02/15/11-05.

Agenda Item #:

Staff Report
City of Manhattan Beach

TO: Honorable Mayor Montgomery and Members of the City Council

THROUGH: David N. Carmany, City Manager

FROM: Bruce Moe, Director of Finance
Henry Mitzner, Controller

DATE: February 15, 2011

SUBJECT: Consideration of Fiscal Year 2010-2011 Mid Year Budget Review

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

FISCAL IMPLICATION:
Current budget projections indicate that the City will finish FY 2010-2011 with a slight deficit of $37,700 in the General Fund. Other funds are expected to perform as planned.

DISCUSSION:
Overall, the FY 2010-2011 General Fund budget through mid year is performing slightly better than expected. Revenues are estimated to exceed the adopted budget by approximately $871,000 (1.8%). Expenditures (including all budget adjustments subsequent to adoption) are expected to come in $692,000 under the adjusted budget[1]. When comparing projected year-end revenues and expenditures, irrespective of the budget, a deficit of $37,700 is expected.

While the recent recession had significant impacts on our key revenues, including property tax, sales tax, hotel bed tax and construction related fees, stabilization and slow improvement in these revenues is occurring. Staff continues to closely monitor expenditures, with cost control remaining a priority.

It is important to note that the policy reserve of 20% of General Fund expenditures ($10.4 million) and the economic uncertainty reserve of $4 million are maintained. Staff projects an unreserved General Fund balance of $2.7 million at fiscal year end.

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[1] The Adjusted Budget includes City Council-approved amendments during the current year as well as encumbrances carried forward from the prior year which are added to the budgeted expenditures in the new fiscal year.

Fiscal Year 2010-2011 General Fund Budget Projections

	Revenues	Expenditures	Surplus/(Deficit)
Adopted Budget	$49,274,023	$49,254,226	$19,797
Adjusted Budget	$49,437,323	$50,873,957	($1,436,634)
Full Year Estimate	$50,145,091	$50,182,764[2]	($37,673)

General Fund Revenues

Compared to one year ago, the City's revenue picture has improved in a number of areas, but remains sluggish in some key revenues. The chart below illustrates our General Fund revenues for FY 2010-2011 through mid year:

Key Revenues	2010 Actual	2011 Budget	2011 Full Year Estimate	Full Year Difference to Budget	Percentage Change	Full Year Difference to Prior Year	Percentage Change
Property Tax	$ 20,006,557	$ 19,528,792	$ 19,447,972	$ (80,820)	-0.4%	$ (558,585)	-2.8%
Sales & Use Tax	$ 7,301,378	7,480,000	7,900,000	$ 420,000	5.6%	$ 598,622	8.2%
Transient Occupancy Tax	$ 2,706,413	2,706,300	2,786,356	$ 80,056	3.0%	$ 79,943	3.0%
Business License Tax	$ 2,783,641	2,550,000	2,700,000	$ 150,000	5.9%	$ (83,641)	-3.0%
Building Permit Fees	$ 710,292	575,000	760,000	$ 185,000	32.2%	$ 49,708	7.0%
Plan Check Fees	$ 558,350	470,000	800,000	$ 330,000	70.2%	$ 241,650	43.3%
Interest Income	$ 283,979	450,000	350,000	$ (100,000)	-22.2%	$ 66,021	23.2%
Real Estate Transfer Tax	$ 356,354	310,000	348,300	$ 38,300	12.4%	$ (8,054)	-2.3%
Other Revenues by Category							
Other Taxes	$ 1,501,147	1,445,625	1,596,757	$ 151,132	10.5%	$ 95,610	6.4%
Revenue from Permits	$ 486,421	445,450	427,732	$ (17,718)	-4.0%	$ (58,689)	-12.1%
Fines & Forfeitures	$ 2,871,972	2,753,000	2,803,000	$ 50,000	1.8%	$ (68,972)	-2.4%
Use of Property & Money	$ 1,966,750	2,060,720	2,110,693	$ 49,973	2.4%	$ 143,943	7.3%
Other Governments	$ 430,454	298,259	479,776	$ 181,517	60.9%	$ 49,322	11.5%
Service Charges/Transfers	$ 7,276,510	7,970,877	7,399,840	$ (571,037)	-7.2%	$ 123,330	1.7%
Miscellaneous Revenues	$ 160,718	230,000	234,666	$ 4,666	2.0%	$ 73,948	46.0%
Total General Fund Estimated Revenue	$ 49,400,936	$ 49,274,023	$ 50,145,091	$ 871,068	1.8%	$ 744,155	1.5%

Note:
2011 Budget figures are budget as adopted. Grants totaling $163,300 have been received and are included in the full year estimates. Those grants were not included in the original budget as adopted.

[2] The full year expenditure total includes $974,000 for the City Manager home loan/City equity agreement in early 2011.

Property Tax

Property tax is the General Fund's largest revenue source, accounting for approximately 40% of total revenue. The forecast is for Property Tax as a group to come in $80,820 (.4%) under budget and 2.8% ($558,585) below last year's results. The main reason for this trend is a reduction in the amount of prior year taxes being collected (27% below one year ago levels, or $124,000) and a concomitant reduction of interest and penalties ($31,850).

While the process of budgeting for FY 2011-2012 has just commenced, preliminary forecasts for property taxes indicates growth of 1.62% for next fiscal year. If it holds true, this would result in additional revenue of approximately $300,000 in FY 2011-2012.

FY 2009 Revenue:	$19,930,491
FY 2010 Revenue:	$20,006,557
FY 2011 Budget:	$19,528,792
FY 2011 Full Year Estimate:	$19,447,972

Real Estate Transfer Tax

Real Estate Transfer Tax revenue is derived from a charge of fifty-five cents per $500 of sales price, split evenly between the City and the County of Los Angeles. As home sales volume slowly recovers along with sales prices, this revenue source is expected to improve. Single family residential sales volume in 2010 (329 units) was slightly below 2009 levels (340 units), however, the median price for 2010 ($1.5 million) was 9.1% ahead of the prior year[3]. For the current fiscal year, this revenue is expected to surpass budget by 12.4% ($38,300).

FY 2009 Revenue:	$325,001
FY 2010 Revenue:	$356,354
FY 2011 Budget:	$310,000
FY 2010 Full Year Estimate:	$348,300

Sales Tax

Sales tax is the city's second largest General Fund revenue source, accounting for 15.2% of total revenue. After several years of declining sales tax revenues, it appears growth is returning. At mid-year, revenues are trending 5.6% ($420,000) above budget and $600,000 (8.2%) above last year (please note that this is after accounting for the projected sales tax sharing agreement with DeWitt Petroleum). While Sales Tax typically sees a boost in the 4th quarter due to holiday shopping, those statistics are not available until March, so the effects of this past holiday season will remain unknown for a few more weeks (although other sources indicate an increase in holiday spending from the prior year).

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3 Source: DQ News

One important factor in analyzing sales tax is the "Triple Flip"[4] calculation by the State. In short, each year the State estimates sales tax growth in order to calculate the Triple Flip payment, which is received twice a year (January and May). Last year, the State underestimated the actual sales tax collected (this reversed the allocations from the prior year in which the State over advanced the tax revenues by $300,000). As a result, at the end of FY 2010 the City received a correction amount of $97,000, which is now reflected in estimates for the full year.

FY 2009 Revenue:	$7,480,516
FY 2010 Revenue:	$7,301,378
FY 2011 Budget:	$7,480,000
FY 2010 Full Year Estimate:	$7,900,000

Transient Occupancy Tax (TOT)

Also known as the hotel bed tax, the TOT through the first half of the fiscal year is performing 3.1% ($82,300) above last year – a reversal of the downward trend for the past two years. As a result, hotel bed tax (General Fund portion) is projected to total $2.73 million. This will also positively affect Capital Improvement Project Fund revenue by $14,000 since 15% of the TOT is dedicated for Police & Fire Facility debt service[5] and future projects within that fund. The improvement in activity will also be evident in the Marriott Hotel Percentage Rent revenue that is partially derived from performance of the hotel.

	Gen. Fund	CIP Fund	Total
FY 2009 Revenue:	$2,931,689	$517,427	$3,449,116
FY 2010 Revenue:	$2,651,466	$467,906	$3,119,372
FY 2011 Budget:	$2,652,000	$468,000	$3,120,000
FY 2011 Full Year Estimate:	$2,734,000	$482,500	$3,216,500

Building Permit & Plan Check Fees

While the housing and construction slowdown had a remarkable impact on building related fees over the past few years, there are signs of stability and recovery. Residential remodeling activity is stable, and there has been recent activity in "spec" home building (homes built by developers prior to having a buyer). However, the biggest impact on revenues comes from the adoption in May 2010 of revised construction valuations used in determining the cost of building permits and plan check fees. The combination of these factors will result in Building Permits exceeding budget estimates by $135,000 (32.2%), and Plan Check Fees performing $330,000 (70.2%) ahead of schedule.

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[4] Created by the State in 2004 to reduce the State deficit at that time, the Triple Flip reduces the local sales tax rate by ¼ cent, which is then used by the State to repay economic recovery bonds issued at that time. Cities and counties were provided with property tax revenues in lieu of the sales tax revenues, with the growth tied to retail sales.

[5] Sufficient revenue remains dedicated to the CIP Fund to cover the annual debt service.

By way of valuations, total projects in 2009-2010 through January (prior to the change in construction valuations) were valued at $31,475,373, while 2010-2011 projects through the same period were valued at $36,011,201, an increase of 14.4%.

	Building Permit	Plan Check
FY 2009 Revenue:	$626,346	$605,565
FY 2010 Revenue:	$710,292	$558,350
FY 2011 Budget:	$575,000	$470,000
FY 2010 Full Year Estimate:	$760,000	$800,000

Business License Tax

Business license tax, which is generally calculated upon a business's gross receipts, is expected to come in approximately 3% ($83,641) below last year's collections, but $150,000 (5.9%) ahead of budgetary estimates. While over the past few years the City had expected a decline in this revenue to mirror the overall economy, such reductions have not occurred, and the tax has remained stable.

An analysis of FY 2009-2010 licenses compared to the previous year indicates that licensed businesses' total gross receipts declined by 9.8%, but business license revenues remained steady. Similarly, the year before, gross receipts for businesses rose by a reported 22%, and yet the revenues remained even. Some key reasons for the inelasticity in this revenue may be explained in that over 50 businesses pay the maximum gross receipts business license ($7,923 in 2010), and any changes in their gross receipts are unlikely to change their license tax. Additionally, 22% of all business license revenue comes from commercial property owners whose business is taxed on square footage (which remains consistent from year-to-year) and not gross receipts. It is also interesting to note that 25% of all business license taxes are paid by just 27 businesses, and 50% of all such taxes are paid by just 160 businesses, this out of more that 4,000 licensed to operate in town.

Given this data and trends for the past few years, staff expects revenues to approximate last year's levels. However, the precise amount will not be known until the license tax collections are substantially completed in April 2011.

FY 2009 Revenue:	$2,767,070
FY 2010 Revenue:	$2,783,641
FY 2011 Budget:	$2,550,000
FY 2010 Full Year Estimate:	$2,700,000

Interest Income

The City invests its idle cash in a number of instruments ranging from the state-run Local Agency Investment Fund (LAIF) and corporate debt, to U.S. Treasury notes and Governmental Agencies. During the recent recession and economic problems, interest rates declined dramatically, and remain at very low levels (although in recent weeks there has been an improvement in yields). The City's maturing investments are being reinvested at the current low rates, resulting in a drop in portfolio yield. Two years ago the City's portfolio yielded 3.59%, and last year at this time it was yielding 1.70%. Today, the portfolio is returning 1.63%. As a result, the City's interest income will suffer, which affects all funds that receive such income (General, Water, Parking funds, etc.). This revenue is expected to underperform budget estimates by $100,000 this year, but improve in the coming months as funds are reinvested at today's improving rates.

FY 2009 Revenue:	$1,353,304
FY 2010 Revenue:	$ 283,979
FY 2011 Budget:	$ 450,000
FY 2011 Full Year Estimate:	$ 350,000

Other General Fund Revenues

In addition to the General Fund, there are several other revenues that are worth mentioning:

- **Marriott Hotel Percentage Rent** – Up 12.2% ($71,900) from a year ago. This revenue is based on room, and food and beverage sales, and reflects the improvement in tourism and travel. This is forecast to come in $90,000 (16.1%) over budget at year end.
- **Franchise Tax** – up 7.1% from last year at this time due to increased franchise payments from Verizon as their FIOS TV expands their customer base. This is forecast to end the year 11.7% over budget or $136,729.
- **Ambulance Fees** – These fees were increased July 1 and are now tied to the LA County rates. While collections are up 86% from the year prior at this time, collection rates have dropped (mainly from Medi-Cal and Medicare patients), resulting in a projected $124,400 shortfall in this revenue for the full year.

General Fund Expenditures:

Half way through the year the City has expended and encumbered $24,325,575 or 48.75% of the total adjusted budget allocation. An analysis of the expenditures, after accounting for one time expenditures and anomalies, indicates the following spending patterns by category:

Expenditure Category	Adjusted Budget	Projected Year End	Difference (Under)/Over
Salary and Wages	$ 24,685,667	$ 24,697,193	$ 11,526
Employee Benefits	$ 10,259,355	$ 9,692,368	$ (566,987)
Contract and Professional Services	$ 5,293,493	$ 5,313,327	$ 19,834
Materials and Services	$ 2,507,627	$ 2,325,375	$ (182,251)
Utilities	$ 882,555	$ 849,178	$ (33,377)
Internal Service Charges	$ 4,442,926	$ 4,431,993	$ (10,933)
Property and Equipment	$ 9,700	$ 9,700	$ -
Debt Service	$ 1,798,203	$ 1,569,200	$ (229,003)
Interfund Transfers	$ 20,431	$ 20,431	$ -
Subtotals	$ 49,899,957	$ 48,908,764	$ (991,192)
Adjustments:			
City Manager Home Loan	$ 974,000	$ 974,000	$ -
Carryforward PO's to be expended	$ -	$ 300,000	$ 300,000
Totals	$ 50,873,957	$ 50,182,764	$ (691,192)

General Fund Revenue/Expenditure Summary

Total Projected Revenue	$ 50,145,091
Total Projected Expenditures	$ 50,182,764
Surplus	$ (37,673)

A review of the expenditure categories above indicates that Employee Benefits will come in 5.5% below budget, or $566,987. This category includes group medical insurance which will come in 9% under budget. This savings is due to medical plan premiums coming in below budgetary assumptions which were set before the release of information on the premiums (which go into effect in December of each year). Further, employee vacancies add to the savings in most of the expenditures in this category.

With the fiscal challenges before us, staff is very aware of the implications of filling vacancies, and carefully evaluates each and every vacant position for criticality before proceeding with recruitment. Additionally, because the City budgets a staff vacancy factor ($400,000), each vacancy is further evaluated for affordability.

Other Funds:

Other City fund revenues and expenditures have been reviewed, and are trending appropriately at mid-year. Citywide expenditures for all other operating funds are pacing below budget levels on a combined basis.

Conclusion:

Mid Year results for the General Fund are encouraging. A slight budget deficit of $37,700 is expected in the General Fund. However, this includes the one time joint home purchase with the City Manager in which the City funded (loan and equity) a total of $974,000. After factoring out that one time transaction, the mid year General Fund results suggest a $936,600 year end surplus.

Revenues appear to be stabilizing and improving, but the biggest concern is the slow growth of property taxes since this is the City's largest revenue source, accounting for 40% of General Fund revenues. Sales tax results are encouraging, but are economically sensitive. A rising interest rate environment may signal the beginning of a recovery in interest income, which just a few years ago generated over $1.3 million to the General Fund, far more than the $350,000 expected this year. Improving tourism will help the transient occupancy tax as well as Marriott hotel revenues which are shared with the City as landlord. Overall, revenues are projected to come in $871,000 over budget.

Expenditures are being monitored closely. Personnel costs, which make up 70% of the General Fund, are scrutinized, with hiring decisions based on the criticality of the need and availability of funds. With this monitoring, expenditures are expected to come in approximately $700,000 under the adjusted budget.

While the budgeting process for FY 2011-2012 has just started, challenges exist, the biggest being the cost of funding employee pensions. CalPERS, with which the City contracts for pension benefits, is considering a reduction in the assumed rate of return on their portfolio. The reduction may increase City pension costs by an additional $1 million to $2 million per year (depending upon the depth of the investment return reduction). This in addition to the expected increase in costs that are the result of the losses in fiscal year 2008-2009 (which will be reflected in the City's FY 2011-2012 rates).

The two most recent budgets have included a reduction in fleet rental charge outs ($600,000) to the departments as a method to reduce expenditures. While the fleet fund has been able to manage vehicle replacements utilizing fund balance for purchases, it is not a long term solution and cannot be relied upon, particularly when large dollar fleet purchases are necessary (fire apparatus, sewer vacuum jet trucks, etc.). Staff is performing an analysis of the fleet replacement schedule and will discuss this issue during the FY 2011-2012 budget sessions.

Another area of concern is the on-going State budget crisis, which is a perennial threat to local government funding. In 1992, facing a serious deficit position, the State of California began shifting local property tax revenues from cities, counties and some special districts to reduce the cost of education to the State's general fund (this shift is referred to as the Education Revenue Augmentation Fund, or ERAF). ERAF is still in place today, and the State continues to redirect City of Manhattan Beach property taxes of over $1 million annually. This is in addition to the approximately $40 million of City funds that have been redirected to ERAF since 1992. Other tactics used by the State in the past include borrowing of Gas Tax funds and not funding reimbursements for State mandates on local government as required by law. While cities now enjoy the protections of recent voter approved ballot measures, the State's continuing structural deficits, currently valued at $25.4 billion over the next 16 months, serve as a reminder of potential future raids of local government revenues.

Also worth noting are General Fund subsidies of other fund's activities, which diverts funds from Police, Fire and other general governmental services. For example, the Street Lighting and Landscaping Fund has no fund balance and assessments are inadequate to fund operations or provide for future capital needs. As a result, the General Fund subsidized this fund by $173,993 in FY 2009-2010. The General Fund is also providing uncompensated services to the Storm Water Fund of over $400,000 per year, this as the fund will encounter higher operating costs due to legislative action to clean storm water runoff. While these issues require a Proposition 218 vote, it is most appropriate that the General Fund no longer support these ancillary services.

In addition to the challenges discussed above, the economic environment will leave few if any opportunities for even minimal capital projects, since the City relies on General Fund surpluses to produce the bulk of the funding for these community projects. With the exception of the Library project, which has its own dedicated and restricted resources for construction, there clearly will be limited funding for significant projects or major rehabilitation of existing facilities.

Labor costs represent approximately 70% of General Fund expenditures. With all three labor contracts being negotiated this year, this will be an important step in ensuring the long term fiscal sustainability of the community, while also retaining the present package of municipal services and the excellent, skilled workforce that provides their outstanding services to the community.

As the FY 2011-2012 budget proceeds, staff will present the City Council with a balanced spending plan utilizing the tools available. Workshops will be scheduled for decision making purposes. Updated financial forecasts will be provided to facilitate the discussion. As always, there will be several opportunities for public input, including the budget study session(s), in which Council will review each department's budget. Input may also be received at the public hearing prior to adoption.

Staff appreciates this opportunity to provide this financial information, and is available to answer questions.