



Budget and Audit Committee Report

915 I Street, 1st Floor

Sacramento, CA 95814

www.cityofsacramento.org

File ID: 2017-00228

February 7, 2017

Discussion Item 04

Title: FY2017/18 Budget Development Policies and Guidelines

Recommendation: Review, provide direction and pass a Motion forwarding to the City Council budget policies and guidelines for development of the FY2017/18 Proposed Budget.

Location: Citywide

Contact: Leyne Milstein, Director (916) 808-8491; Dawn Holm, Budget Manager (916) 808-5574, Department of Finance

Presenter: Leyne Milstein, Director, (916) 808-8491, Department of Finance

Department: Finance

Attachments:

- 1-Description/Analysis
- 2-EUR Policy
- 3-Measure U Policy
- 4-Innovation and Growth Fund Policy
- 5-Draft Resolution

Description/Analysis

Issue Detail: The annual budget process provides the City Council the opportunity to review and provide direction on budget development policies and guidelines. This input establishes budget expectations and provides a framework for the development of the Proposed Budget. On March 1, 2016, the City Council adopted the following Core Budget Policies (Motion No. 2016-0058) for the FY2016/17 Budget.

1. City Council must adopt a balanced budget.
2. The Economic Uncertainty Reserve (EUR) is to be increased gradually to Council's goal of 10 percent of the General Fund revenue.
 - a. Unbudgeted one-time revenues from an unexpected source must go to the reserve.
 - b. Unbudgeted one-time revenues from an expected source (surpluses) will be allocated at the direction of the Mayor and City Council and may be dedicated to the reserve.
 - c. Council can allocate other sources of revenue to the reserve at any time.
3. Measure U uses
 - a. Restoration, not new programs.
 - b. Resources will not be used to balance the General Fund Budget.
 - c. Resources will not be used to increase employee compensation.
 - d. Resources will be set aside for contingency funding, one-time expenses, and transition with expiration in 2019.
4. Innovation and Growth Fund
 - a. Directed new property taxes resulting from the dissolution of redevelopment to the fund.
 - b. Directed proceeds from the sale of surplus General Fund properties to the fund.
 - c. Fund is used to invest in projects and programs that will grow revenue.

As the City Council adopted separate policies addressing the EUR, Measure U and the Innovation and Growth Fund, staff is recommending removing items 2-4 above and replacing them with the following:

1. City Council must adopt a balanced budget.

2. Funding decisions should be consistent with Council adopted policies. ~~The Economic Uncertainty Reserve (EUR) is to be increased gradually to Council's goal of 10 percent of the General Fund revenue.~~
 - d. ~~Unbudgeted one-time revenues from an unexpected source must go to the reserve.~~
 - e. ~~Unbudgeted one-time revenues from an expected source (surpluses) will be allocated at the direction of the Mayor and City Council and may be dedicated to the reserve.~~
 - f. ~~Council can allocate other sources of revenue to the reserve at any time.~~
3. ~~Measure U uses~~
 - g. ~~Restoration, not new programs.~~
 - h. ~~Resources will not be used to balance the General Fund Budget.~~
 - i. ~~Resources will not be used to increase employee compensation.~~
 - j. ~~Resources will be set aside for contingency funding, one-time expenses, and transition with expiration in 2019.~~
4. ~~Innovation and Growth Fund~~
 - k. ~~Directed new property taxes resulting from the dissolution of redevelopment to the fund.~~
 - l. ~~Directed proceeds from the sale of surplus General Fund properties to the fund.~~
 - m. ~~Fund is used to invest in projects and programs that will grow revenue.~~

In addition to Core Budget Policies, the City Council also adopted the following budget guidelines on March 17, 2015 (Motion No. 2015-0059) and modified them on March 1, 2016 (Motion No. 2016-0058):

1. Maintain a fiscally sustainable, balance budget.
2. The Mayor and Council's priorities, based on community input, should drive the budget creation.
3. Continue a community-based budget process where city residents are engaged and educated on budget processes and provide feedback on budget priorities.
4. Look for ways to grow the reserve beyond its current goal.
5. All budget actions must be considered in a five-year context, with new revenues not counted or spent until realized. One-time resources should be used for one-time needs, not ongoing expenses.

6. Do not make spending decisions in isolation. Avoid spending money on one-off projects or without looking at the big picture. Understand long-term consequences and opportunity costs.
7. Keep Council informed on the fiscal condition of the City and conduct continuous evaluations for efficiencies and effectiveness.
8. The City must consistently look for opportunities to proactively grow revenues instead of simply being reactive.
9. Make every effort to identify private financing or federal and state grant opportunities before using City resources. Pursue new and enhance existing revenue sources.
10. Before new expenditures are made, identify return on investments and impacts; fiscal and social benefits.
11. Address unfunded long-term liabilities.
12. Remain a full-service City.

Staff will be recommending adoption of the above policies and guidelines with any Council changes on February 7, 2017.

Policy Considerations: This report is consistent with Council's direction and adopted budget principles to keep the Council informed on the fiscal condition of the City.

Economic Impacts: None

Environmental Considerations:

California Environmental Quality Act (CEQA): This action is not a project subject to CEQA because it involves only administrative activities, general policy and procedure making, and government fiscal activities that do not involve any commitment to any specific project that may result in a potentially significant physical impact on the environment. (CEQA Guidelines § 15378(b)(2), (b)(4), and (b)(5).)

Sustainability: Not applicable.

Commission/Committee Action: None.

Rationale for Recommendation: An annual review of the City Council's adopted budget policies and guidelines provides the Council and community an opportunity to reflect on and modify these guiding principles that will serve as the framework for the budget development process.

Financial Considerations: While revenues are continuing to grow at a healthy pace, the General Fund continues to be challenged with structural sustainability, keeping expenditures below revenues. While it is early in the budget process to forecast with certainty it is important to understand the underlying financial position of the City. The preliminary General Fund forecast below includes updated revenue projections capturing robust growth in secured and supplemental property taxes as well as property transfer tax, the result of a substantial increase in the volume and value of real estate transactions in the City.

In addition, it includes a preliminary update of expenditure assumptions which incorporates an initial estimate of the December 21, 2016 action of the California Public Employee Retirement System (CalPERS) Board lowering the interest earning assumption from 7.5% to 7.0%. This change is estimated to increase the City's PERS costs substantially over the eight-year phase-in period. The initial cost estimate is based on very preliminary and incomplete information and as such could be substantially less than actual costs. CalPERS is still developing information to assist employers in estimating the long-term costs of the change and the forecast will be updated as soon as information becomes available.

Finally, the forecast below has been updated to reflect the prior action and direction of Council and the City Manager's recommendations included in the midyear report. It is important to remember that this forecast does not include future labor growth beyond existing contractual requirements. Contracts with all but two of the City's recognized labor organizations expire in June of this year, with those remaining expiring in June 2018 (Sacramento Exempt Employees Association and Sacramento Firefighters Local 522). The forecast has been extended for an additional year to demonstrate the growth and financial impact on the out years of the forecast from the recent CalPERS change.

General Fund (\$ in 000s)	FY18 ^a Projection	FY19 Projection	FY20 Projection	FY21 Projection	FY22 Projection	FY23 Projection
Revenues/Resources						
FY16 CAFR Resources (one-time)						
Other Sources (Uses)	105	105	105	105	105	105
Revenues	447,746	455,642	464,338	473,296	482,498	492,001
Total Resources	447,851	455,747	464,443	473,401	482,603	492,106
Expenditures^b						
FY17 Approved Budget	440,104	452,362	463,364	469,923	482,460	492,650
CalPERS Rate Change (7.5% to 7%) ^c	0	574	1,878	4,569	7,475	10,414
Approved Council Actions (Resolutions)	0	0	0	0	0	0
Litigation	0	0	0	0	0	0
Audits	71	71	71	71	71	67
Council Priorities	1,782	1,809	1,836	1,863	1,891	1,920
City Manager (operations)	1,560	1,583	1,607	1,631	1,656	1,681
Crisis Intervention Training (I11002200)						
ETP Pilot Program (I01000300)						
Subtotal Midyear Changes	3,413	4,037	5,392	8,135	11,093	14,081
Total Expenditures	443,517	456,399	468,756	478,058	493,553	506,731
Annual Surplus/(Deficit)^d	4,334	(652)	(4,313)	(4,657)	(10,950)	(14,625)
Loss of Measure U Revenues/Reserves (March 2019)			(33,414)	(50,811)	(52,335)	(53,905)
Annual Surplus/(Deficit) with Measure U	4,334	(652)	(37,727)	(55,468)	(63,285)	(68,530)
Beginning Fund Balance	18,210	22,544	21,892			
Ending Fund Balance	22,544	21,892	(15,835)			

^a This forecast includes adjustments included in the Midyear Report.

^b General Fund support for 4th R, START and Summer Night Lights has been removed, includes continued transfer of \$105k from arts reserve.

^c Actual estimates for the rate change will not be available until summer 2017, this estimate assumes a 15% impact to the City's contributions.

^d This forecast does not include labor growth beyond contractual obligations in the existing contracts - 1% of General Fund labor = \$3.7 million

The FY2017/18 Proposed Budget will be developed over the next several months with release anticipated by the end of April. The above forecast will be updated to address current employee salaries, the CalPERS costs based on available information, as well as any changes necessary to continue to deliver programs and services.

Local Business Enterprise (LBE): No goods or services are being purchased under this report.



General Fund Economic Uncertainty Reserve Policy

Scope: CITYWIDE

Policy Contact

Leyne Milstein

Finance Director

Department of Finance

(916) 808-5843

LMilstein@cityofsacramento.org

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Regulatory References

Council Motion 2016-0122

Effective Date: April 26, 2016

General Fund Economic Uncertainty Reserve Policy

2. PURPOSE

To establish the targeted level of General Fund operating reserves, a basic component of a financially strong city. Adequate reserves help sustain City operations when adverse or unexpected circumstances affect the City, providing resources to minimize service disruption in the event of temporary revenue shortfalls or unpredicted one-time expenditures. This policy establishes the amounts the City will strive to maintain in its Economic Uncertainty Reserve (EUR) and the conditions under which the reserve may be used.

3. BACKGROUND

Financial reserves strengthen the City's financial status and provide valuable resources for unexpected events. Every fund of the City represents a stand-alone financial set of accounts and has its own operating characteristics, financial capabilities, and constraints. The level of reserves needed should be based on the financial and operating characteristics of each fund. In June 2011, the City Council adopted a goal of establishing a General Fund EUR equivalent to 10% of annual General Fund revenues.

According to the Government Finance Officers Association (GFOA), it is essential that governments maintain adequate levels of fund balance to mitigate current and future risks (e.g., revenue shortfalls and unanticipated expenditures) in order to protect taxpayers and employees from unexpected changes in financial conditions.

GFOA recommends, at a minimum, that general-purpose governments, regardless of size, maintain an unrestricted budgetary fund balance in their General Fund of no less than two months of regular general fund operating revenues or regular general fund operating expenditures (<http://www.gfoa.org/appropriate-level-unrestricted-fund-balance-general-fund>).

This policy establishes 10% of annual General Fund budgeted revenues as the minimum level of funding in the City's General Fund EUR and establishes two months of operating revenues as a target reserve level. The policy also outlines the methods the City will utilize to achieve the target reserve level, defines the conditions under which these funds can be used and describes how the City's expenditure and/or revenue levels will be adjusted to match any new economic realities that are causing the use of fund balance reserves as a financing bridge.

3. POLICY

3.1 Minimum and Target Reserve Levels

The City will maintain an EUR at a minimum of 10% of budgeted General Fund revenues. The City will seek to achieve and maintain a General Fund EUR equal to two months of regular on-going General Fund expenditures, including transfers (i.e. 17% of General Fund expenditures).

The EUR shall be reported as a commitment of fund balance in the General Fund for external financial reporting. Appropriations from the EUR may only be made by a vote of the City Council to meet a critical, unpredictable financial need.

3.2 Methods to Achieve Funding Levels

Funding of the EUR will generally come from excess revenues over expenditures or one-time revenues.

At a minimum, during the budget process, staff shall review the current and five-year projected reserves to ensure that they are appropriate given the economic and financial risk factors the City faces.

3.3 Criteria for Expenditure of Reserve Funds

The EUR is intended to contend with significant short-term issues, inclusive of unexpected revenue shortfalls, higher than anticipated expenditures, or declared emergencies.

It is the intent of the Council to limit use of the EUR to address unanticipated, non-recurring needs. Reserves shall not normally be applied to recurring annual operating expenditures. The EUR may, however, be used strategically to allow time for the City to restructure its operations in a deliberate manner (as might be required in an economic downturn), but such use will only take place in the context of a Council-adopted long-term plan.

3.4 Timeline for Replenishment of the EUR

If the EUR is drawn down below the minimum level, a plan will be developed and implemented to replenish the reserve, generally from future surpluses. Replenishing the EUR will be a priority use of one-time resources. Generally, the City should seek to replenish the EUR to the minimum reserve level within one to three years.

Measure U Financial Management



Scope: CITYWIDE

Policy Contact

Dennis Kauffman

Finance Operations Manager

Department of Finance

(916) 808-5843

dkauffman@cityofsacramento.org

Dawn Holm

Budget Manager

Department of Finance

(916) 808-5574

dholm@cityofsacramento.org

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Purpose

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November 2012 Ballot Measure U

Measure U Financial Management Policy

1. PURPOSE

The City's Measure U Financial Management Policy documents the methods the City will use to demonstrate prudent financial management over Measure U tax revenue. The policy:

- Establishes a Measure U Reserve to address unanticipated revenue reductions and the transition that will occur upon the expiration of the tax;
 - Commits to allocating the additional Measure U resources, above the amount needed to fund the Measure U Reserve and to accommodate growth of already-funded Measure U programs, to one-time expenditures;
 - Prohibits using Measure U resources to increase General Fund non-Measure U employee compensation or to balance the General Fund budget;
- Requires performance audits by the City's external independent auditor in addition to the City's annual financial and compliance audits; and
- Requires development of a transition plan to address the expiration of the Measure U tax and the reduction or phase out of services funded by Measure U.

2. BACKGROUND

Voter approval of the City of Sacramento Essential Services Protection Measure (Measure U) in November 2012 authorized the implementation of a six-year, one-half cent transaction and use tax effective April 1, 2013, which expires on March 31, 2019. The objectives of Measure U are "to restore and protect essential safety services, including 9-1-1 response, police officers, gang/youth violence prevention, fire protection/emergency medical response, and other essential services including park maintenance, youth/senior services, and libraries..."

3. POLICY

3.1 Measure U Reserve

The City shall maintain a Measure U Reserve dedicated to mitigating the effects of unanticipated revenue reductions and the transition away from Measure U revenue upon the expiration of the tax on March 31, 2019. The Measure U Reserve shall be funded equal to the estimated Measure U program/service costs in FY2020/21 to provide time and adequate funding to phase out the use of Measure U funds.

3.5 Use of Measure U Resources

- Measure U revenue, above the amount needed to fund the Measure U Reserve and to accommodate growth of Council-authorized Measure U programs, will be allocated to one-time expenditures focused on investment in City infrastructure used to deliver Measure U programs/services.
- Measure U revenue shall not be allocated to fund new or expanded programs with ongoing costs after June 30, 2015, as the expiration of the tax measure in 2019 may require those new programs to be reduced or eliminated.

3.6 Prohibited Uses

Measure U resources shall not be used to increase General Fund non-Measure U employee compensation or to balance the General Fund budget, except where funds would provide for the protection of programs/services specifically included in the Measure U ballot language.

3.7 Transparency and Reporting

Measure U revenue and expenditures should be transparent to the City Council, the Measure U Citizens Oversight Committee, and Sacramento residents. In order to achieve this transparency, Measure U resources will be accounted for and reported separately in order to facilitate review by the Council and the Oversight Committee. In addition, the following information shall be available:

- The City's annual financial and compliance audit will include revenues and expenditures for the Measure U Fund.
- As requested by the Citizens Oversight Committee, the City shall engage its external independent auditors to conduct annual performance audits of Measure U spending by budget allocation.

3.5 Transition Plan

The City Manager will prepare a transition plan as part of the FY2018/19 Proposed Budget to address the expiration of the Measure U tax and the phase out of services funded by Measure U. The transition plan should reduce the reliance on Measure U resources over time by utilizing the Measure U Reserve and converting support for essential programs and services to any alternative sources of funding identified.

Innovation and Growth Fund (Fund 2031) Policy

I. PURPOSE

The purpose of the Innovation and Growth Fund (Fund) is to advance City economic development actions that foster innovation, economic growth, and job creation in Sacramento. The Fund will provide a long-term source of revenue for high priority economic development projects and programs. The Economic Development Department will manage and administer the Fund, under the direction of the City Manager and approval of the City Council.

2. BACKGROUND

In recognition of the need to create resources for projects focused on job creation and private investment, the City Council established the Economic Development Fund (ED Fund, Fund 2031) on June 11, 2013 (Resolution 2013-0198). The property tax revenues received as a result of the dissolution of Redevelopment were to be the primary source of funding.

On May 27, 2014, the City Council approved the ED Fund Policy and directed staff to return with guidelines, and process and procedures (Resolution 2014-0151). On February 10, 2015, the City Council directed future proceeds from General Fund and Redevelopment Agency Successor Agency surplus land sales, unless otherwise specified, to be deposited in the ED Fund (Resolution 2015-0038).

The ED Fund has been renamed the Innovation and Growth Fund (Fund) to reflect the aspirations of the program. This change will be effective with the Fiscal Year 2015/16 budget.

3. POLICY

The Fund will focus resources on the following distinct program areas:

1. **Development to Induce Growth, Innovation, and Technology (DIG-IT):** Projects that provide a significant return to the city. Specifically, development and infrastructure projects that revitalize specific sites or surrounding areas, expand or retain Sacramento businesses, and/or promote the formation and growth of innovative businesses and emerging technology.
2. **Innovation Accelerator Program:** Programs and grant matches that support commercializing research, launching new start-ups and accelerating private investment and industrial expansion efforts that result in sizeable capital investment.

3. **Innovation Districts:** Projects and programs that promote development, attract investment, and foster the exchange of technical knowledge and expertise between students, faculty, entrepreneurs, and private sector businesses in Sacramento's three Innovation Districts: the MedZone, Sacramento Center for Innovation (SCI), and Railyards.

4. GUIDELINES

- (a) Purpose of Funds: Funds allocated under the distinct program areas must advance economic development projects and programs that result in achieving all of the following:
 1. **Retain or Create Jobs:** Projects and programs must create and/or retain quantifiable permanent, private sector jobs.
 2. **Leverage Funds with other Private or Public Funds:** The Fund will be used to fill financial gaps or shortfalls in projects and programs. Funds will not be used as a primary financing source or as an ongoing operational funding source.
 3. **Increase Revenue to the City:** Projects and programs using Fund resources must directly increase city revenue and/or generate other significant public benefits that provide a return on investment to the city.
 4. **Stimulate Economic Development:** Projects and programs must result in development or redevelopment of a specific site or surrounding area and/or the expansion or retention of businesses in Sacramento.
 5. **Accelerate Growth:** Projects and programs must promote the formation and growth of businesses that engage in the transfer of technology and commercialization of innovative research and products, and/or promote emerging industries.
 6. **Result in a Completed Project or Program:** The Fund award, combined with other resources, must result in sufficient funding to construct a completed project or fully implement and deliver a program.
- (b) Eligible Use of Funds: Fund awards will be used for one or more of the following:
 1. **Grant Match:** Leverage grant opportunities for economic development projects and programs.
 2. **Public Infrastructure Improvements:** Fill a funding gap for public infrastructure projects directly related to an economic development project.

3. **City/Private Partnerships:** Fill a funding gap for construction projects in which the City is a partner or property owner as documented by a contractual agreement between the City and a private sector entity or through City property ownership.
4. **City Investment:** Investment in a project or program that identifies the City as a major stakeholder and supports the growth of innovation, businesses, and job creation.

(c) Ineligible Use of Funds: The following expenses are not eligible uses of the Fund:

1. Environmental assessments
2. Housing projects (except as ancillary use in projects that otherwise meet the above eligibility criteria)
3. Stand-alone infrastructure projects
4. Pre-application and pre-development costs
5. Ongoing program staffing or operating costs
 - Phasing a larger project is acceptable as long as the portion of work completed is operational as a stand-alone project.

5. PROCEDURES

(a) DIG-IT and Innovation District Project Evaluation

Funding requests will be evaluated based on the following:

1. How the project meets and/or exceeds the Fund goals and eligibility criteria.
2. How the project advances the 2013 Economic Development Strategy or any subsequent versions of it.
3. The financial strength and the feasibility of the project.
4. Confirmation that a funding gap exists and that the gap poses an impediment to project completion.

(b) Innovation Accelerator and Innovation District Program Evaluation

Funding requests will be evaluated based on the following:

1. How the program meets and/or exceeds the Fund goals and eligibility criteria.

2. How the program advances the 2013 Economic Development Strategy or any subsequent versions of it.
3. The financial feasibility of the program.
4. The City's role and participation in the program.
5. Program deliverables and metrics established to measure the success of the program.
6. The ongoing sustainability of the program.

(c) Approval

Grants or loans over \$100,000 will be presented to Council with detailed information on how the project or program meets the evaluation criteria identified above for approval. Grants or loans of \$100,000 or less may be approved by the City Manager.

(d) Reporting

The City Manager will report annually to the City Council on the Fund activities. The report will include:

1. Number and amount of investments approved during the year.
2. Status of projects and programs that were awarded funds.
3. How projects and programs are meeting Fund goals.
4. Revenues collected and balance of Fund.

RESOLUTION NO.

Adopted by the Sacramento City Council

APPROVING FY2017/18 BUDGET DEVELOPMENT PRINCIPLES

BACKGROUND

- A. The City Manager is required to present a balance budget to the Mayor and City Council no less than 60 days prior to the beginning of each fiscal year pursuant to Article 9, Section 111 of the City Charter.
- B. Establishing and adopting budget development principles by the Council at the beginning of the annual budget process provides direction to the City Manager and establishes a framework for developing and discussing the City's proposed budget for next fiscal year.
- C. The City of Sacramento, through the leadership and direction of the Mayor and City Council, has maintained a sustainable budget philosophy. Given this concept of fiscal sustainability, the Council adopted Core Budget Policies on March 17, 2015 (Motion No. 2015-0059) and modified them on March 1, 2016 (Motion No. 2016-0058), for the development of an annual budget.

BASED ON THE FACTS SET FORTH IN THE BACKGROUND, THE CITY COUNCIL RESOLVES AS FOLLOWS:

Section 1. The FY2017/18 Proposed Budget shall be based on the following core budget policies:

- 1. City Council must adopt a balanced budget.
- 2. Funding decisions should be consistent with Council adopted policies.

Section 2. The FY2017/18 Proposed Budget shall be developed and managed based on the following budget guidelines:

- 1. Maintain a fiscally sustainable, balanced budget.
- 2. The Mayor and Council's priorities, based on community input, should drive the budget creation.
- 3. Continue a community-based budget process where city residents are engaged and educated on budget processes and provide feedback on budget priorities.
- 4. Look for ways to grow the reserve beyond its current goal.

5. All budget actions must be considered in a five-year context, with new revenues not counted or spent until realized. One-time resources should be used for one-time needs, not ongoing expenses.
6. Do not make spending decisions in isolation. Avoid spending money on one-off projects or without looking at the big picture. Understand long-term consequences and opportunity costs.
7. Keep Council informed on the fiscal condition of the City and conduct continuous evaluations for efficiencies and effectiveness.
8. The City must consistently look for opportunities to proactively grow revenues instead of simply being reactive.
9. Make every effort to identify private financing or federal and state grant opportunities before using City resources. Pursue new and enhance existing revenue sources.
10. Before new expenditures are made, identify return on investments and impacts; fiscal and social benefits.
11. Address unfunded long-term liabilities.
12. Remain a full-service City.