CITY OF SAN PABLO
City Manager

San Pablo
All-America City
NATIONAL CIVIC LEAGUE
2014

CITY OF SAN PABLO
City of New Directions

DATE: **June 5, 2017 - DRAFT BUDGET PUBLIC HEARING**

TO: **MAYOR AND SAN PABLO CITY COUNCIL**

FROM: **Matt Rodriguez City Manager**

Re: **CITY MANAGER ANNUAL BUDGET MESSAGE:**
PRELIMINARY DRAFT FY 2017-2021 QUADRENNIAL GENERAL FUND OPERATING BUDGET (DRAFT BUDGET)

To the Honorable Mayor and Members of the San Pablo City Council:

Please accept on behalf of myself and the City's Budget Team, the Preliminary Four-Year Quadrennial GF Operating Budget (DRAFT BUDGET) for Fiscal Year 2017-2021 period.

Pursuant to San Pablo Municipal Code Section 3.04.230, the DRAFT BUDGET document enclosed herein provides detailed financial information about the policies, expenditures and revenues forecasted for the City's upcoming four-year quadrennial operational period beginning July 1, 2017 and ending June 30, 2021, with a mid-year period for adjustment of forecasted expenses and revenues after the fiscal year period ending June 30, 2019, or completion of year 2 period of the budget.

BUDGET, FISCAL & LEGISLATIVE STANDING COMMITTEE REVIEW

The DRAFT BUDGET for the FY 2017-2021 period was submitted for formal consideration and review by members of the Budget, Fiscal & Legislative Standing Committee (Mayor Cecilia Valdez/Councilmember Rich Kinney) on May 24, 2017. Following the Standing Committee's review of all proposed expenses and revenues for period 2017-2021, the DRAFT BUDGET is now being submitted as presented by the City Manager to the City Council for formal consideration, review and adoption. The Standing Committee had no recommended changes and is forwarding the DRAFT BUDGET as-is for formal public hearing scheduled on June 5, 2017.

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During this budget process, there were several noteworthy fiscal achievements that are highlighted, as follows:

BUDGET & FISCAL ACCOMPLISHMENTS

Previously, the City Council adopted the Biennial Operating Budget for the period FY 2015-17 which will conclude this June 30, 2017. Since January 2017, the new budget cycle was initiated by the City Manager, and the City's Budget Team. All internal budget planning has been completed by the all City Departments. All non-essential spending was eliminated from the DRAFT BUDGET and revenues adjusted to present a balanced four-year DRAFT BUDGET. There are several budget rationale for the development of a long-term multi-year budget, as follows:

Four-Year Stability Approach to GF Budget

In January 2017, the City Manager proposed a multi-year operating budget for the City Council's consideration for the upcoming budget cycle. This multi-year approach was authorized by the Budget Standing Committee in January 2017. A four-year, quadrennial General Fund operating budget format was proposed following the ongoing success of the last three (3) consecutive Two-Year Biennial General Fund Operating Budget adoptions by the City Council for fiscal year periods 2011-13, 2013-15, and 2015-17. A key factor to the multi-year budget approach is to simultaneously achieve agreements with all representative employee labor groups along with a the long-term General Fund Operating Expenditure Plan resulting in long-term economic stability of major cost factors while new economic development opportunities are pursued. Projected labor costs are the most significant annual cost factor of the City's Annual General Fund Budget.

U.S. Economy Rebounding and Recovering

The U.S. Economy has been recovering slowly and unevenly since the depths of the economic recession in 2009. The economy has received further support through expansionary monetary policies. This includes not only holding interest rates from increasing significantly but also the unconventional practice of the U.S. government buying large amounts of financial assets to increase the U.S. money supply and hold down long term interest rates—a practice known as "quantitative easing".

While the labor market has recovered significantly and employment has returned to pre-crisis recession levels, there is still widespread debate regarding the future and health of the U.S. Economy. In addition, even though the worst effects of the recession are now fading, the economy still faces a variety of significant challenges going forward. Deteriorating infrastructure, wage stagnation, rising income inequality, elevated pension and medical costs, as well as large current government budget deficits, are all issues facing the U.S. Economy in the coming years.

- **GF Designated Reserves Allocation Growth**

For the projected year-end of FY 2015-17 period, the City is completing a successful and financially productive year. All City Departments are on-target to spend nearly all of their respective allocated budgets through June 30, 2017. An important factor contained in this DRAFT BUDGET is the ongoing practice of using audited fund balance generated from budget surplus at the end of the previous FY 2014/15 and FY 2015/16 periods, respectively. Both year-end budgets resulted in year-end budget surplus, where annual revenues exceeded annual expenses at the end of the fiscal year period.

Following review by the City's Auditor, the Comprehensive Annual Financial Reports (CAFR) for periods ending June 30, 2015, and June 30, 2016 resulted in substantial audited fund balance being generated which consisted of year-end cost savings from City Departmental Budgets and unforeseen revenue increases from one-time federal and state grants, and increased Casino annual revenues, with other external revenue sources combined.

Since January 2014, following Fiscal Resiliency Policies adopted in October 2013, the City Council has maintained the fiscal practice of allocating year-end audited fund balance to new GF Designated Reserves. Much of this year-end audited fund balance is being allocated as one-time budget allocations by the City Council during the course of the fiscal operating period. Typically, each January, these allocations have been approved by the City Council for financial programming.

Most recently, in January 2017, the ongoing and continued practice of using year-end audited fund balance for future allocations (which totaled $4.7M in FY 2014/15 and $9.1M in FY 2015/16) resulted in a combined $13.9M build-up of one-time GF Designated Reserves. This is above and beyond the Fiscal Resiliency Reserves of $19.2M coupled with the GF Designated Reserves of $18.9M have provided positive bond ratings and a source of one-time funding for City projects.

The build-up of City Fiscal Resiliency Reserves and GF Designated Reserves have resulted in ongoing favorable bond ratings from rating agencies needed for restructuring $2.7M in Local Successor Agency's (LSA)/RDA debt obligations incurred by the former redevelopment agency in August 2016. Additionally, favorable bond ratings will greatly assist with a future $11.8M bond issuance during the first quarter of FY 2017/18. Lease Revenue Bonds will be authorized by the City Council, and it's Joint Powers Financing Authority, to generate one-time capital funds for building the City's new City Hall Project.

- **Continue practice of using One-time Funding for Economic Development Projects is recommended (Year-end audited fund balance)**

With increased operating expenses planned for the next four-year budget cycle, there are risks associated with adding new financial cost obligations to the General Fund Operating Budget if and when year-end audited fund balance diminishes in future years.

However, for now, the City Council has seen ongoing growth in year-end audited fund balance but caution should be noted here as this is not a long-term funding source that will materialize in future years, especially during a rebounding economy.

- **No Annual Growth Factor**

NO annual growth factor on expenditure side to curb costs and eliminate budget "creep is proposed in the new DRAFT BUDGET for the next four-year budget cycle. This will assist with fiscal controls and financial discipline so that projected revenues continue to outpace annual expenses year after year.

- **Fiscal Resiliency Reserve Policy Reforms**

The City's fiscal outlook needs to be one focused on the implementation of guiding principles of "fiscal resiliency" to ensure that enough resources are safely earmarked for dealing with future financial contingencies. This means that the City **DOES NOT** maintain a windfall of revenue to spend year-to-year in the GF Operating Budget. There continues to emerge the ability to use one-time GF Designated Reserve Funding Allocations for the City's ongoing implementation of its Capital Improvement (CIP) Budget, and economic development projects. But, based on these fiscal reform achievements, the City's fiscal situation is **very cautionary** for the next four-year budget cycle.

There must be continued resolve by City Council and City staff to monitor and ensure that modest revenue increases or year-end audited fund balance is carefully managed as the City's budget stabilizes during the economic recovery, with revenues and expenses in **close alignment** each fiscal year period.

CITY MANAGER FINANCIAL RISK WARNING

- **Rebounded economy, BUT New Norm is Slow Growth**

As previously mentioned, the City Council needs to acknowledge that the City Manager and staff are monitoring the recovering U.S. Economy which could impact State and local governmental budgets nation-wide. Additionally, with the sweeping reforms imposed by the current Federal Administration and newly elected President, there is considerable uncertainty of these reforms on the U.S. Economy in a number of areas, especially health care, unemployment and stagnated wage growth.

- **Proper fiscal management and internal controls**

With a long-term DRAFT BUDGET, and the economic uncertainty for the U.S. Economy, it would be prudent for the City Manager to propose that all City financial operations identify, assess and manage risk for the City's financial condition over the next four year budget cycle. This will mean audit or financial assessment findings must have the internal capacity of key staff to effectively monitor and ensure the integrity of the City's programmatic and financial operations. Additionally, it means that the City Council and City Departments remain prudent in making financial decisions in the future that does not extend beyond the City's financial capabilities and debt capacity.

- **Plan for Major Financial Contingencies**

The City Manager has always planned for major unforeseen contingencies that may impact the City organization. However, not all major unforeseen contingencies can be expected for during the economic recovery period. Resources are being proposed in the DRAFT BUDGET to plan ahead whenever practical to meet significant cost factors such as debt obligations and ongoing CalPERS and retiree health cost increases during this next four-year budget cycle. Ongoing pension and retiree health are **<u>significant cost factors</u>** for the City going forward in future years.

- **Focus on long-term economic viability**

Following budget adoption by the City Council in June 2017, the City Manager stresses that internal policy focus must be on long-term economic viability for the City. This means continued development of new revenue sources and encouraging new private investment through economic development in key areas. Emphasis over the past six years has been to transition from the dissolution of redevelopment to a new economic development paradigm using one-time audited fund balance. In recent years, the City of San Pablo has continued to develop major community projects to enhance the quality of life and amenities for its residents which has had a positive impact on encouraging future private investment opportunities within the City's small 2.6 square miles for the future.

- **Revenue and Expenditure adjustments planned for Mid-Year Budget Cycle (June 30, 2019)**

At the end of Year 2 in the DRAFT BUDGET or fiscal period ending June 30, 2019, the City Manager indicates that revenue projections may be adjusted and increased for the remaining Years 3 and 4 in the DRAFT BUDGET due to economic development and parking expansion at Casino San Pablo once the Lytton Rancheria Band of Pomo Indians prospectively close escrow on the 8.3 acre DMC parcel. This influx of new Casino revenue may have a positive impact on City projected revenues in the next two years. At the same time, if no potential revenue is on the horizon, the City Council must continue to exercise fiscal restraint as this projected revenue is anticipated but has not materialized as of yet.

- **Adherence to Fiscal Resiliency Policies (Adopted Oct. '13)**

The City Council's continued compliance with Fiscal Resiliency Polices adopted in October 2013 have increased the financial stability of the City's General Fund Operating Budget and shored up much needed critical funding with one time funding for projects, services and equipment through the GF Designated Reserves. This continues to be a positive impact to the City's financial condition but may not last indefinitely over the remaining next four year budget cycle.

- **Limited audited fund balance projected for one-time spending on economic development projects in 2018-21**

Casino San Pablo annual revenue to the City continues to grow on average of 3% annually. In fact, for the DRAFT BUDGET, a greater reliance on increased Casino revenue will systematically reduce the amount of year-end revenue which contributes to year-end audited fund balance. Therefore, with increased reliance on Casino annual revenue to balance the DRAFT BUDGET in outlying year, a greater reliance on year end cost savings will result. This may contribute to a diminished year-end audited fund balance for future programming and budget planning into the GF Designated Reserves to fuel economic development projects in the future.

- **Increasing interest rates will affect cost of borrowing**

In May 2017, the Federal Reserve took one more step toward removing the economic stimulus policies that still linger from the former Federal Administration under former President Obama, and the aftermath of the economic recession. The U.S. Federal Reserve finally raised its key short-term interest rate to a range of 0.75% to 1%. That's the highest that rate has been since 2008, and it's the first time the Federal Reserve raised its rate this year.

What investors, economists, and borrowers, however, have been waiting to find out is the Federal Reserve Bank's updated economic projections which suggests that the new Federal Administration under newly elected President has not been able to boost the economy since the new President took office in January 2017. However, continued growth hopefully comes along with more jobs, and eventually rising wages as the economy continues to rebound and recover.

With the unemployment rate at 4.7% in February 2017, the job market is already considered near "full employment" by several Federal officials. Meanwhile, the Federal Reserve's preferred measure of inflation shows prices are up 1.9% over the previous 12 months ending in January 2017, inching closer to the central bank's goal of 2% inflation per year. Additional interest rate hikes are forecasting for late summer 2017, and another rate hike possibly by year end 2017. Increased interest rate hikes will affect the cost of borrowing and may be detrimental to the City's future bond issuance scheduled for the First Quarter of the new FY 2017/18 for the new City Hall Project. Currently, as proposed in the DRAFT BUDGET, a total of $700,000 in proposed annual debt obligations are budgeted adequately in line with today's current interest rate projections.

- **Dollar impact for changes to CalPERS discount rate and actuarial assumptions**

Contained in the DRAFT BUDGET are expense forecasts for implementation of the new CalPERS discount rate on actuarial assumptions for the City which are slated to increase over the next four-year budget cycle. Beginning in FY 2017/18, the annual cost impact is forecasted at $1.75M, increasing to $2.25M in FY 2018/19. Additionally, another increase in FY 2019/20 is anticipated at $2.86M, with an additional expense impact of $3.33M in FY 2020/21.

In December 2016, the CalPERS Board approved the discount rate what the CalPERS Board assumes will result in a $304 billion annual investment return for CalPERS in a typical fiscal year, July 1 to June 30. It's a critical component of pension financial planning, because it's used in calculating the amount of money those who are part of the CalPERS system contribute.

Based on the advice from financial advisors to CalPERS, achieving a 7.5 percent return – the rate in place since 2012 – was now far less likely than it was just two years ago when CalPERS last revisited their investment policy. Solid investment returns are the cornerstone of the CalPERS system: They pay for nearly two-thirds of every dollar paid out in pension benefits.

But, cutting the discount rate has real financial impacts for California taxpayers. Local public agencies, state and school districts that make up CalPERS will have to contribute more money annually. So will many individual public employees, especially those hired after the Public Employees' Pension Reform Act took effect in January 2013. Pension liabilities too will grow before they level off and begin a downward trend.

Those hard realities helped inform the CalPERS Board when it decided to reduce the rate over three years - to 7.375% immediately, to 7.2%5 in July 2018, and, finally, to 7% a year later. To sustain the CalPERS Fund for decades to come, and pay the benefits promised to public employees, the discount rate had to be reduced by the CalPERS Board. For their own budgeting purposes, they didn't want the rate to be cut dramatically in one fell swoop and is thus will be phased in over the next three years.

Overall, the reduction is a key step to ensuring the long-term sustainability of the CalPERS Retirement Fund and keeping in place reasonable retirement benefits that public employers need as they compete in the marketplace for talented workers.

CalPERS is a maturing pension fund like many across our nation. More money is going out in pensions than coming in, CalPERS has a low funded status, a decline in the number of active workers supporting retirees, and a low-return investing environment. These issues cumulatively are real financial policy reform issues, but CalPERS states they are on the right path to full funding - and the CalPERS Board's action on the discount rate has strengthened their efforts in that direction.

CITY MANAGER FINANCIAL OUTLOOK

- **City must create new Economic Development Opportunities**

The City is heavily dependent on annual Casino San Pablo revenues which represent 53% of City's annual GF revenues. New economic development opportunities need to be fostered over the next budget cycle. Additional new revenue sources were added to annual forecasted revenue in the DRAFT BUDGET from Plaza San Pablo development (i.e. County WIC Project; Future Medical Office Building), and the new Digital LED I-80 Freeway Sign to annual GF revenue projections. Economic diversification is key and encouraging private investment into infill development sites throughout the City are needed to contribute to the City's economic tax base in future years.

- **Support ongoing development of City-wide Municipal Broadband Project through new CFD mechanism (O&M)**

The City-wide Municipal Broadband Project is still a work in-progress with Phase I of construction slated for implementation in FY 2017/18. However, capital funds needed and a U.S. EDA Grant are needed to cover the cost of this initial phase of construction. Additionally, the City Council must support establishment of a future Community Facilities District (CFD) mechanism during FY 2017/18 to help sustain the annual operating and maintenance costs and for capital financing to continue to build our the open fiber optic network. Once accomplished, the new broadband project could result in substantial economic benefits to the City as well as provide faster and larger internet bandwidth capacity for San Pablo businesses and residents in the coming years.

- **New Economic Partnership with Lytton Tribe once DMC escrow closure completed**

The City must continue to develop a new economic partnership with Lytton Tribe who operate Casino San Pablo. With potential escrow proceedings coming to a close in early

FY 2017/18 on the 8.3 acre DMC parcel, the Lytton Tribe's immediate plans on parking expansion opportunities would directly result in potential new revenue to the City under current terms of the adopted Municipal Services Agreement with the Lytton Tribe. However, the potential for future economic development on the largest commercially-zoned property in the City would also result in potential new jobs and economic benefits to the City and its residents, and could greatly complement the current Casino San Pablo. A balanced approach to seeking any new or potential commercial development of the DMC parcel by the Lytton Tribe must be a mutually beneficial partnership between the City and Lytton Tribe in the future.

- **Avoid frivolous GF spending**

The City Manager has warned the City Council that any frivolous GF spending would result in potential deficits or compounding of annual expenses. There is a delicate balance of expenses and revenues forecasted over the next four year budget cycle. The City Council needs to refrain from elaborate or increasing GF spending unless a dedicated revenue source is identified (i.e. one-time GF Designated Reserves; New Revenue Source) to mitigate any impacts on the GF operating budget including annual GF subsidies.

- **Measure Q revenue <u>cut by 50%</u> in Nov. 2017**

The Measure Q Sales Tax Measure passed in June 2012 is slated to be reduced from ½ cent to ¼ cent sales tax in November 2017, and sunsets in year 2020. A number of municipal services are funded from this dedicated funding source. Therefore, the City's revenues from this source approved by local voters will be reduced by 50% annually. Losses totaling $380,000 are projected in FY 2017/18, with additional ongoing losses of $416,000 beginning in FY 2018/19. This loss in annual revenue will be substantially absorbed (or therefore subsidized) by the City's GF Operating Budget over the next four year budget cycle so that programs such as: School Resource Officers, Police Cadets, SPEDC workforce development programs, and Youth Services/Full Service Community Schools grants and programs can remain substantially funded over the next four year budget cycle.

- **Healthcare and Retiree Healthcare costs projected to increase**

Healthcare expenses for City employees continue to escalate over the next four-year budget cycle by +5% per year. With the demise of the Affordable Health Care Act in 2017, additional health care industry impacts are not known at this time. For City employees, increased healthcare costs are contained in the DRAFT BUDGET with $2.2M budgeted in FY 2017/18 plus an additional $500,000 for Retiree Healthcare. These costs are not controlled by the City and will continue to be a **<u>major cost factor</u>** for the City.

- **Invest in Deferred Maintenance (i.e. City infrastructure replacement, vehicles, and computers)**

The City Manager is concerned about ongoing funding availability to address deferred maintenance with includes City infrastructure replacement, city vehicles replacement and Computer Replacement. These are costs managed using one-time appropriations from the GF Designated Reserves with some funding contained in the DRAFT BUDGET and 5-year CIP BUDGET over the next four year budget cycle. City infrastructure replacement for aging City facilities, and/or upgrades to existing City parks, lacks a consistent and dedicated funding source. City vehicles and IT replacement are essential items needed for City service delivery and for employee work productivity. All items must be continually budgeted for City operations to be effective and resolute. As we all know, technology becomes obsolete year after year. Therefore, IT resources must be replaced periodically to maintain productivity and service levels for the City.

- **Preservation of Casino Revenue (Class II Gaming) per current MSA agreement & build-up of new Casino Revenue Sustainability Reserve**

In June 2016, the City Council established a new Casino Revenue Sustainability Reserve (Fund: 180). The new reserve fund contained in the GF Designated Reserves currently is allocated at $1M. At the completion of each annual audit, and following certification of the Comprehensive Annual Financial Report (CAFR) by the City's independent auditor for that particular fiscal year, a percentage of the net change in year-end audited fund balance- **up to a maximum 50.0 percent** may be deposited into the Casino Revenue Sustainability Reserve (Fund 180). The purpose of the reserve is to mitigate against the potential impact that a sudden shutdown or loss of casino revenue would have on the City's ability to maintain current operations and service levels. All deposits and withdrawals from the fund are discretionary, but require approval by the Budget, Fiscal & Legislative Standing Committee and a majority approval by resolution of the City Council. The new reserve is intended, and must continue, to grow over time.

- **Maintain long-term, stable Partnerships with Employee Labor Groups (4-year MOUs)**

The City has always had long-term sustainable employee labor group partnerships with representative units in the City. These MOUs have sustained labor costs in the GF Annual Budget over the last six (6) years, with two (2) consecutive 3-year labor MOU agreements. Our City employees have greatly contributed to the economic stability of the City over the last six (6) fiscal year periods by assisting with sustaining labor costs over time, and contributing more to the pension costs through CalPERS. Currently, a total of $550,000 in City Council approved projected labor costs are contained in the DRAFT BUDGET following collective bargaining to conclude in June 2017.

Support ROI/sale proceeds back to City

With the economic recovery period abounding, the City Manager stresses that continued support for return on investment policies (or ROI) must be an ongoing financial policy supported by the City Council when disposing of City surplus property. With limited opportunities, the City must take advantage of market considerations and the potential generation of future sale proceeds that could be re-invested into the community through new public or park facilities and/or City activities, programs and services. This reduces the dependency of relying on one-time GF Designated Reserves and the GF Budget resulting in opportunity costs that could supplant critical and essential funding.

MEETING THE FISCAL CHALLENGES

Budget Strategies for FY 2017-2021

During the previous FY 2015-17 budget cycle, the City's Budget Team eliminated potential risks which would have resulted in operating deficits. As the City developed the DRAFT BUDGET for FY 2017-2021, the City's Budget Team again turned to a combination of strategies, including looking to a multi-year approach to solving financial issues. This included the following:

(1) Adopt a Multi-Year Operational Budget
(2) Increased operational costs compared to FY 2015-17 base-year levels
(3) Eliminated non-essential spending that would have resulted in operating deficits
(4) Projected realistic revenues to meet projected expenditures
(5) Cut Measure Q Sales Tax Revenue by 50% in Nov. 2017
(6) Funneling "one-time funds" following year-end audits to create positive balances in the GF Designated Reserves for economic development
(7) Predictability in growth of labor costs with four-year agreements

Major Cost Factors for FY 2017-2021

Please note that the DRAFT BUDGET is built upon a series of assumptions needed to stabilize operating costs through efficiencies, and eliminate non-essential (one-time) spending to be on pace with revenue projections. There are major cost factors contained in the DRAFT BUDGET to be continually monitored. Major cost increases in Year 1 (FY 2017/18) of the DRAFT BUDGET include the following:

- **Employee Labor Costs:** Effective July 1, 2017, a cost-of-living increase (COLA) for miscellaneous and safety employees will be implemented following collective bargaining with representative units. This represents a $555,000 increase from the final year of multi-year employee labor groups' MOU's which expire on June 30, 2017. All negotiated cost factors and/or savings realized from collective bargaining with employee labor groups are incorporated into the FY 2017-2021 period.

- **CalPERS Pension Costs:** In FY 17/18, unfunded actuarial liability (UAL) totals $1.8M to address lowered discount rate (investment rate of return), longer mortality rate assumption, updated actuarial tables, etc. Annual pension ("normal") cost equals $1.7M for total pension expense of $3.5M

- **Rising Healthcare Costs:** Total $2.2M in FY 17/18 for all employees plus an additional $500,000 for Retirees.

- **FY 17/18 Workers' Compensation Costs:** A significant cost factor for the DRAFT BUDGET at $666,000. When combined with unemployment insurance of $313,000, the two total nearly $1M.

- **MPA Insurance:** Costs $777,000 in FY 17/18 for property, fire, crime and general liability

- **Increased Supplies & Services Costs:** An overall increase of $530,000 in Public Works for deferred maintenance and to cover new facilities following construction (i.e. County Library, New City Hall, etc.) and other previously unbudgeted expenses

- **Community Affairs:** $465,000 in new annual Library lease payments in FY 17/18 plus a contractual increase of $300,000 with the Contra Costa County Fire Protection District (ConFire) to continue to sustain EMS services at County Fire Station #70 during FY 18/19.

- **Special Departmental Expenses:** An increase of $700,000 to cover projected debt service on the future $11.8M New City Hall Lease Revenue Bonds to be issued during the first quarter of FY 2017/18.

- **New Tri-Cities Dispatch and CAD/RMS Agreement:** Ongoing costs of approximately $1.1M with the Cities of Hercules and Pinole which will be minimally offset by one-time revenue from CAD/RMS reserves resulting from dissolution of the previous West County Consortium under the management of the City of Richmond. Most of the one-time set-up costs for the new service model have been incurred during FY 2016-17.

- **Utilities:** Expenses total $403,000 in FY 2017/18, including the annual solar loan payment of $88,000 to the State of CA Energy Commission. Diesel and gasoline costs are also rising to $309,000 in FY 2017/18. However, the increase in fuel will be fully offset by higher gas tax revenue associated with the Road Repair and Accountability Act (SB 1) which was adopted by the State Legislature and signed by the Governor in early 2017.

- **Program Costs and Supplies:** Service level enhancements of $350,000 are included for Community Services Department - Youth Services Division which will be covered with the City's GF Budget revenues following 50% reduction of Measure Q Sales Tax revenue. These are costs outside of the Measure Q spectrum.

- **No FTE Layoffs:** No layoffs necessary as a budget reduction or cost savings strategy for any year of the four-year budget period are proposed. Note: The last FTE reductions used for budget balancing purposes was incurred during FY 2010-11. This is a potential **10-year period of no FTE layoffs** over the last six (6) years and next four (4) year budget cycle.

Major Revenue Factors for FY 2017-2021

In preparing for General Fund revenue forecasts, the DRAFT BUDGET includes **conservative and practical** projections to determine Total Revenues, which generally include no revenue increases in Year 2 with a modest 1% annual increase thereafter. Many of these revenue projections were factored into the DRAFT BUDGET, as follows:

PRELIMINARY DRAFT BUDGET RECOMMENDATIONS – BUDGET SUMMARY

The following table represents the preliminary DRAFT BUDGET summary (expense vs. revenue) for the period FY 2017-2021, as follows:

- **Casino Business Tax*:** Annual Casino Revenue was budgeted at $18M during FY 2015/17, and increased by 14% and budgeted at $21.0M in FY 2017/18. This comprises 53% of total budgeted GF revenues. Annual increases of 3.0% are realistically projected in Years 2, 3 and 4 over the next four-year budget cycle.

- **Property Tax Revenue:** No major adjustments in revenue from FY 2015-17. FY 17/18 is budgeted to be basically flat with minimal growth over the next four year budget cycle.

- **Sales Tax Revenue:** Significant decreases are certain with the reduction of Measure Q Sales Tax from ½ cent to ¼ cent in Nov. 2017. Losses totaling $380,000 are projected in FY 2017/18, with additional ongoing losses of $416,000 beginning in FY 2018/19.

- **Franchise Tax Revenue:** Projected to remain steady at $750,000, an increase of $80,000 over FY 2016/17 amounts. Franchise fee revenue is generally associated with the City's Refuse and Franchise Fee with Republic Services (dba RSS).

- **Digital LED Sign Revenue:** New revenue budgeted at $100,000 in FY 2017/18 and increasing to $300,000 in FY 2018/19 and beyond.

- **Rental Income:** Lease revenue increases to $607,000 in FY 17/18 due to the new County WIC Building, then to $750,000 in Year 2 with the addition of another Medical Office Building lease.

- **Road Repair and Accountability Act (SB 1):** Recently enacted legislation in early 2017 by Governor will create $178,000 in new revenue in FY 2017/18, increasing to $530,000 during the next four year budget cycle.

DRAFT BUDGET RECOMMENDATIONS – DRAFT BUDGET SUMMARY (FY 2017-21)

The following two tables represents the Preliminary DRAFT BUDGET summary (annual expense vs. annual revenue) for the period of FY 2017-2021 as recommended by the City Manager for City Council review and consideration, as follows:

FY 2017/18 PROPOSED BUDGET		FY 2018/19 PROPOSED BUDGET	
Baseline Revenue	39.3	Baseline Revenue	40.3
Sale of City Parking Lot	0.0	Sale of City Parking Lot *	0.3
One-time Transfer from GFDR	0.0	One-time Transfer from GFDR	0.3
Total Revenue	**39.3**	**Total Revenue**	**40.9**
Total Salary & Benefits	20.7	Total Salary & Benefits	20.9
Total Service & Supplies	15.3	Total Service & Supplies	16.8
CalPERS UAL	1.8	CalPERS UAL	2.2
CIP Budget	1.2	CIP Budget	1.0
Transfer to GFDR	0.3	Transfer to GFDR	0.0
Total Expenditures	**39.3**	**Total Expenditures**	**40.9**

* Partial proceeds based on sale price of $2.5M

FY 2019/20 PROPOSED BUDGET		FY 2020/21 PROPOSED BUDGET	
Baseline Revenue	41.2	Baseline Revenue	42.0
Sale of City Parking Lot *	0.9	Sale of City Parking Lot *	1.3
One-time Transfer from GFDR	0.0	One-time Transfer from GFDR	0.0
Total Revenue	**42.1**	**Total Revenue**	**43.3**
Total Salary & Benefits	21.1	Total Salary & Benefits	21.3
Total Service & Supplies	17.2	Total Service & Supplies	17.7
CalPERS UAL	2.8	CalPERS UAL	3.3
CIP Budget	1.0	CIP Budget	1.0
Transfer to GFDR	0.0	Transfer to GFDR	0.0
Total Expenditures	**42.1**	**Total Expenditures**	**43.3**

* Partial proceeds based on sale price of $2.5M

* Partial proceeds based on sale price of $2.5M

ANALYSIS OF UNDESIGNATED FUND BALANCE (RESERVES)

FISCAL RESILIENCY RESERVE POLICY

On October 21, 2013, in order to protect the fiscal solvency of the City and to achieve greater fiscal resiliency, the City Council took the important step of establishing the *Fiscal Resiliency Reserve Policy* (Resolution 2013-159). This new policy adopted by City Council Resolution established several new reserves and funded each at the recommended level in accordance with a pre-designated formula along with audited financial figures provided by the Comprehensive Annual Financial Report (CAFR).

For the DRAFT BUDGET, the undesignated fund balance reserves are allocated based on the Fiscal Resiliency Policy. Reserves are to be used to provide temporary financing for unanticipated or extraordinary needs of an emergency nature, as follows:

- Natural Disaster or Calamity
- Economic Recession
- Unexpected Liability created by Federal or State action
- Unanticipated Litigation or Legal Costs

The following table summarizes the new Fiscal Reserves for the upcoming FY 2017/18 (Year 1) and FY 2018/19 (Year 2) based on adopted expenditure levels, as follows:

FISCAL RESILIENCY RESERVES AMOUNTS:

FISCAL RESERVES:	FY 2017/18	FY 2018/19
Catastrophic Reserve (50%)	$19,628,529	$20,482,727
Budget Stabilization Reserve (5%)	$ 1,962,852	$ 2,048,272
CM Contingency Account(1%)	$ 392,571	$ 409,653

PROPOSED GF DESIGNATED RESERVES:

PROPOSED GF DESIGNATED RESERVES:	FY 2017/18
Major Operating Contingency Reserves	$ 3,915,000*
Future Capital Project Reserves *(includes Casino Revenue Sustainability Reserve of $1,000,043)*	$ 14,940,163*
Projected Total:	**$ 18,855,163***

*Note: *Major Operating Contingency & Capital Project Reserves as adopted by CC on 01/17/17.*

CONCLUSION AND ACKNOWLEDGEMENTS

The City Manager wishes to thank the City's Budget Team and City employees who participated in the budget planning process for the first-ever four-year budget for the City. Without their support, the City Manager would not be able to present a "balanced budget" for review and consideration to the City Council for the FY 2017-2021 period.

I would like to acknowledge and thank the City's Executive Leadership Group for their tremendous efforts in helping to develop efficient and long-term budget spending plans for City Departments, and for the time and effort they spent in analyzing fiscal impacts and service level options to keep projected expenses in-line with projected revenue levels.

As reiterated again by the City Manager, there are fiscal risks during this current period of economic recovery and rebounding of the U.S. Economy. With this fiscal uncertainty and risk, a more permanent, long-term financial strategy to avoid the constant cycle of adding increased operating costs or budgeting which far exceeds the City's financial and debt service capacity must be closely monitored over the next four year budget period. Any fluctuations in revenues will result in a direct adjustment to expenditure plans to avoid deficit spending in future years. There needs to be constant monitoring of efficient spending (versus the reluctance to make frivolous spending) in the future due to the fiscal risk warnings outlined by the City Manager in this City Budget Message. Additionally, the City Manager recommends following the financial guiding principles as we continue to exercise **"fiscal resiliency**" over the next four year budget cycle, as follows:

- **Continue service delivery efficiencies using new emerging technologies to minimize annual operating costs; and**
- **Promote new revenue growth opportunities; and**
- **Exercise fiscal discipline and spend within appropriated budget levels; and**
- **Target one-time funding investments from GF Designated Reserves to meet economic development goals has been a positive impact to the City. Note: Limited audited fund balance is projected for one-time spending on economic development projects in 2018-21; and**
- **Continual growth by City Council of the Casino Revenue Sustainability Reserve**

ACKNOWLEDGEMENTS

I also want to thank a few key staff members who significantly assisted in the preparation and timely delivery of this multi-year GF Operating Budget, namely Assistant City Manager Reina J. Schwartz, Finance Director Kelly Sessions, and Assistants to the City Manager Charles Ching and Tina Gallegos. My thanks also extends to all members of our City Executive Leadership Team and all City employees for their due diligence in making this DRAFT BUDGET even possible, and for their ongoing focus, reflections and support on our

long-term economic stability for the City of San Pablo, and it's quality programs and services for all of its residents.

Finally, I also want to thank the San Pablo City Council for their support of this City Administration. My staff and I look forward to working with you during the next four year budget cycle following adoption of the City's first-ever FY 2017-2021 Quadrennial GF Operating Budget.

Respectfully submitted:

______________________________ **Date:** ____________________

Matt Rodriguez, City Manager

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