

CITY CHIEF EXECUTIVE OFFICER'S BUDGET MESSAGE



May 5, 2015

Honorable Mayor, Members of the City Council, and Citizens of Costa Mesa:

I am pleased to submit the Fiscal Year 2015-16 Preliminary Operating and Capital Budget. The objectives used in developing this budget were to submit a balanced budget to the City Council; to do the best job possible of maintaining current excellent levels of service to the community; to implement City Council's priorities as feasible; and to be prudent in our revenue estimates and cautiously optimistic overall. The City's management team and staff have put together an operating and capital expenditure plan that addresses the City Council's priorities while fulfilling the service requirements of the people who live, work, and play in our community.

As presented, this represents a balanced budget for the coming fiscal year without the use of General Fund reserves and provides the highest level of service to the community within existing financial resources.

This preliminary budget maintains and, in a few areas, enhances the current level of service from FY 14-15. Having already reduced operating expenditures to a minimum base level in prior years, management decided to use the FY 14-15 budget as the starting point while allowing Departments to make their requests known for new items that they believed met the community and City Council needs.

On March 3, 2015 the Council adopted updated financial and budget policies. These policies are outlined in detail in the Appendix Section. Highlights of these policies as they relate to this budget include:

- Consistency with Council and CEO priorities
- Balanced budgets with the exception of using dedicated non-General Fund balances for carry-over or one-time items
- Realistic assumptions for revenue forecasts
- A minimum of 5% General Fund revenues dedicated to funding capital projects
- A new goal of an additional 1.5% of General Fund revenues dedicated to capital facilities
- A goal of \$1 million budgeted for contingencies
- Provision for an additional \$500,000 payment to reduce unfunded pension liabilities

The first set of FY 15-16 General Fund base operating budget requests submitted by the departments to the Finance Department totaled \$112.8 million; \$3.3 million or 3% over the prior year budget. A large part of this increase was due to an increase in retirement costs, assumption of increased number of filled positions, increases in utilities and certain other operating costs and the additional 1.5% of General Fund revenues dedicated to capital facilities projects. In addition, departments requested \$4 million in budget increases for operating expense increases, enhanced service levels and a few new positions. During the month of March, the Budget Review Team held meetings with each department to review and discuss these budget requests.

The first set of FY 15-16 revenue estimates totaled \$111.7 million using the assumptions of modest economic growth, a gradually improving real estate market and increasing development activity in the City. Revenue assumptions are discussed in detail in the Summaries of Financial Data section of this budget book.

The departmental budget requests and revenue estimates described above combined to create an initial budget gap of \$5 million. The budget gap was closed by making the following adjustments in concert with discussions with the CEO, department heads, Finance and departmental budget liaisons:

- Reduction in the CEO budget for part-time, consulting and professional development costs of about \$276,000
- Reduced the City Attorney budget from a \$400,000 increase to a \$200,000 increase
- Reduced the Police Department preliminary budget by about \$354,000; a combination of deleting six vacant custody officers and keeping part-time positions at the current year level of hours while reclassifying five Community Service Specialist positions to Park Ranger positions.
- Initial City-wide salary savings of \$1.75 million was increased by about \$1.4 million representing an average City-wide vacancy factor of just under 4.7% for the entire fiscal year
- CEO, department heads and Finance reviewed all requests for budget increases and made further budget reductions of \$1.3 million by identifying one-time items that could be purchased out of the current budget and deferring lower priority items
- Revenue projections were increased by about \$1.3 million based on updated year-to-date actuals and other items

As a quick overview, here is the preliminary budget for FY 15-16 for all funds compared to the FY 14-15 adopted budget:

ADOPTED BUDGET - ALL FUNDS				
Appropriations/ All Funds	Adopted	Preliminary	Increase (Decrease)	
	<u>FY 14-15</u>	<u>FY 15-16</u>	<u>Amount</u>	<u>Percent</u>
Operating Budget	\$ 114,958,461	\$ 118,083,807	\$ 3,125,346	2.7%
Transfers Out	5,517,067	7,452,140	\$ 1,935,073	35.1%
Capital Budget	19,421,001	22,299,929	\$ 2,878,928	14.8%
Total	\$ 139,896,529	\$ 147,835,876	\$ 7,939,347	5.7%

GENERAL FUND PRELIMINARY BUDGET

The General Fund provides 89.2% of the total operating budget for all governmental funds. The total preliminary General Fund budget is \$113 million, an increase of \$3.5 million or 3.2% from the current year adopted budget. Table 1 is a summary of the total General Fund resources and requirements for FY 15-16:

Table 1

PRELIMINARY BUDGET - GENERAL FUND				
	Adopted	Preliminary	Increase (Decrease)	
	<u>FY 14-15</u>	<u>FY 15-16</u>	<u>Amount</u>	<u>Percent</u>
Estimated Revenues	\$ 109,451,662	\$ 113,067,900	\$ 3,616,238	3.3%
Transfer in	-	-	-	-
Use of Fund Balance	-	-	-	-
Total Resources	<u>\$ 109,451,662</u>	<u>\$ 113,067,900</u>	<u>\$ 3,616,238</u>	3.3%
Operating Budget	\$ 103,934,595	\$ 105,502,050	\$ 1,567,455	1.5%
Transfer Out	5,517,067	7,452,140	1,935,073	35.1%
Total Appropriations	\$ 109,451,662	\$ 112,954,190	\$ 3,502,528	3.2%

FINANCIAL OUTLOOK

As a result of the continued improvement in the economy, most revenue sources are projected to continue to increase. The City experienced increases in Sales Tax, Property Tax, Transient Occupancy Tax (TOT) and Building Permit revenue last year and expects those to continue in FY 15-16. The City will evaluate revenues and

continue to find ways to mitigate costs. Doing so will continue to stabilize the City's budget, provide necessary services to the community and work towards re-building reserves.

The City remains careful about its cash position. With the depletion of reserves in previous years, it is very important for the City to maintain a balanced budget and stabilize cash. Based on the timing of the receipt of certain revenues, the City has periods of time when it uses more cash than it receives. That use of cash is replenished later in the fiscal year with the receipt of property tax revenue. The General Fund had operating surpluses at the end of both FY 12-13 and FY 13-14 which helped increase the overall cash position. The City plans for this trend to continue in the current and next fiscal years.

HIGHLIGHTS OF THE PRELIMINARY BUDGET

The FY 15-16 preliminary budget contains funding for on-going services to the community. The following highlights reflect some of the changes and facts regarding the budget:

- Budgeted amounts for the City's share of employee retirement cost are affected by:
 - Increased retirement rates from CalPERS
 - Miscellaneous employees contributing 60% of the rate increases
 - City pick-up of 5% of Police employee retirement
 - Inclusion of new retirement tier rates
 - Corrections to budget calculation formulas used to determine retirement budget amounts
- The budget contains funding for an additional payment of \$500,000 toward reducing the unfunded liability associated with retirement costs.
- Internal charges for vehicle replacement are reinstated after a one-year internal rate holiday.
- General Fund contribution to Capital Projects is 5% of the General Fund budget: \$5,587,335
- General Fund contribution to Capital Facility Projects is 1.5% of the General Fund budget: \$1,676,201
- Capital Projects include the second year of advance funding of a four-year level-pay plan for the next generation of the 800 MHz Coordinated Communication System at \$1,239,969 per year. The Police Department will fund \$763,889 of this project.
- Allocations to the Information Technology (IT) Replacement Fund will increase from \$100,000 to \$150,000 for the accumulation of funds for future IT equipment replacements and upgrades.
- Conversion from City Jail staffing to G4S contract staffing is implemented by fully funding the G4S contract and deleting the remaining Custody Officer positions.
- Fire Department
 - Staffing is increased by the addition of an EMS/Training Captain

- Planned replacement of thirteen cardiac monitors
- Replacement of two aging fire trucks
- Development Services:
 - Permit & plan check revenue is estimated to increase by \$568,000 based on projected development activity.
 - Budget reflects the creation of a new Community Improvement Division staffed with existing resources and a new Assistant Director position.
- Public Services Department
 - Includes the new street sweeping contract offset by a reduction of three full-time positions
 - Includes the new custodial services contract with enhanced services
 - Staffing is increased by the addition of an Assistant City Engineer to assist with the high volume of capital projects.
- Three new Code Enforcement Officer positions are added to enhance services to the community from various perspectives: one each in the Fire Department, Police Department and Development Services.
- Contingency appropriations are \$1,000,000.

GENERAL FUND RESERVES/USE OF FUND BALANCE

The General Fund – Total Fund Balance was \$50.2 million as of June 30, 2014. As part of the mid-year budget report on March 3, 2015 the Council approved allocation of \$4 million toward the planned Neighborhood Community Center/Library/Park project. The City continues to maintain a \$14.125 million emergency general operating reserve, in addition to reserves for workers’ compensation, general liability claims, and compensated absences. On March 3, 2015 the Council reviewed a new Reserves Study that took a risk-based approach to establishing reserves for economic volatility, major infrastructure failure, natural disasters and other emergencies. The Council approved a reserves goal of \$52 million and a plan to achieve that goal by increasing existing reserves by up to \$1.5 million per year funded by any actual annual operating surplus.

A schedule of estimated fund balances for all budgeted funds is found in the Summaries of Financial Data section of this budget book.

CAPITAL IMPROVEMENT PROJECTS

The capital budget is recommended at \$22.3 million. In reviewing the Capital Improvement budget, it is important to keep in mind that most projects are funded by restricted revenue sources or grants. Consequently, there will potentially be significant differences from year to year in both the numbers of projects adopted and the total dollars budgeted.

Approximately \$11.3 million or 50.5% of the total funding for capital projects is from the General Fund; \$5.35 million or 24% is funded by the Gas Tax Fund and another \$2.3 million or 10% is from Measure M Funds. Both the Measure M Funds and Gas Tax

Funds are earmarked for streets and/or transportation-related expenditures. Other funding sources for capital improvements are the Community Development Block Grant (CDBG) Fund, Drainage Fees, Traffic Impact Fees and Narcotics Asset Forfeiture Funds.

Table 2 below illustrates the total capital projects funding by category planned for FY 15-16. It reflects an emphasis on streets, parks, and capital facilities projects including \$4 million for the Neighborhood Community Center/Library/Park facilities and nearly \$1.7 million set aside for eventual replacement of Fire Station 1.

Table 2

<u>CAPITAL IMPROVEMENT PROJECTS</u>				
<u>Program Category</u>	Adopted	Preliminary	Increase (Decrease)	
	<u>FY 14-15</u>	<u>FY 15-16</u>	<u>Amount</u>	<u>Percent</u>
Parkway & Median Improvements	\$ 813,900	\$ 700,000	-\$113,900	-13.99%
Street Improvements/Maintenance	5,038,307	6,675,946	1,637,639	32.50%
Storm Drain Improvements	2,090,000	510,000	(1,580,000)	-75.60%
Curbs and Sidewalks	550,000	1,150,000	600,000	109.09%
Traffic Planning	3,257,000	1,022,208	(2,234,792)	-68.62%
Traffic Operations	3,330,694	-	(3,330,694)	N/A
Park Development & Maintenance	1,116,100	3,912,350	2,796,250	250.54%
Building Maintenance	1,641,000	1,377,255	(263,745)	-16.07%
Equipment Maintenance	-	36,000	36,000	N/A
Capital Facility Projects	-	5,676,201	5,676,201	N/A
Next Gen 800 Mhz Comm System	1,584,000	1,239,969	(344,031)	-21.72%
Total	<u>\$19,421,001</u>	<u>\$22,299,929</u>	<u>\$2,878,928</u>	<u>14.82%</u>
General funds	5,450,000	11,263,536	5,813,536	106.67%
Other Funds	13,971,001	\$11,036,393	(2,934,608)	-21.00%
Total Appropriations	<u>\$19,421,001</u>	<u>\$22,299,929</u>	<u>\$2,878,928</u>	<u>14.82%</u>

NEXT STEPS

The next steps in the FY 15-16 budget process include the following events:

- May 12, 2015 Council Study Session
- May 21, 2015 Community Meeting
- June 15, 2015 Council budget hearing and adoption.

SUMMARY

Although current economic conditions are improving, and continue to do so, this adopted budget does not fully support the overall high level of operating service that the citizens of Costa Mesa had grown accustomed to in the past. Those levels are likely unsustainable. It does however propose a balanced financial plan, maintains and in a few areas, enhances the current level of service and enhances infrastructure improvements.

ACKNOWLEDGEMENT

The development of the adopted budget takes a great amount of staff time and effort, and has to be completed within a defined timeline. I sincerely appreciate the contribution made by all department directors, division managers, and departmental budget liaisons. Special recognition is extended to the Finance budget team and Central Services staff. I thank the City Council for their continued support in making Costa Mesa a financially stable and well-balanced community.

Respectfully submitted,

A handwritten signature in black ink that reads "Thomas R. Hatch". The signature is written in a cursive, flowing style.

Thomas R. Hatch
Chief Executive Officer
City of Costa Mesa