

CITY OF ALAMEDA

Memorandum

To: Honorable Mayor and Members of the City Council
Honorable Chair and Members of the Community Improvement
Commission
Honorable Chair and Members of the Alameda Reuse and
Redevelopment Authority

From: Debra Kurita
City Manager/Executive Director

Date: February 19, 2008

Re: Accept the Fiscal Year Second Quarter Financial Report and Budget
Adjustments

BACKGROUND

As a result of the downturn in the economy, cities, counties, school districts, and special districts throughout California are facing significant budget shortfalls in the current fiscal year and in future years. In the City of Alameda, staff estimates that revenues will be approximately \$4 million less than projected when the City Council adopted the budget for fiscal year 2007-08 on June 19, 2007. This situation is expected to continue in FY 2008-09 and worsen as the regular costs of business increase and the economy continues to falter. For that reason, City staff has taken immediate steps to reduce spending and is exploring alternatives for raising revenues.

DISCUSSION

State Budget:

The State of California is facing an estimated \$14.5 billion budget shortfall by the end of fiscal year 2008-09 and spends \$400-600 million more each month than it receives in revenues. In order to curb this imbalance, the Governor's recently released budget proposal includes 10% reductions to nearly all General Fund departments and programs, boards, commissions, and elected offices, as well as a reduction in K-14 spending in the current year and suspension of the Proposition 98 minimum funding guarantee in FY 2008-09.

Local governments emerged relatively unscathed in the Governor's budget, with no takeaways to date of local property tax revenues pursuant to Proposition 1A's provision that allows the State to suspend the basic protection of the property tax in cases of a "severe State fiscal hardship." The budget proposal does, however, include a series of cash management solutions to help close the gap between revenues and expenditures. One proposal involves a one to five month delay in gas tax disbursements for local

streets and roads beginning in April 2008, with the funds paid in full without interest in September 2008. For the City of Alameda, this provision would delay the receipt of as much as \$600,000 in funding for local streets and roads depending on the length of the delay. In addition, the Governor's proposed 10% across-the-board reduction will mean a loss in the Public Library Foundation revenues the Alameda Free Library receives from the State and a potential loss of funding for library-related grants.

The Governor's January budget proposal is the first step in the State's efforts to pass a budget for FY 2008-09. There will likely be many revisions to the proposal before final passage some time next summer, and the full extent of takeaways, if any, remains unknown.

Regional Economy:

The State's budget difficulties stem primarily from a significant decline in revenues caused by the sub-prime mortgage market crisis that began last summer. Declining home values and large increases in interest rates have combined to cause a significant rise in foreclosures, a tightening of available credit, a slowing of the housing market, and a decrease in consumer spending. Although Beacon Economics notes that sub-prime loans are a larger problem in Southern California than in Northern California, they are still posing difficulties for homeowners in the Bay Area and in Alameda. RealtyTrac, a service that monitors real estate activity, identified 56 Notices of Default in Alameda for the five-month period of August 2007 to January 2008. This situation may worsen as credit tightens even further.

The Center for Responsible Lending projects that foreclosures will cost Californians a total of \$67 billion in lost property values. A recent study commissioned by the U.S. Conference of Mayors found that California cities may see a decline in collected property, sales, and transfer taxes of as much as \$4 billion due to the mortgage crisis. Similar to the State, the City of Alameda is now facing a significant revenue shortfall as a result of changes in the economy. The projected effect on the City's budget is detailed below.

Second Quarter Update:

The total adjusted FY 2007-08 budget for all City funds is \$236,591,937. Attachments A through H detail, by fund category, the revenues and expenditures as of December 31, 2007. Included in the Attachments are the recommended adjustments to the current budget resulting from estimated changes in revenues and expenditures. The Attachments also reflect the intra-period changes, such as transfers between funds, and Council-approved adjustments since the adoption of the budget.

General Fund Revenues:

The main sources of local tax revenues, as shown in Attachment I, include the property tax (28%), utility users tax (11%), motor vehicle in lieu (8%), property transfer tax (6%), the local component of the sales and use tax (6%), and a variety of "all other levies" (11%), which include franchise fees, payment in lieu of taxes, and other various sources of income. Many of these revenue sources are sensitive to changes in the economy. When the economy is strong, these taxes perform well for the City; when the economy slows, however, the City sees a reduction in these revenues.

With the ongoing crisis in the mortgage industry and the subsequent downturn in the economy, the City is facing a precipitous decline in many of its revenues. For the period ending December 31, 2007, which is halfway through the fiscal year, the General Fund had received only \$35,169,625 in revenues, or 45% of the \$78,040,277 amended revenue estimate. Last year, in comparison, the City had received 47% of its revenues by the end of December. Staff estimates that FY 2007-08 revenues will be \$4.0 million less than projected when the budget was adopted last June, a reduction of 4.7 percent.

The largest revenue decline is in the property transfer tax, which is the tax paid when real property is sold in Alameda. With credit difficult to obtain and home prices falling, home sales are beginning to slow, making the property transfer tax the City's most volatile revenue under current economic conditions. For that reason, staff has reduced its estimate of property transfer tax revenues by \$1.4 million and may need to reduce it even further should the negative trend in the housing market continue to further worsen. Similarly, property tax revenues increase as properties are sold and new owners assume a higher property tax rate. Staff has therefore lowered the projected property tax by \$820,624 for the current fiscal year.

The motor vehicle in-lieu fee is a tax on the ownership of a registered vehicle in place of taxing vehicles as personal property. The fee, which declines as the vehicle ages, is paid annually to the State upon vehicle registration, and a portion is remitted to cities and counties on a per capita basis to fund needed services. Similar to the property transfer tax, the revenues collected from motor vehicle in-lieu fees are sensitive to changes in the economy, with potential buyers deferring car purchases as problems arise in the economy and credit tightens. In addition, a bill enacted in 2006 increased the per capita motor vehicle in-lieu fee revenue received by cities that annexed areas of land after August 5, 2004. As a result of these two factors, the amount of motor vehicle in-lieu fee revenue available to distribute to cities and counties has declined, and cities that have not annexed land are receiving a smaller share of the revenue. Staff has therefore reduced the motor vehicle in-lieu projection by \$828,000 for the current fiscal year.

Finally, revenues associated with building permit activity and other current services have fallen, likely as a result of the weakening economy. These reductions have been

partially offset by permit penalties due to increased inspection activity as well as the receipt of grants. Details of all adjustments to the revenue estimates can be found in Attachment D, Summary of Adjustments. General Fund revenue detail can be found in Attachment B.

Certain revenue sources in the Attachments appear below projected annual estimates. Property tax payments are received twice yearly, in January and April. There is also a 30 to 60 day delay in the receipt of several other major revenues, such as sales tax, utility user tax, vehicle-in-lieu subventions, and franchise fee payments from Alameda County Industries. These revenues are only accrued at year-end and recorded on a cash basis during the fiscal year. The cable television providers make franchise fee payments quarterly, while PG&E remits a franchise fee for natural gas on an annual basis. Transfers from Alameda Power & Telecom are remitted to the City's General Fund in ten equal installments. Finally, sales tax payments received in July and August are accrued for the prior year as these payments represent taxes paid or generated in Alameda for sales transactions in April, May and June of the prior fiscal year. A separate report analyzing the sales tax revenues appears on this agenda.

General Fund Appropriations:

General Fund adjustments of \$2,336,227 for the second quarter primarily reflect transfers to Risk Management: \$1,365,572 for reimbursement of Beltline litigation and \$344,992 for current year costs. The recommended adjustments, including Police and Fire grants, an increase for debt service, and other offsetting items, are detailed in Attachment D, Summary of Adjustments.

General Fund Expenditures:

Year-to-date General Fund operating expenditures for the period ending December 31, 2007, are \$39,709,770, which is 45% of the adjusted operating budget of \$87,994,545. Non-departmental expenditures include a rent subsidy to the Alameda Historical Museum and administrative support for the Social Services Human Resources Board. Additionally, transfers from the General Fund to special funds include: Capital Improvement Projects, \$1,896,941; Library operations, \$1,006,402; Post-Employment Benefits, \$984,000; Debt Service - City Hall, \$414,444; Risk Management, \$404,440; and Urban Runoff \$33,153. General Fund expenditures by departments are detailed in Attachment C.

Due to the faltering economy and its projected effect on the City's revenues, the departments were asked at the beginning of the fiscal year to identify ways to reduce their General Fund spending and develop other strategies to help balance the budget in the current year. As a result, the departments have implemented expenditure reduction measures that include implementing a selective hiring freeze for non-safety positions, developing alternate funding sources for positions when appropriate, deferring some

capital projects until next year, and reducing other expenses. In addition, staff was able to identify a variety of special revenue funds that could be used to fund capital projects that had been previously appropriated from General Fund resources. As a result of these measures, the City was able to identify \$3 million in savings, which will be reflected in the Third Quarter Financial Report.

Many of the expenditure reduction strategies employed to help balance the budget in the current fiscal year are one-time in nature. With economists predicting that the economy will continue its downward trend for the near term, it will be important to find additional ways to reduce spending during the development of the 2008-09 budget.

Special Revenue and Enterprise Funds:

The summaries of revenues and expenditures for special funds and enterprise funds are provided in Attachments E and F, respectively. Major adjustments include receipts and transfers for debt service, amendments in the CDBG budget, reimbursement to Risk Management for Beltline litigation, developer cost recovery contributions, and various capital improvement projects. A summary of adjustments can be found in Attachment G. It is important to note that the timing of receipts and payments may cause deviations from the straight-line projections.

The City is entitled to receive approximately \$1.2 million in Proposition 1B funding for local streets and roads improvement projects during this fiscal year. Staff is working to prepare a list of eligible projects, submit the necessary forms to the State Department of Finance by May, get disbursement approval before the end of the fiscal year, and include projects in the summer 2008 resurfacing program.

BUDGET CONSIDERATION/FINANCIAL IMPACT

A Summary Analysis of Funds for Fiscal Year 2007-08 is found in Attachment H. Alameda Power & Telecom and Alameda Housing Authority are included only as memo entries. The projected General Fund balance for June 30, 2008, based on estimated revenues and expenses, is \$14,362,493, representing 17.0% of Fiscal Year 2007-08 appropriations.

General Fund Reserves Outlook:

The purpose of the General Fund reserve is to allow the City to respond to economic downturns, State takeaways of local revenues, and natural or manmade disasters. Therefore, these funds are a resource available to the City to address potential State actions as well as respond to further revenue shortfalls caused by the faltering economy. The reserve outlook includes approximately \$3 million in spending reductions proposed by the various City departments. In addition, an identified future liability of \$350,000 for overtime costs is expected to impact the fund balance during the current

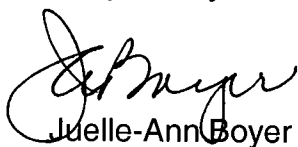
fiscal year. The pro-forma fund balance shown below represents a reserve at 17.0% of current appropriations, which is below the 20% target by \$2,560,105 and short of the 25% target by \$6,790,755.

		Pct of Appropriations
6/30/08 Estimated Fund Balance as of Sept 30, 2007	\$ 17,943,323	20.9%
Less ABL Legal fees	<u>\$ 1,655,401</u>	
	\$ 16,287,922	18.9%
Net Use of Reserves	<u>(1,175,429)</u>	
6/30/08 Estimated Fund Balance as of Dec 31, 2007	\$ 15,112,493	17.9%
Less designated fund balance: Fire Station #3	<u>400,000</u>	
	\$ 14,712,493	17.4%
Less Estimated Obligations:	<u>350,000</u>	
6/30/08 Estimated Fund Balance as of Dec 31, 2007	<u><u>\$ 14,362,493</u></u>	17.0%
 Targeted Fund Balance Range:		
	Upper value	\$ 21,153,248 25%
	Lower value	16,922,598 20%
 Fund Balance Over(Under) Target:		
	\$ (2,560,105)	20%
	(6,790,755)	25%

RECOMMENDATION

Accept the second quarter financial report on the results of operations for the quarter ending December 31, 2007, for all funds and approve the supplemental appropriations.

Respectfully submitted,



Juelle-Ann Boyer
 Chief Financial Officer



By: Annette Brisco
Financial Analyst

JAB: dl

Attachments:

- A. General Fund Recap
- B. General Fund Detail Receipts
- C. General Fund Detail Disbursements
- D. Summary of General Fund Adjustments
- E. Special Funds Detail Receipts
- F. Special Funds Detail Disbursements
- G. Summary of Special Funds Adjustments
- H. Summary Analysis of Funds
- I. Sources of Revenue

GENERAL FUND RECEIPTS AND DISBURSEMENTS PERIOD ENDING December 31, 2007	2007-08 Actual to date	Actual vs Budgeted	2007-08 Amended Budgeted	Qtr 2 Amendments	Qtr 1 Amendments	2007-08 Adopted
UNAUDITED FUND BALANCE - June 30, 2007	\$ 21,823,982		\$ 21,823,982		\$ 4,213,899	\$ 17,610,083
Property Taxes	\$ 10,948,939		\$ 21,510,042	\$ (820,624)	\$ -	\$ 22,330,666
Other Local Taxes	11,305,510		26,298,413	(1,400,000)	-	27,698,413
Licenses and Permits	2,211,369		3,772,053	(425,000)	-	4,197,053
Use of Money and Property	933,226		1,898,394	-	-	1,898,394
Fines and Forfeitures	405,334		1,011,950	220,000	-	791,950
Revenue from Other Agencies	3,467,250		7,245,943	(404,402)	229,633	7,420,712
Current Services	2,579,554		7,449,469	(962,508)	-	8,411,977
Contributions from other funds	3,022,884		8,269,558	-	800,916	7,468,642
Equipmt Replmt/Depreciation	295,558		584,455	-	-	584,455
	\$ 35,169,625	45.07%	\$ 78,040,277	\$ (3,792,534)	\$ 1,030,549	\$ 80,802,262
City Administration	\$ 3,379,233		\$ 7,089,555	\$ 6,111	\$ 41,576	\$ 6,977,698
Public Safety	23,798,861		49,147,829	482,835	249,633	48,415,361
Planning/Building	1,852,189		4,421,342	-	-	4,421,342
Public Works	3,271,218		9,500,378	602	861,183	8,598,593
Recreation Services	2,133,959		4,217,649	-	-	4,211,165
Capital Outlay	70,748		151,347	3,500	60,352	91,779
Depreciation	271,227		552,455	-	-	658,713
Non-Departmental	160,909		937,120	-	(10,000)	962,232
Transfers	4,324,937		10,699,422	1,695,564	3,532,867	5,455,991
Vehicles & Equipment Replacement	32,045		356,098	-	175,598	180,500
Debt Service	414,444		976,503	147,615	-	828,888
	\$ 39,709,770	45.10%	\$ 88,049,698	\$ 2,336,227	\$ 4,911,209	\$ 80,802,262
CURRENT YEAR BALANCE OF REVENUES VS. EXPENDITURES	\$ (4,540,145)				\$ (3,880,660)	\$ 0
ESTIMATED FUND BALANCE - JUNE 30, 2008	\$ 17,283,838		\$ 11,814,561			\$ 17,610,083

CC/ARRA/CIC
Attachment A to
Agenda Item #4-A
02-19-08

