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Agenda Item #:

Staff Report
City of Manhattan Beach

TO: Honorable Mayor Tell and Members of the City Council

THROUGH: David N. Carmany, City Manager

FROM: Bruce Moe, Director of Finance
Henry Mitzner, Controller
Eden Serina, Budget Analyst

DATE: February 7, 2012

SUBJECT: Fiscal Year 2011-2012 Mid-Year Budget Review

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

FISCAL IMPLICATION:
Current budget projections indicate that the City will finish FY 2011-2012 with a surplus of $2.4 million in the General Fund. The status of other funds is discussed later in this report.

DISCUSSION:
Overall, the FY 2011-2012 General Fund budget to actuals through mid-year is performing better than expected. Revenues are estimated to exceed the adopted budget by approximately $1.3 million (2.4%). Expenditures (including all budget adjustments subsequent to adoption) are expected to come in $1.0 million under the adjusted budget[1]. When comparing projected year-end revenues and expenditures irrespective of the budget, a surplus of $2.4 million is projected.

This year, there is considerable improvement over the prior year in the City's major revenues, particularly property tax and sales tax. Construction-related fees are also showing notable gains as signs of an economic upturn are becoming evident. While revenues may be on an upswing from the prior year, cost control continues to remain a priority.

It is important to note that the policy reserve of 20% of General Fund expenditures ($10.0 million) and the economic uncertainty reserve of $4 million are maintained. Staff projects an unreserved General Fund balance of $4.4 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 2011-2012 General Fund Budget Projections

	Revenues	Expenditures	Surplus
Adopted Budget	$51,170,408	$50,657,495	$512,913
Adjusted Budget	51,220,408	51,140,985	79,423
Full Year Estimate	$52,470,571	$50,101,795	$2,368,777

General Fund Revenues

Compared to one year ago, the City's revenue picture has improved in a number of areas, particularly in several major revenues. The chart below illustrates our General Fund revenues for FY 2011-2012, estimated at mid-year:

	2011 Actuals	2012 Adjusted* Budget	2012 Full Year Estimate	Full Year Variance From 2012 Budget		Full Year Variance From 2011 Actuals	
Key Revenues							
Property Tax	$19,791,424	$19,753,700	$20,132,203	$378,503	1.9%	$340,780	1.7%
Sales & Use Tax	8,180,674	8,125,000	8,527,900	402,900	5.0%	347,226	4.2%
Transient Occupancy Tax	2,693,937	2,769,951	2,694,000	(75,951)	(2.7%)	63	0.0%
Business License Tax	2,844,066	2,754,000	2,844,000	90,000	3.3%	(66)	(0.0%)
Building Permits	818,468	720,000	830,668	110,668	15.4%	12,201	1.5%
Building Plan Check Fees	797,742	840,000	930,991	90,991	10.8%	133,250	16.7%
Interest Earnings	647,027	500,000	534,000	34,000	6.8%	(113,027)	(17.5%)
Real Estate Transfer Tax	473,280	360,000	500,000	140,000	38.9%	26,720	5.6%
Subtotal Key Revenues	***$36,246,616***	***$35,822,651***	***$36,993,763***	***$1,171,112***	***3.3%***	***$747,147***	***2.1%***
Other Revenues by Category							
Other Taxes	$1,642,425	$1,597,543	$1,677,557	$80,014	5.0%	$35,132	2.1%
Revenue from Permits	462,931	492,060	630,011	137,951	28.0%	167,080	36.1%
Fines	2,757,131	2,924,500	2,885,677	(38,823)	(1.3%)	128,546	4.7%
Use of Property & Money	1,922,376	2,139,952	1,659,349	(480,603)	(22.5%)	(263,028)	(13.7%)
Other Governments	499,736	341,359	393,811	52,452	15.4%	(105,925)	(21.2%)
Service Charges & Transfers	8,045,664	7,681,493	7,730,906	49,413	0.6%	(314,759)	(3.9%)
Miscellaneous	456,750	220,850	499,498	278,648	126.2%	42,748	9.4%
Subtotal Other Revenues by Category	***$15,787,014***	***$15,397,757***	***$15,476,809***	***$79,052***	***0.5%***	***($310,205)***	***(2.0%)***
Total General Fund Revenues	**$52,033,630**	**$51,220,408**	**$52,470,571**	**$1,250,163**	**2.4%**	**$436,941**	**0.8%**

Positive Variance indicates above budget; negative variance indicates below budget

** The General Fund Adjusted budget includes the adopted budget plus a $50k increase adjustment for a police grant made during the fiscal year.*

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Property Tax

Property tax is the General Fund's largest revenue source, accounting for approximately 38% of total revenue. The forecast is for Property Tax as a group to come in $378,503 (1.9%) over budget and $340,780 (1.7%) above last year's results. Growth in assessed property values has led to an increase over the prior year in secured property tax, improving on the prior year's stagnation in property valuations.

FY 2010 Revenue:	$20,006,557
FY 2011 Revenue:	$19,791,424
FY 2012 Budget:	$19,753,700
FY 2012 Full Year Estimate:	$20,132,203

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 starts to recover along with sales prices, this revenue source is expected to improve. Single family residential sales volume in calendar year 2011 (301 units) was below 2010 levels (396 units), while the median price for 2011 ($1.4 million) remained in line with prior year[3]. For the current fiscal year, this revenue is expected to be slightly ahead of the prior year and to surpass the budget by 38.9% ($140,000).

FY 2010 Revenue:	$356,354
FY 2011 Revenue:	$473,280
FY 2012 Budget:	$360,000
FY 2012 Full Year Estimate:	$500,000

Sales Tax

Sales tax is the city's second largest General Fund revenue source, accounting for 16.3% of total revenue. After several years of declining sales tax revenues at the end of the last decade, growth is returning. At mid-year, revenues for the full year are trending 5.0% ($402,900) above budget and $347,266 (4.2%) above last year. A full year inclusion of the sales tax sharing agreement with DeWitt Petroleum (commenced in October 2010), as well as the addition of a new car dealership (Power Pre-Owned, located in the old Mercedes location) are contributing to the gains. External sources predict growth in Sales Tax statewide this fiscal year, continuing into next fiscal year.

FY 2010 Revenue:	$7,301,378
FY 2011 Revenue:	$8,180,674
FY 2012 Budget:	$8,125,000
FY 2012 Full Year Estimate:	$8,527,900

[3] Source: L.A. County DataQuick Property Data

Transient Occupancy Tax
Also known as the hotel bed tax, the City levies a 10% Transient Occupancy Tax (TOT) on hotel and motel rooms, with 8.5% going to the General Fund and the remaining 1.5% going to the Capital Improvement Fund to fund Police & Fire Facility debt service and future projects. TOT through the first half of the fiscal year is performing slightly below the first half of the previous year due to remodeling and construction at the Marriott Hotel. The Marriott underwent major renovation to its rooms from September through December 2011 resulting in an 18.9% decline in its TOT for the first six months of FY 2012 over the prior year timeframe. Offsetting the decrease is a 5.8% increase in the remaining hotels' TOT in the first half of the fiscal year, indicating an economic recovery. As a result of the Marriott renovation, fiscal year 2012 year end revenues are projected to be in line with the prior year but slightly below budget, with modest growth expected in the years to come.

	Gen. Fund	CIP Fund	Total
FY 2010 Revenue:	$2,651,466	$467,906	$3,119,372
FY 2011 Revenue:	$2,696,937	$475,400	$3,169,339
FY 2012 Budget:	$2,769,951	$488,815	$3,258,766
FY 2012 Full Year Estimate:	$2,694,000	$475,000	$3,169,000

Building Permit & Plan Check Fees
Building-related fees are continuing its upward trend from the prior year, as the economy is starting to show some signs of stability and recovery in the local housing and construction market. Residential remodeling activity is growing from the prior year, and at mid-year the number of permits issued is up 34%, with corresponding valuations up by 48%. Likewise, Plan Checks are also on the rise. Building Permits are estimated to exceed budget estimates by $110,668 (15.4%), and Plan Check Fees expected to perform $90,991 (10.8%) ahead of schedule.

	Building Permits	Plan Checks
FY 2010 Revenue:	$710,292	$558,350
FY 2011 Revenue:	$818,468	$797,742
FY 2012 Budget:	$720,000	$840,000
FY 2012 Full Year Estimate:	$830,668	$930,991

Business License Tax
Business license tax, which is generally calculated upon a business' gross receipts, is expected to come in even with last year's collections, and $90,000 (3.3%) ahead of budgetary estimates. Over the past years, this revenue has shown resilience against the troubled economy, and has remained level or with slight increases year over year. Analysis of previous years has shown that this revenue is somewhat inelastic to the ebbs and flow of the economy. Despite modest declines and increases in businesses' total gross receipts, business license tax has remained steady, likely due to the fact that approximately 65 businesses pay the maximum gross receipts business license, and changes in their gross receipts are unlikely to impact their total license tax.

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 2012.

FY 2010 Revenue:	$2,783,641
FY 2011 Revenue:	$2,844,066
FY 2012 Budget:	$2,754,000
FY 2012 Full Year Estimate:	$2,844,000

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, Governmental Agencies and Certificates of Deposit. During the recent recession and economic problems, interest rates declined dramatically, and currently remain at very low levels with little improvement expected in the near future. The City's maturing investments are being reinvested at the current low rates, resulting in a drop in portfolio yield. Three years ago the City's portfolio yielded 3.59%, and last year at this time it was yielding 1.65%. Due to the sustained drop in interest rates and the maturing of higher yielding securities purchased in previous years when interest rates were high, today's portfolio rests at 1.16%. As a result, the City's interest income will suffer in the upcoming years compared to previous years, and that will affect all funds that receive such income (General, Water, Parking funds, etc.). Knowing this market environment, this revenue is expected to perform close to budget estimates.

FY 2010 Revenue:	$283,979
FY 2011 Revenue:	$647,027
FY 2012 Budget:	$500,000
FY 2012 Full Year Estimate:	$534,000

Other General Fund Revenues

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

- **Parking Citations –** Up 10.4% at mid-year from the prior year timeframe. While the actual number of citations issued is down by 2.6% for the first half of the year compared to the prior year, increased efforts to collect on older and expired citations is boosting revenue. Parking Citations in the General Fund is expected to come in $70,000 (2.7%) above budget.
- **Franchise Tax** – Up 5.8% from last year at this time due to increased franchise payments from Verizon. This is forecast to end the year 2.4% over budget or $30,457.
- **Ambulance Fees** – These fees were increased on July 1, 2010 and are now tied to the L.A. County rates. Collection rates have improved so far this fiscal year resulting in the expectation of this revenue coming in line with the budget and prior year.

General Fund Expenditures:

Half way through the year the City has expended and encumbered $25,464,046 or 49.8% of the total adjusted budget allocation. An analysis of the expenditures indicates the following spending patterns by category:

General Fund Category	Adjusted* Budget	Projected Year End	Variance Under/(Over)	%
Salary & Wages	$23,837,396	$24,275,828	($438,432)	(1.8%)
Employee Benefits	11,850,448	11,485,949	364,499	3.1%
Contract & Professional Services	5,690,065	5,176,469	513,596	9.0%
Materials & Services	2,148,639	1,993,286	155,353	7.2%
Utilities	861,713	856,852	4,861	0.6%
Internal Service Charges	4,947,393	4,801,924	145,469	2.9%
Property and Equipment	12,081	12,059	22	0.2%
Debt Service	1,793,250	1,499,428	293,822	16.4%
General Fund Total	**$51,140,985**	**$50,101,795**	**$1,039,190**	**2.0%**

**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.*
Positive variance indicates under budget, negative variance indicates over budget.

General Fund Revenue & Expenditure Summary	
Total Projected Revenues	$52,470,571
Total Projected Expenditures	50,101,795
Surplus	**$2,368,777**

A review of the expenditure categories above indicates that Salary & Wages will be 1.8% over budget, or by $438,432, primarily due to overtime for sworn employees which is estimated to come in $494,012 (23.3%) over budget. The overage in Salary & Wages is offset by the savings in Employee Benefits of $364,449, which is comprised of savings in group medical insurance and PERS costs. Contract & Professional Services is also expected to come under budget in the amount of $513,596, or 9% of the total budgeted amount. Continued focus on cost containment is resulting in these savings.

Staff is 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 of $500,000 to account for times throughout the year that positions are vacant through attrition and retirements, each vacancy is further evaluated for affordability.

Other Funds:

Other City fund revenues and expenditures have been reviewed, and the majority of the funds are trending appropriately at mid-year. Citywide expenditures for all other operating funds are trending below budget levels on a combined basis. However, as discussed in the audit report for FY 2010-2011, the Refuse Fund is not recovering all City costs associated with providing the service, resulting in a rate subsidy and use of fund balance (estimated at $60,000 for FY 2011-2012). The Street Lighting and Landscape Fund continues to receive an annual cash infusion (from the General Fund) since the assessments are not enough to cover the fund's costs. Additionally, claims paid in the Insurance Fund are trending higher than expected.

Conclusion:

Mid-Year results for the General Fund are very encouraging, and may be a sign of continued improvement in the economy. A surplus in the amount of $2.4 million is expected, both due in part by the increase of the two largest revenue sources in the General Fund, Property Taxes and Sales Tax, and the continual focus of streamlining costs while maintaining the levels of service provided to the residents.

Following Property Tax and Sales Tax, all other major revenues, with the exception of Interest Income, are either level or showing growth from the last year. Revenues resulting from construction-related activities, as well as stabilized Real Estate Transfer Tax, indicate that the local housing and construction market is on a rebound after sluggish activity from prior years. Due to the low interest rate environment, Interest Income will likely remain flat or slightly down for the upcoming years as the focus continues to be a solid and diverse investment portfolio. Transient Occupancy Tax is expected to be even with the prior year due to the impact of the Marriott's four month remodel project. Outside of the remodel, growth for the remaining hotels is estimated at 6%, with modest increases thereafter as tourism returns to the City and the Marriott Hotel releases its full inventory of rooms and reaps the benefits of its newly remodeled hotel. Overall revenues in the General Fund for the fiscal year are expected to come in $1.3 million (2.4%) over budget and $436,941 (0.8%) over the prior year.

Expenditures are being monitored closely. Personnel costs, which make up over 70% of the General Fund, are scrutinized, with hiring decisions based on the criticality of the need and availability of funds. Cost containment remains a high priority as departments continue to find ways to become more efficient with their available resources. With this monitoring, expenditures are expected to come in approximately $1.0 million under the adjusted budget.

While the budgeting process for fiscal year 2012-2013 has just started, challenges exist, the biggest being the cost of funding employee pensions. CalPERS, which the City contracts for pension benefits, continues to consider a reduction in the discount rate (assumed rate of return on their portfolio). If enacted, the reduction could increase City pension costs by an additional $1 million to $2 million per year (depending upon the depth of the investment return reduction). Based on the current information from PERS using the existing discount rate, overall employer rates for all groups will increase slightly resulting in an increase in General Fund pension costs for fiscal year 2012-2013 of approximately $100,000. However, larger increases are expected beyond 2013.

Another concern is the ability to fund general capital needs throughout the City. To that end, the current year budget includes a transfer of $3 million from the General Fund to the Capital Improvement Fund for projects of this nature. Through the FY 2012-2013 budget, staff will further recommend additional transfers of year end surplus funds to address capital needs.

However, a more consistent and solid plan of funding these types of capital expenditures needs to be put in place. This is among the goals outlined in the recent City Council strategic planning retreat.

Along the lines of preventative measures, an analysis was performed on the City's vehicle fleet, revealing an immediate need to replace a significant portion of its vehicles. For fiscal years 2010 and 2011, the City suspended fleet replacement charge-outs (and therefore required the extension of vehicle life beyond its original intended life) to help balance the budget. However, these charge-outs were reinstated due to the urgent need to update the fleet, and to actively reflect the true cost of the City's operations across all funds. As a result, the next few years will see increased internal service fleet rental charges as the fleet catches up on its service and replacement requirements.

The on-going State budget crisis is a perennial threat to local government funding. While the State's recent action to eliminate Redevelopment Agencies does not directly affect Manhattan Beach, it is indicative of the lengths the State will go to in attempting to solve their budget problems. Previously, 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 in fiscal 2010-2011 the annual impact of the ERAF shift was $7.5 billion from cities, counties, special districts and the citizens those entities serve. Approximately $40 million of Manhattan Beach funds have been redirected to ERAF since 1992[6]. 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. The State's continuing structural deficits 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 $172,666 last fiscal year and is budgeted to subsidize this fund by $186,587 this fiscal year. The General Fund is also providing uncompensated services to the Storm Water Fund of over $400,000 per year. This fund is encountering higher operating costs due to legislative action to clean storm water runoff and limits, which reduces funds for highly needed capital improvement projects. While these issues require a Proposition 218 vote, it is most appropriate that the General Fund no longer support these ancillary services.

Labor costs represent approximately 70% of General Fund expenditures. All three labor contracts were extended into the next fiscal year, and negotiations will commence in early 2012. 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 skilled workforce that provides outstanding services to the community. This is also one of the goals outlined in the recent City Council strategic planning retreat.

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[6] Source: California Local Government Finance Almanac

As the FY 2012-2013 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 and updated financial forecasts will be provided to facilitate the discussion. As always, there will be opportunities for public input, including City Council meetings and budget study sessions, in which Council will review each department's budget. Input may also be received at the public hearing prior to adoption, and individual meetings with staff may be scheduled.

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