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DEPARTMENT OF
FINANCE

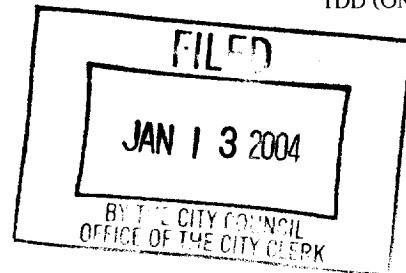
FINANCE ADMINISTRATION

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January 5, 2004



City Council
Sacramento, California

Honorable Members in Session:

SUBJECT: Budget Update

LOCATION AND COUNCIL DISTRICT: Citywide

RECOMMENDATION:

This report is for Council information and direction to staff.

CONTACT PERSON(S): Reina Schwartz, Budget, Policy & Strategic Planning
Manager, 808-7195

FOR MEETING OF: January 13, 2004

SUMMARY:

This report provides an update on City, County and State budget issues for City Council information and direction to staff.

BACKGROUND:

City Budget

The City's Approved FY2003/04 Budget was balanced using a three-pronged approach including:

- ✓ Department savings of \$8 million to be achieved through hiring controls;
- ✓ New revenues totaling approximately \$2.6 million; and
- ✓ Use of approximately \$13 million reserves and funding reallocations.

During the hearings on the FY2003/04 Budget, staff reported to the City Council that based on somewhat sluggish revenue growth and higher-than-expected expenditure increases it was estimated that there would be a structural "gap" in the FY2004/05 budget and beyond of approximately \$25 million. It was (and is) anticipated that the \$25 million annual gap would be solved over a two-year period (FY2004/05 and FY2005/06) using a combination of organizational efficiencies, new revenues, reserves and operating reductions. Additional information on the two-year strategy can be found in Attachment A to this report.

Specifically, in order to look at organizational efficiencies, the City launched a program called SOAP – Sacramento's Organizational Assessment Project. The first phase of SOAP was to generate ideas from employees on how to make the organization more efficient. During this Idea Generation Phase, over 1,540 individual ideas were submitted in the areas of organization efficiency, revenue generation and reorganization. More than 100 efficiency ideas were submitted to the City's executive management team for immediate consideration and many of them will be incorporated into the FY2004/05 Proposed Budget. In addition, more than 200 ideas for reorganization have been considered and a report on proposed reorganization efficiencies is currently scheduled for City Council on January 20th. Finally, more than 300 revenue ideas were also submitted through the SOAP process.

Over the next several months, staff also will be finalizing a community outreach strategy related to organizational improvement efforts and community input will be incorporated as an ongoing part of the process for developing the FY2004/05 Budget. A more complete report-back on the SOAP revenue and efficiency efforts as well as community outreach efforts will be included as part of the Midyear financial review scheduled for March.

County Budget

For the FY2003/04 budget, Sacramento County made cuts totalling nearly \$80 million. County budget cuts affected a majority of county programs including: General Assistance, some CalWORKs services, Probation (adult and juvenile), Health Clinics, Child Protective Services, Homeless Services, the Sheriff's Department as well as a wide variety of Safety Net services. While these reductions do not affect the direct funding for City programs, they may well have an impact on demand for certain types of City services including public safety and human services. An area where County reductions have a more direct affect is on programs jointly funded by the City and County.

At the time the City adopted its budget last June, staff was requested to return to Council with information on whether the cuts made by the County had a disproportionate effect on City residents. By way of background, County services can be broken in to two basic categories: 1) countywide services; and 2) additional non-countywide services to the unincorporated area (such as Sheriff, animal control, etc...).

Revenue sources for countywide services include Vehicle License Fee (VLF) and property tax revenues. The major revenue sources for the additional non-countywide services in the unincorporated area include sales tax, utility users tax, franchise fees, transient occupancy tax and some fine revenues.

According to County estimates, costs for providing the additional non-countywide services in the unincorporated areas exceed the related revenues by about \$15 million annually. As a result some countywide revenues are used to pay for these additional non-countywide service costs.

In addition, in the reductions adopted by the County in their FY2003/04 budget, countywide services took a disproportionate share of the cuts, meaning there were relatively more cuts in countywide services than there were in non-countywide services for the unincorporated area. These greater cuts in countywide services have an even more disproportionate impact on city residents because they represent the majority of the utilization of many countywide services, particularly in the social services arena.

As both the City and the County begin preparations for the FY2004/05 budget, staff will work together to provide additional information on understanding the impacts of County budget decisions on the City and its residents.

State Budget

The City's approved FY2003/04 budget strategy did not account for any specific reductions in revenue from the State. After the City adopted its budget, the State took action which reduced the City's Vehicle License Fee (VLF) revenue by approximately \$5 million on a one-time basis. To address this impact, the City Council approved extending the hiring controls to generate a total of \$13 million in savings, rather than \$8 million included in the original Approved Budget.

Vehicle License Fee Background. Vehicle License Fee (VLF) revenues for the City of Sacramento were anticipated at approximately \$24.5 million in the FY2003/04 Budget, approved June 17, 2003. This represents approximately nearly 10 percent of all discretionary General Fund revenues.

Of the original budget amount, approximately two-thirds (\$16.5 million) was anticipated to come from the State as "backfill" payments (related to the State having reduced the VLF rate charged to car owners) and one-third (\$8 million) would come from VLF revenues directly. On June 20, 2003 (after the City had already adopted its FY2003/04 Budget), the State "pulled the trigger" on the VLF rate, raising it back to a full 2 percent of vehicle value, eliminating the need for a State backfill. Unfortunately, the higher rate would not take effect until October 1, 2003, leaving a "gap" between the time the backfill payments were stopped and the new higher revenues began flowing in. The State proposed that this gap be considered a loan by local governments to the state, to be repaid by 2006. This action reduced the anticipated flow of VLF revenues to the City by about \$5 million for this fiscal year.

When the new Governor took office after the recall election, one of his first actions was to reverse the increase in the VLF reducing the rate charged to car owners, and authorizing rebates to car owners who had paid the higher rate in October and November 2003. Absent any additional action, the repeal of the higher rate would cost the City an additional \$11 to \$12 million this fiscal year, for a total loss of approximately \$17 million in FY2003/04. In terms of magnitude, covering a \$17 million loss would require about an eight percent reduction in discretionary General Fund spending, or the equivalent of about 250 positions citywide, including over 100 positions in police and fire if the reductions were made proportionately.

Fortunately, due in substantial part to the influence of Mayor Fargo and other big-city Mayors in the state, the Governor announced on December 18, 2003 that the State would begin backfill payments to cities and counties in December 2003 based on an emergency deficiency appropriation, and without requiring state legislative action. While this was extremely positive news for the City, we must remain cautious as ultimately successful implementation of the backfill deficiency appropriation will require:

- ✓ A decision by the Legislature to accept (not vote to overturn) the enactment by the Governor of the deficiency appropriation; and
- ✓ Some combination of the following actions to provide funding:
 - Adoption by the Legislature of approximately \$2 billion in spending cuts;
 - Improvement in state revenues;
 - Adoption by the voters of the deficit bond in March 2004;
 - Use by the Governor of extraordinary authority to reduce state spending as provided in the FY2003/04 budget.

As of January 8, 2004, the State Controller's Office has indicated that the regular January VLF payment to cities will include the December allocation of VLF revenues, the backfill for December as well as the backfill for November, bringing the State current with payments anticipated so far this year. This will still leave in place the \$5 million "gap" originally approved in this year's State budget and no proposals have been made to fund that gap any time prior to the original 2006 date.

Other State Budget Proposals. In December 2003, the Governor proposed approximately \$2 billion in midyear budget reductions. Among the proposed reductions was a reduction in funding for Non-Core Regional Centers, which would have eliminated funding for a City program serving disabled teens. After the reduction proposal was made, there was strong public outcry regarding those cuts. As a result, the Governor has since backed away from that particular reduction and there appears to be no immediate threat to that particular program.

FINANCIAL CONSIDERATIONS:

Current Situation – Update on Savings from Hiring Controls

As described earlier, one of the key components to balancing the FY2003/04 budget was the implementation of hiring controls to generate savings. Staff has been tracking vacant positions since the fiscal year began and has projected the level of savings that could be achieved based on year-to-date spending patterns. Since the beginning of the fiscal year, the City has had approximately 8 percent of all positions vacant. Citywide, this translates to approximately 350 vacant positions at any given time, about 250 of those funded by the City's General Fund. Those vacancies span a wide range of classifications and levels in the organization and affect nearly all departments. Based on year-to-date spending on labor costs, combined with a projection of anticipated labor costs for the rest of the year, staff estimates that the City will achieve the needed \$13 million in savings this year. Hiring controls must stay in place, however, in order stay on track to achieve this target.

Key Dates

Given the ongoing State budget problems, there are a number of specific points in time where additional financial information should be available and staff will bring forward additional recommendations. Specifically:

- ✓ **January 9, 2004:** Governor releases Proposed FY2004/05 State Budget
- ✓ **January 20, 2004:** City of Sacramento Comprehensive Annual Financial Report (CAFR) scheduled for City Council, reporting the final financial results for the FY2002/03 fiscal year
- ✓ **March 9, 2004:** Midyear Budget Review scheduled for City Council. This will include an update on FY2003/04 fiscal condition, recommendations for any changes required this fiscal year, an update on the results of the March election (specifically the proposed \$15 billion state bond issue), and proposed budget strategies for development of the FY2004/05 budget
- ✓ **May 2004:** City Manager's Proposed FY2004/05 Budget released to City Council (May 1st) as well as State budget May Revise available

Options for Closing the Gap

At each of the key dates listed above (or others as they occur), staff will bring forward to Council recommendations for needed financial adjustments. Some of the options for closing any financial gaps will include:

- ✓ Tightening existing hiring controls further;

- ✓ Requiring departments to meet additional savings targets during the current year;
- ✓ Using unanticipated positive results from FY2002/03 (as will be discussed at the January 20th Council meeting during the presentation of the Comprehensive Annual Financial Report for FY2002/03; and
- ✓ Use of other reserves (one-time basis).

POLICY CONSIDERATIONS:

The City Council has been committed to a sustainable budget policy for many years now. While poor financial conditions put additional pressure on keeping a sustainable budget, the City continues to adhere to this philosophy.

ENVIRONMENTAL CONSIDERATIONS:

Not applicable.

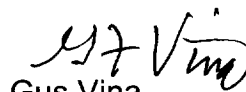
ESBD CONSIDERATIONS:

Not applicable.

Respectfully submitted,



Reina Schwartz
Budget, Policy & Strategic Planning Manager



Gus Vina
Finance Director

RECOMMENDATION APPROVED:



ROBERT P. THOMAS
City Manager

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Two Year Strategy

