$1.2 million (2%). Expenditures are in-line with budget and will come in close to the full-year estimates. As a result, we expect the year end results to provide a modest budgetary surplus of approximately \$1.2 million.

It is important to note that moving into FY 2008-2009, financial challenges exist. We briefly discuss some of those concerns later in this report, and are developing options for addressing those issues.

DISCUSSION:

The City's main operating fund is the General Fund. This Fund accounts for typical City services including Police, Fire, Paramedics, Parks & Recreation, Community Development and general governmental services. Overall, we expect General Fund revenues to exceed budget by 2% or \$1.2 million. We also expect expenditures to approximate budget.

The following is a list of major General Fund revenues, and the performance of each source through mid-year:

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<u>Revenue Source</u>	<u>Prior Year Total</u>	<u>Current Mid Year</u>	<u>Full Year Estimate</u>	<u>Budget</u>	<u>Variance</u>
Property Taxes	\$ 17,116,975	\$ 8,017,654	\$ 18,388,041	\$ 17,658,000	\$ 730,041
Sales & Use Tax	6,047,086	3,087,105	6,050,000	6,244,000	-194,000
Franchise Tax	1,200,503	367,544	1,200,500	1,189,000	11,500
TOT	3,122,618	1,754,526	3,500,900	3,136,000	364,900
Business License Tax	2,464,239	299,108	2,500,000	2,471,000	29,000
Property Tax in Lieu of Sales Tax	2,034,479	1,050,817	2,100,000	2,128,000	-28,000
Real Estate Transfer Tax	788,347	377,493	750,000	625,000	125,000
PSAF Sales Tax	335,279	110,888	340,000	319,000	21,000
Parking Citations	1,762,964	922,475	1,829,000	1,829,000	0
Building Permits	969,554	424,980	840,000	900,000	-60,000
Interest Earnings	1,228,502	704,436	1,475,000	1,250,000	225,000
Marriott Hotel Rent	792,973	429,512	850,000	800,000	50,000
Building Plan Check Fees	<u>846,131</u>	<u>410,725</u>	<u>790,000</u>	<u>850,000</u>	<u>-60,000</u>
Major Revenue Source Totals	<u>\$ 38,709,650</u>	<u>\$ 17,957,261</u>	<u>\$ 40,613,441</u>	<u>\$ 39,399,000</u>	<u>\$ 1,214,441</u>

Property Tax is the General Fund’s largest revenue source, accounting for 36% of General Fund revenues. We have forecast Property Tax to come in at \$730,000 (4%) over budget. While we have enjoyed solid growth in this major revenue over the past several years, the housing slowdown will certainly affect this revenue, as well as in building related fees and real estate transfer taxes. In fact, we are seeing an increase in property tax delinquencies county-wide which affect all cities in the county, since delinquencies are allocated across all cities in the county, not just to the city in which the delinquency occurs. Ultimately, those late payments are collected through the sale process, but it may take several years. We estimate that this year’s delinquencies will result in \$600,000 in deferred revenue, which has already been factored into the full-year estimates above.

Sales Tax is the city’s second largest General Fund revenue source, accounting for 17% of the total revenues. At mid-year, we are seeing revenues similar to the prior year, but below budget estimates. As a result, we expect year end totals to be below the original budget by up to \$222,000 (2.7%). Sales Tax is seasonal, with holiday shopping sales receipts from November-December arriving later in February, so the effects of this past holiday season will remain unknown for a few more weeks. However, based upon retail sales reports, we should not expect an unusually large boost from holiday sales. Sales Tax revenue remains sensitive as approximately 50% of our revenue is derived from fifteen businesses.

Council may recall that Sales Tax revenue was affected by the State’s “Triple Flip” three fiscal years ago, which changed the timing of the allocation of funds. Twenty-five percent (25%) of the City’s sales tax receipts are now received in January and May (shown above as “Property Tax in

Lieu of Sales Tax”), while the balance follows the traditional monthly timing. While the totals are the same by the end of the year, it does affect cash flow to a certain degree.

Transient Occupancy Tax (TOT) continues to reflect strong tourism and travel to this region. As a result, we expect to surpass budget by \$364,900, or 11.6%. These better-than-expected results also benefit our Capital Improvement Project Fund since 15% of the TOT is dedicated for Police & Fire Facility debt service and future projects within that fund. The strong occupancy numbers are also evident in the Marriott Hotel Rent line item that is partially derived from performance of the hotel.

The housing and construction slowdown is reflected in the performance and projections of the **Building Permits** and **Plan Check Fee** revenues. While we conservatively budgeted this year’s revenues as flat from the prior year’s results, we expect them to fall short of budget by a combined \$120,000 (6.9%). It is important to note, however, that through this slow down, we will also see a decrease in our plan check costs since fewer projects are being reviewed by our outside contractor. Overall, we have seen a decline in residential activity, but a slight increase in commercial activity. In particular, residential demolition permits issued have dropped by 50% as a result of fewer “spec” houses (constructed by a developer on speculation that there will be a buyer when it is completed) being constructed. This has served as a leading indicator of future residential construction and permits/planning fees. With this indicator trending lower, we expect the housing and construction related revenues to remain stagnant in the coming year.

Interest Earnings are ahead of last year and are expected to exceed budget by \$225,000, or 18%. However, recent interest rate reductions are expected to impact future interest earnings, and result in lower revenues in the future.

The remaining major revenue sources are expected to perform in line with budget estimates.

General Fund Expenditures:

General Fund expenditures through December 2007 are trending on budget, but above prior mid-year levels. **At the end of this year, we project full expenditure in the General Fund, with little or no savings being realized.** Although we remain within established budget levels, it is clear that rising costs are a key theme again this fiscal year. A similar pattern was noted during the 2006 and 2007 audit reports.

Two departments (Fire and Recreation) are tracking over budget at mid-year. For Recreation, expected cost patterns from the summer season (early in the FY) give the appearance of going over budget, but are expected to normalize as the year progresses. The Fire department has incurred additional overtime costs as a result of injuries, as well as our involvement in mutual aid responses to several regional fires (we are reimbursed by the State for these costs). Additionally, overtime incurred as the result of our Firefighters temporarily filling vacancies with the Hermosa Beach Fire department, appears as an expenditure, but is offset by reimbursement from Hermosa. However, the expenditure is presented without the reimbursement revenue. The cost of this assistance is fully reimbursed.

Personnel vacancies among all departments at mid year usually contribute to projected savings. However, because the fifteen to twenty vacancies are mostly in safety, overtime is incurred to fill the vacancies, which reduces any savings that may be attained.

With General Fund expenditures projected to come in on budget at year end, it is clear that continued expenditure control is important.

Capital Project Fund:

The Capital Improvement Fund (CIP) revenue is expected to exceed budget estimates by \$60,000 (11%) due to the strong performance of TOT. Expenditures in the Capital Improvement Fund at mid-year are at 35.9% of budget. The most material costs in this fund include debt service for the Police & Fire Facility, the Village soccer field, and the Facility Strategic Plan.

The CIP fund supports debt service for the Police/Fire facility and civic center improvements. With fund revenues dedicated to paying this debt service (\$818,700), the funding of additional capital projects is largely subject to our ability to generate General Fund surpluses. Reserves for previously approved capital projects have been provided for.

Other Funds:

All other City fund revenues are at expected rates at mid-year. Citywide expenditures for all other operating funds are pacing below budget levels on a combined basis. The City's Special Revenue, Enterprise and Internal Service Funds, with the exception of the Insurance Reserve Fund, are also operating as expected and remain in line with budget expectations.

FY 2008-2009 Challenges

Over the past several years, we have seen a recurring pattern of General Fund expenses growing at a faster pace than revenues. The result has been year-end budgetary surpluses trending lower.

FY 2007-2008 is shaping up the same way, with an expected surplus of \$1.2 million – well below the \$2.9 million positive outcome in FY 2006-2007, and the \$4.3 million in FY 2005-2006. While we are just now developing the proposed budget for FY 2008-2009, it is clear that we face challenges on a number of fronts. These include:

- *Increasing labor costs.* While we have long term agreements with all of our bargaining units, labor costs represent over 70% of our General Fund expenditures, so even cost-of-living adjustments have a major impact on expenditure levels;
- *Medical Benefits.* Providing employees with adequate healthcare also comes with a price tag that often goes up each year by double digits. We can expect the same this next year.
- *Retiree Medical.* With the passage of State Assembly Bill 2544, which took effect January 1, 2008, we are now required to provide an increased minimum allowance towards our retirees' medical premiums. A recent actuarial study indicates that our new annualized contribution will be in the \$400,000 to \$600,000 range over a thirty-year period. This is a new cost to the General Fund in FY 2007-2008.

- *Revenues.* As we have discussed in this report, our revenue outlook is flat, particularly in the housing related revenues (property tax, building permits, plan check fees, etc.)
- *State Budget Crisis.* Despite the passage of Proposition 1A in November 2004, there are circumstances under which the State may borrow from local government in a fiscal emergency (which the Governor has declared). The question at this point is not “if,” but “when” the raid on local government funds will take place. When it occurs, it will have a dramatic and immediate impact on us.
- *Subsidization of Other Funds by the General Fund.* As discussed in the 2006-2007 audit report, a number of funds that should be self-sustaining are receiving funding from the General Fund. For example, the Parking Fund required \$170,000 in the current year to maintain policy funding levels. The Street Lighting and Landscaping Fund has a -0- fund balance and assessments are inadequate to fund operations or provide for future capital needs. As a result, the General Fund is subsidizing this fund by \$131,000 in FY 2007-2008. Finally, the General Fund is providing uncompensated services to the Storm Water Fund of over \$400,000 per year. While some of these issues may require a Proposition 218 vote, it is clear that the General Fund can no longer afford to support these ancillary services.

Another fund that will require attention in the near term is our Water utility. As reported in the FY 2006-2007 audit report, the Water Fund expenses have been rising at a faster pace than revenues, due in large part to the higher cost of imported water, as well as continued investment in our infrastructure. Further, the costs are expected to increase as conservation measures are imposed by the regional water agencies in efforts to reduce demand. Of course, as demand for water decreases in response to conservation, some costs are reduced, while certain other costs of operating this utility remain constant, thereby placing further pressure on the fund. Finally, operating a utility effectively requires constant repairs, maintenance and improvements. Given these factors, staff will be requesting funding for an infrastructure analysis and rate study in the FY 2008-2009 budget. The last such study was performed 12 years ago, with the last water rate increase occurring 10 years ago.

Storm Water operations are increasingly impacted by new regulations and mandates, resulting in increased expenditures. Given that the revenues in this fund are virtually fixed, and cannot be changed without a Proposition 218 vote, General Fund subsidies (aside from the previously mentioned non-cash subsidy) may be required in the future to support operations.

In FY 2006-2007, the Parking Fund generated \$609,744 cash flow from operating activities. However, operational expenses, capital purchases and debt service for the Metlox Parking structure resulted in expenses of \$1,079,104. Interest income of \$126,938 and a General Fund subsidy of \$50,000, lessened the impact to the fund. However, at the end of the year, the fund had negative net cash flow of \$292,422. Excluding the interest and transfer-in, the fund would have suffered \$469,360 in negative cash flow loss from operations. The FY 2007-2008 budget includes a \$155,000 General Fund subsidy. Clearly, the Parking Fund is in need of immediate attention, and an increase in rates is unavoidable.

Workers Compensation claims and reserves continue to remain at high levels and have resulted in increased departmental charge outs in the Insurance Reserve Fund to match these claims. Due to the increasing trend of both Workers Compensation and Liability costs, charge outs have not kept pace. In order to relieve the total net asset deficit position of the fund, there was a General Fund transfer of \$1.3 million in FY 2007-2008. The increasing trend of paid claims continues to be an area of concern for us.

All-in-all, it is clear that our financial situation across a number of funds will require attention in the immediate future so that we can sustain service levels.

Fiscal Policy Compliance:

As of December 31, 2007 the City remains in compliance with all aspects of the established financial and investment policies for all funds. In particular, the City remains in compliance in the following key areas:

- The General Fund is projected to be balanced.
- General Fund working capital reserves, as set by policy, have been maintained.
- Reserves for approved capital projects have been recorded and maintained.
- Budget control at the fund level has been maintained citywide.
- We remain in compliance with the City's investment policy.
- Restricted cash balances in Special Revenue, Enterprise and Internal Service Funds continue to be safeguarded and monitored for appropriate use.

CONCLUSION:

The City remains in a sound financial position and we expect to out perform budget estimates for the 2007-2008 year. However, current economic trends will require us to aggressively address the many financial challenges we face. Significant labor-related costs, coupled with flat revenues and a gloomy State budget outlook are all challenges ahead. We will approach the upcoming budget in the same comprehensive and conservative manner we are accustomed to, by presenting a budget that will address the issues at hand.

Attachments:

- A. Revenue by Fund
- B. Expenditures by Fund

**City of Manhattan Beach
Month End Financial Report
Revenue By Fund - Fund Summary**

Data Date 01/15/2008

Percent Year 50.00
Fiscal Year 2008
Month December

Fund No.	Fund Title	Budget	Budget Adj.	Adjusted Budget	Current Month	YTD Actual	Unrealized Amount	Percent Realized
100	General Fund	48,585,105	80,229	48,665,334	7,894,284	20,987,065	27,678,269	43.13
201	Street Lighting & Landscape Fund	408,146	-	408,146	149,016	151,824	256,322	37.20
205	Gas Tax Fund	750,900	94,711	845,611	44,383	374,341	471,270	44.27
210	Asset Forfeiture Fund	24,000	-	24,000	14,986	61,602	-37,602	256.67
211	Police Safety Grants Fund	-	-	-	867	103,781	-103,781	0.00
220	Federal & State Grants Fund	-	2,222,250	2,222,250	-	-	2,222,250	0.00
230	Prop. A Fund	593,200	-	593,200	2,328	260,173	333,027	43.86
231	Prop. C Fund	518,450	-	518,450	8,210	252,101	266,349	48.63
232	AB 2766 Fund	46,580	-	46,580	12,064	34,968	11,612	75.07
401	Capital Improvement Fund	1,298,816	-	1,298,816	76,896	717,163	581,653	55.22
402	Safety & Civic Center Construction Fund	-	-	-	-	-	-	0.00
403	Underground Assessment Districts	30,000	-	30,000	1,895	14,662	15,338	48.87
501	Water Fund	7,247,050	-	7,247,050	469,757	4,062,756	3,184,294	56.06
502	Stormwater Fund	353,600	-	353,600	129,436	156,591	197,009	44.28
503	Wastewater Fund	1,407,440	-	1,407,440	92,993	722,313	685,127	51.32
510	Refuse Fund	3,888,910	66,247	3,955,157	324,285	1,935,932	2,019,225	48.95
520	Parking Fund	1,342,726	-	1,342,726	76,739	749,667	593,059	55.83
521	County Parking Lots Fund	399,500	-	399,500	18,742	237,969	161,531	59.57
522	State Pier and Parking Lot Fund	374,750	-	374,750	24,008	199,996	174,754	53.37
601	Insurance Reserve Fund	3,453,140	-	3,453,140	283,863	1,772,871	1,680,269	51.34
605	Information Systems Fund	1,252,614	-	1,252,614	104,385	626,307	626,307	50.00
610	Fleet Management Fund	1,780,775	-	1,780,775	167,411	778,188	1,002,587	43.70
615	Building Maintenance & Operations Fund	1,148,450	-	1,148,450	111,148	550,370	598,080	47.92
710	Special Assessment Redemption Fund	962,666	-	962,666	369,205	495,353	467,313	51.46
801	Pension Trust Fund	165,000	-	165,000	42,009	88,561	76,439	53.67
803	UAD Loan Program	-	-	-	-	3,076	-3,076	0.00
Grand Total - All City Funds		76,031,818	2,463,437	78,495,255	10,418,911	35,337,629	43,157,627	45.02

Data Date 01/15/2008

**City of Manhattan Beach
Month End Financial Report
Expenditures By Fund- Summary**

Percent Year 50.00
Fiscal Year 2008
Month December

Fund Number	Fund Title	Annual Budget	Current Month	YTD Exp	YTD Encumbr	Available Budget	Percent Realized
100	General Fund	49,152,993	3,934,433	24,112,810	481,760	24,558,424	50.04
201	Street Lighting & Landscape Fund	542,428	50,259	248,963	-	293,465	45.90
205	Gas Tax Fund	2,369,412	9,249	338,469	-	2,030,943	14.28
210	Asset Forfeiture Fund	177,717	5,345	50,187	47,713	79,817	55.09
211	Police Safety Grants Fund	6,227	-	3,182	3,045	-	100.00
220	Federal & State Grants Fund	2,222,250	-	-	-	2,222,250	0.00
230	Prop. A Fund	607,842	36,102	282,195	13,531	312,116	48.65
231	Prop. C Fund	1,031,745	384	2,473	-	1,029,272	0.24
232	AB 2766 Fund	2,000	-	-	-	2,000	0.00
401	Capital Improvement Fund	4,868,246	180,281	1,746,294	-	3,121,952	35.87
402	Safety & Civic Center Construction Fund	-	-	-	-	-	*
403	Underground Assessment Districts	-	3,753	61,848	-	(61,848)	*
501	Water Fund	10,229,342	637,241	3,827,538	54,473	6,347,331	37.95
502	Stormwater Fund	711,741	18,988	100,629	24,182	586,930	17.54
503	Wastewater Fund	2,096,347	86,083	583,351	-	1,512,996	27.83
510	Refuse Fund	4,100,606	314,035	1,716,005	2,241	2,382,360	41.90
520	Parking Fund	2,033,611	44,774	913,955	71,966	1,047,690	48.48
521	County Parking Lots Fund	316,349	5,047	69,165	-	247,184	21.86
522	State Pier and Parking Lot Fund	308,249	11,773	97,454	-	210,795	31.62
601	Insurance Reserve Fund	3,451,447	738,253	3,301,644	-	149,802	95.66
605	Information Systems Fund	1,461,378	42,578	488,685	201,692	771,001	47.24
610	Fleet Management Fund	1,899,495	128,645	735,403	194,503	969,589	48.96
615	Building Maintenance & Operations Fund	1,148,450	108,253	552,733	8,879	586,838	48.90
710	Special Assessment Redemption Fund	949,311	-	927,015	-	22,296	97.65
801	Pension Trust Fund	130,685	8,091	50,396	-	80,289	38.56
803	UAD Loan Program	15,000	-	7,277	-	7,723	48.51
Grand Total - All City Funds		89,832,870	6,363,566	40,217,670	1,103,987	48,511,213	46.00