

City Council Memorandum

City of Arts & Innovation

TO: HONORABLE MAYOR AND CITY COUNCIL DATE: DECEMBER 20, 2016

FROM: FINANCE DEPARTMENT WARDS: ALL

SUBJECT: FISCAL YEAR 2016/2017 FIRST QUARTER FINANCIAL REPORT, INCLUDING FISCAL YEAR 2017/2018 FINANCIALS, CASH AND INVESTMENT REPORTS AND DEBT REPORTS

ISSUES:

Receive and provide input on the fiscal year (FY) 2016/2017 First Quarter Financial Report, including 2017/2018 financials, cash and investment reports, and debt reports and authorization to amend the FY 2016/17 and 2017/18 Budgets.

RECOMMENDATIONS:

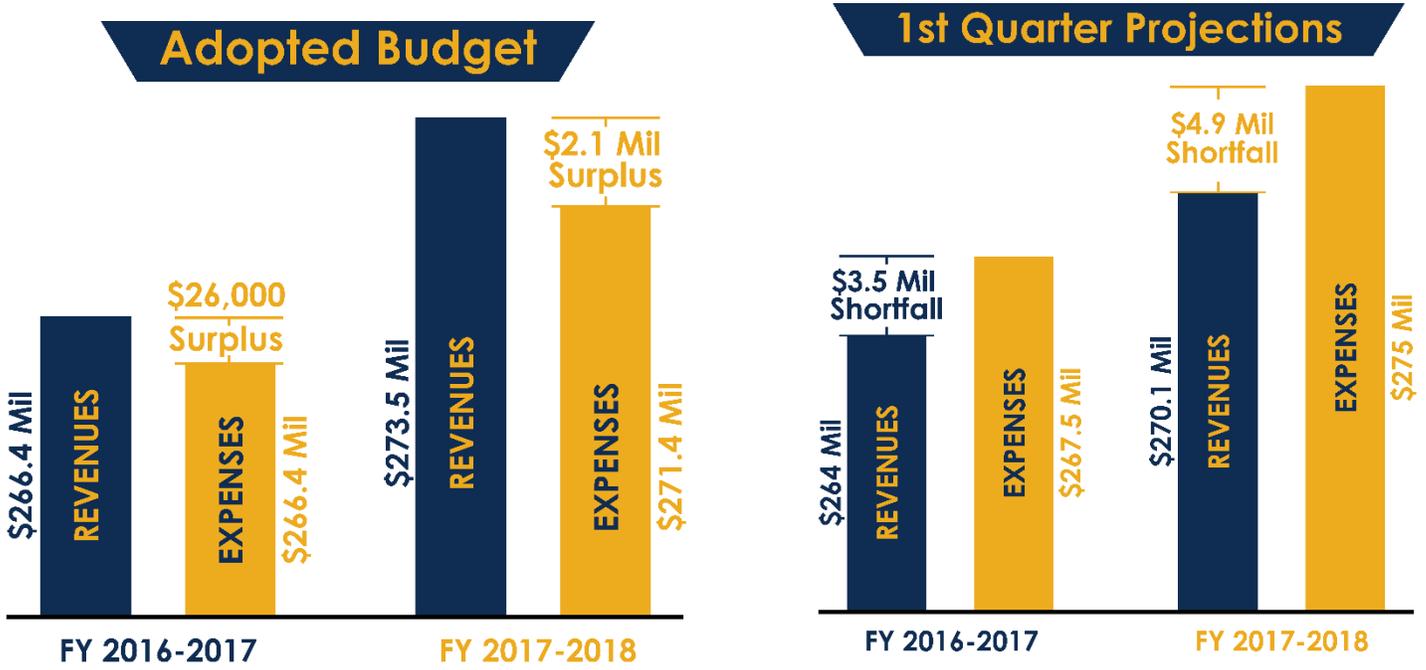
That the City Council:

1. Receive and provide input on the attached FY 2016/2017 First Quarter Financial Report and FY 2017/2018 financials for the General Fund with preliminary analysis of Measure Z revenues, as well as cash, investment and debt reports for all funds;
2. Amend the FY 2016-2018 Two-Year Budget to include the anticipated Measure Z revenues of \$10,000,000 in FY 2016/2017 and \$51,577,000 in FY 2017/2018 (to be accounted in new Fund 110); and
3. Authorize FY 2016/2017 and FY 2017/2018 budget amendment to appropriate Measure Z funding to ratify reinstatement of one Fire squad as directed by the City Manager on December 7, 2016 (costing \$450,000 in FY 2016/2017 and \$792,728 in FY 2017/2018).

EXECUTIVE SUMMARY:

General Fund and Measure Z Analyses

The attached FY 2016/17 First Quarter Financial Report for the General Fund (Attachment 1) summarizes projected revenue and expenditure results for the period from July 1, 2016 through June 30, 2017, based on actual revenues and expenditures from July 1, 2016 through September 30, 2016. The revenues and expenditures included in this report are stated in annualized totals. Also provided are preliminary analyses of: 1) General Fund financials for the following fiscal year (FY 2017/2018), based on the current projections; and, 2) Anticipated Measure Z financials for Fiscal Years 2016/2017 and FY 2017/2018. The following charts summarize these preliminary results, followed by a high-level summary of the key highlights.



Factors Contributing to Projected Shortfall

	FY 2016-2017	FY 2017-2018
Adopted Surplus	\$26,530	\$2,078,014
Union Contracts	\$(819,081)	\$(3,396,309)
Lower Revenues	\$(2,426,858)	\$(3,395,908)
Insufficient Funds for Parks Debt	\$(600,000)	\$(600,000)
Transfers for Sewer Claims	\$900,000	\$900,000
Other	\$(52,004)	
Fire Department Maintenance	\$(500,000)	\$(500,000)
Estimated Shortfall	\$(3,471,413)	\$(4,914,203)

General Fund Reserve Outlook (Based on 1st Quarter Projections)

15% Reserve	\$39.1 Mil	\$40.1 Mil	\$41.3 Mil
Projected Gap	\$5.9 Mil	\$10.4 Mil	\$16.5 Mil
Projected Reserve	\$33.2 Mil (12.7%)	\$29.7 Mil (11.1%)	\$24.8 Mil (9%)
	FY 2015-2016 Actual	FY 2016-2017 1st Quarter Projection	FY 2017-2018 1st Quarter Projection

General Fund

The FY 2016-2018 Two-Year Adopted Budget projected a balanced General Fund budget in both fiscal years, with a slight surplus of approximately \$30,000 in the first year and a larger surplus of over \$2.0 million in the second year.

The current annualized projections – based on the actual revenues received last fiscal year (FY 2015/2016) and receipts to date for the current year, economic outlook for the current and next year, as well as changes to personnel expenditures – reflect **General Fund deficits in both years, of approximately \$3.5 million in FY 2016/2017 and approximately \$4.9 million in FY 2017/2018**. The projected deficits are driven by the following factors:

	FISCAL YEAR 2016/17	FISCAL YEAR 2017/18
ADOPTED BUDGET – ESTIMATED SURPLUS	\$26,530	\$2,078,014
Employee compensation and benefits	-\$819,081	-\$3,396,309
Lower revenues based on last year’s results and reduced growth assumptions (mainly Property Tax, Sales Tax and Utility Users Tax)	-\$2,426,858	-\$3,395,908
Insufficient funds in the Parks Development Impact Fee Fund for debt service – becomes General Fund obligation	-\$600,000	-\$600,000
Unfunded Fire vehicle maintenance	-\$500,000	-\$500,000
Charges of sewer-related claims to the Sewer Fund instead of the General Fund	\$900,000	\$900,000
Other factors	-\$52,000	\$0
FIRST QUARTER PROJECTION – ESTIMATED ANNUAL SHORTFALL	-\$3,471,413	-\$4,914,203

1. Employee Compensation and Benefits

With each union contract presented to City Council, staff provided an estimated cost over a five-year period. While the two-year budget and five-year plan assumed relatively minor salary increases tied the General Fund revenue growth, the recent voter approval of the Measure Z sales tax will change the growth assumptions for FY 2016/2017 – and, as a result, lead to higher salary increases in FY 2017/2018 based on that growth. Specifically, while the budget assumed approximately 2.5% salary increases in the second year (FY 2017/18), the actual increase is now projected to be 4-6%. Similarly, because the full year of new Measure Z sales tax revenue in FY 2017/2018, employee pay increases will also be in the 4-6% range in FY 2018/19. In future years, more moderate salary increases of 2-3% will occur; however, raises in the first two years will establish a higher level of baseline spending. It must be noted, however, that the passage of Measure Z will yield revenue far in excess of the additional expenses triggered by Measure Z.

In addition, the two-year budget and five-year plan did not account for other negotiated changes with financial impacts, such as increases in health premiums in FY 2016/17 and one-time payments to SEIU union members in the first two years.

2. Lower Revenues

Changes in revenues also add significantly to the projected shortfalls, and are based on the weaker performance of the Property, Sales and Utility Users taxes in the prior fiscal year. **Importantly, the current projections take into account the observed weakening of the Sales Tax growth.** The Adopted Budget and Five-Year Plan included somewhat optimistic growth rates of approximately 5.5% to 5.9%. The current analyses of the political and economic factors, including but not limited to the somewhat unexpected presidential election results, suggests that rates in the range of 4% to 4.5% are more realistic over the next two to five years.

3. Insufficient Funds to Pay Parks-Related Debt Service

When debt was issued for the Renaissance initiative, the plan was to utilize annual development impact fees (DIF) to fund parks projects. Unfortunately, with the downturn in the economy, the revenue never materialized, and the General Fund is subsidizing the parks debt by approximately \$600,000 per year. These funds have never been budgeted in the General Fund, and this omission must be corrected.

4. Unfunded Fire Vehicle Maintenance

As presented to the City Council during the FY 2016-2018 Two-Year Budget process, the Fire Department has an aging fleet of vehicles. Early indications are that vehicle maintenance needed will exceed budgeted projections by approximately \$500,000. Until the Fire Department is able to replace its fleet, this will likely continue to be an issue.

5. Transfer of Sewer-Related Charges to the Sewer Fund

For a number of years now, the City's Liability Fund (and, by extension, the General Fund) were utilized to pay for claims related to sewer laterals from the sewer main to the resident's property line. Effective FY 2016/2017, the Sewer Fund has begun to pay these costs, estimated at \$450,000 per year. In addition, the General Fund will recover the \$1.35 million incorrectly charged there for these claims over the past three-year period (\$450,000 per year). In FY 2016/2017 and FY 2017/2018, the total savings to the General Fund will be approximately

\$900,000 per year.

Measure Z

The collection of the additional one-cent sales tax authorized by voters through Measure Z will begin on April 1, 2017. The City will start accruing these revenues in May-June 2017, with the anticipated collection of \$10 million in FY 2016/17 and \$51 million in FY 2017/18 (full year). The City Council is asked to recognize these expected revenues.

Other than noted below, the City Council is not asked at this time to appropriate Measure Z revenues for any specific purposes. The discussion over Measure Z funding use will begin on January 31, 2017, during an initial budget workshop, and again in May 2017 during the Mid-Cycle budget review. By that time, collection of additional General Fund revenues will determine whether the year-end projection (and shortfalls) should be adjusted, and additional expenditure factors may come into play.

Staff is requesting at this time City Council authorization to restore the Fire Squad budget effective December 7, 2016, and appropriate \$450,000 of Measure Z revenues in FY 2016/2017 and \$792,728 in FY 2017/2018.

There will be additional expenses for the City Council's consideration with regards to Measure Z – to be presented and discussed in January-May 2017. For example, the Fire labor contract calls for the reinstatement of several positions effective July 1, 2017, costing an estimated \$450,000 per year, and there is a need to increase police staffing and fund vehicle repair and replacement.

Investment and Debt Reports

Also included are the Quarterly Investment Report (Attachment 2) and the Quarterly Debt Report (Attachment 3), which highlight the City's portfolio of investments (including cash) and its outstanding debts, respectively, across all funding sources. Overall, the City's financial position remains strong, with any negative cash balances being offset by receivables.

DISCUSSION:

FY 2016-2017 First Quarter Financial Report –General Fund

The Bottom Line

In the FY 2016-2017 First Quarter Financial Report, staff anticipates a **General Fund shortfall of \$3.5 million in FY 2016/17 and \$4.9 million in FY 2017/18.** The projected shortfalls are largely driven by lower tax estimates, employee compensation, unfunded parks debt and fire vehicle repair and maintenance.

A. General Fund Revenues

Compared to the Adopted FY 2016-2018 Two-Year Budget, the First Quarter Financial Report General Fund revenues are estimated to be \$2.4 million lower in FY 2016/17 and \$3.4 million lower in FY 2017/18. The difference is largely due to lowering of sales tax projections and actual tax revenues in FY 2015/16 coming in lower than expected, providing for a diminished starting point for FY 2016/17 and FY 2017/18.

In the **Taxes** category, the final FY 2015/16 revenue is projected to be approximately \$3.2 million below the adopted budget estimates in FY 2016/17 and \$4.4 million below FY 2017/18 estimates. Differences of \$250,000 or higher are explained below.

- *Sales tax* is projected to be lower than adopted budget by approximately \$1.5 million in FY 2016/17 and \$2.5 million in FY 2017/18. These decreases are driven by a lowering of expected annual growth and lower actual receipts in FY 2015/16, which create a lower baseline in FY 2016/17 and FY 2017/18.

Historically, sales tax revenues have been the most subjective General Fund revenue to the economy and the hardest to predict. As of the date this report was published, the City does not have final first quarter sales tax revenue figures from the State. Staff will continue to monitor local economic conditions, which are inconclusive but indicate a potential weakening. The highlights are summarized below.

- As of September 30, 2016, local wage increases in Southern California lead the nation at 3.8% year-over-year-growth.
 - As of September 30, 2016, Statewide unemployment is down; however, Riverside County still has higher unemployment rates (6.5%) than the counties of Los Angeles (5.2%), Ventura (5.5%), San Bernardino (5.9%) and Orange (4.1%).
 - California's sales and use tax revenue in October was \$140 million (\$5.6%) below the month's forecast of \$2.499 billion.
 - In the United States online sales recently hit records for Black Friday and Cyber Monday. The increase on sales made via mobile device (33%) is staggering.
 - Increased online sales and sales tax collection is an issue in California; out-of-state retailers do not always add tax.
 - Reports indicate that with the deep discounts on Black Friday, people actually spent 3.5% less than they did the year before. At the same time other reports indicate that people will spend 8% more this holiday season than the prior holiday season.
 - As of September 30, 2016, at the State level, new car sales are down 5.6% compared to last year.
 - Locally, the Galleria at Tyler expects growth to be similar to last year, which equates to annual increases of approximately 4%.
- *Property taxes* are estimated to be lower than adopted budget by approximately \$820,000 in FY 2016/17 and \$864,000 in FY 2017/18 – again due to lower actual collections in FY 2015/16, mainly related to Successor Agency properties.
 - *Utility users tax (UUT)* is estimated to be lower than adopted budget by approximately \$594,000 in FY 2016/17 and \$675,000 in FY 2017/18. Revenues are estimated to be lower due to the rapid decline of telephone related revenues and FY 2015/16 UUT revenue ending lower than projected.
 - *Property Transfer taxes* are estimated to be lower than adopted budget by approximately \$255,000 in FY 2016/17 and \$280,000 in FY 2017/18, due to lower actual receipts in FY 2015/16.

Special Revenue - Entertainment revenues are estimated to be approximately \$817,000 higher

than adopted budget based on FY 2015-16 actual receipts. These additional revenues are largely offset by additional expenditures.

B. General Fund Expenditures

General Fund expenditures are estimated to exceed adopted budget amounts in FY 2016/17 by \$1.1 million and in FY 2017/18 by \$4.3 million. Differences from adopted budget are described below.

- *Employee Costs* are estimated to add to the FY 2016/17 adopted budget approximately \$820,000 and approximately \$3.4 million to the FY 2017/18 budget.
- The *Finance Department* currently anticipates salary savings of approximately \$200,000 in the Business Tax Division; these savings are offset by revenue reductions. As the Finance Department continues to move forward with the Business Tax Inspection Program, including hiring of 2.5 employees, both revenue and expenditures will continue to be evaluated. Additionally, credit card charges paid by the Finance Department on behalf of all City Departments are estimated to decrease by \$500,000. This will also reduce the cost allocation of these costs to other departments (e.g. Public Utilities) by the same amount. This is a net zero impact to the General Fund.
- The *Fire Department* is projected to exceed the adopted FY 2016/17 Budget by approximately \$750,000. \$500,000 of the overage is attributed to unfunded vehicle maintenance costs. The additional \$250,000 is attributed to the delay of implementing budget reductions.
- The *Budget Balancing Measures* adopted by the City Council, included Fire concessions of \$1.24 million related to the removal of a Fire Squad (\$788,000) and two captain positions (\$450,000). As noted earlier in this report, staff is recommending that Measure Z funds are utilized to restore the Fire Squad, effective December 7, 2016, which will incur an additional \$450,000 in estimated expenditures in FY 2016/17.
- As indicated in the FY 2015/16 Final Financial Report the *Parks, Recreation and Community Services* budget does not address \$600,000 needed to cover Renaissance Parks Projects, that did not materialize in the development impact fee revenue accounts. As such, the General Fund has to pick up an unbudgeted debt expense of approximately \$600,000.
- The *Public Works Department, Finance Department, and City Manager's Office* have worked together to identify charges to Public Work's General Fund budget that should have been charged to the Sewer Fund. Specifically, \$1.35 million in sewer lateral repairs that occurred between the sewer main to the property line (residential only), have been paid by the General Fund over the past three years. Per City Council action in October 2008, the City's sewer system is responsible for sewer laterals from the sewer main to the resident's property line, which represented an expansion of the system – previously the City was only responsible for the sewer main, not the laterals. The General Fund will recover the \$1.35 million over a three-year period (\$450,000 per year). Additionally, the Sewer Fund has begun to pick up the annual costs, when appropriate, which will save the General Fund and additional \$450,000 per year. The total savings to the General Fund will be approximately \$900,000 per year in FY 2016/17 and FY 2017/18.

C. Measure Z

On November 8, 2016, the residents of Riverside approved Measure Z, which is a general transaction and use tax of 1%. For FY 2016/17, Measure Z revenues are estimated to be approximately \$10 million and for FY 2017/18, Measure Z revenues are estimated to be approximately \$51.6 million. The anticipated revenue projections are based on recommendations of the City's sales tax consultant, HdL. To account for the revenues and associated expenditures, the Finance Department has established Fund 110, Measure Z.

On January 31, 2017, the City Council and the Budget Engagement Commission will hold a budget workshop to further review General Fund financials and Measure Z revenues. At this time, staff does not recommend any appropriation of Measure Z revenues outside of the Fire Squad. At the January 31st meeting, staff will present the City Council and Budget Engagement Commission with spending options for Measure Z.

D. General Fund Reserves

Without the use of Measure Z revenues, the impact of the variances in General Fund revenues and expenditures amount to a projected draw on the General Fund reserve of approximately \$3.5 million in FY 2016/17 and \$4.9 million in FY 2017/18. **This would effectively reduce the General Fund reserve levels to 11.1% (\$29.7 million) in FY 2016/17 and 9.0% (\$24.8 million).**

Per the City's General Fund Reserve Policy, adopted by the City Council on September 6, 2016, the General Fund reserve should be 15%. The City Council set an aspiration goal of the General Fund Reserve at 20%; this goal was recently reaffirmed through adoption of the "Responsible Spending Vision Pledge" on October 4, 2016.

Quarterly Investment Report Status

Sound investment practices are an essential component of the City's strong fiscal management. The Finance Department is responsible for managing the City's investment portfolio, focusing first on the safety of investments, and then on liquidity and an appropriate rate of return. The investment results and portfolio composition are summarized and reported to the City Council each quarter. As of September 30, 2016, the City's pooled investment portfolio's market value was \$510.7million, with the market value of investments held by fiscal agents (bond proceeds and reserve funds primarily) amounting to an additional \$281.5 million. The weighted average yield of the pooled investment portfolio continues to hold steady at 0.97%. Through prior City Council approval, the Chief Financial Officer/Treasurer has the authority to invest/reinvest funds and to sell or exchange purchased securities, consistent with the City's adopted investment policy. This approval is a requirement of State law and is received at the start of each fiscal year.

The Investment Report, including a listing of cash balances by fund, is included in Attachment 2. These cash balances reflect each fund's share of the City's pooled investment portfolio. Also shown are interfund loan receivables, which are treated as available cash due to the Finance Director/Treasurer's authorization to move loan receivables to other funds as needed.

All listed funds have a positive cash balance with the exception of the following funds:

1. The General Fund (\$1,462,611), which is offset by an outstanding capital lease receivable related to the Police Records Management System and Computronix

permitting system. Historically, the revenues related to the capital lease have been received prior to the initiation of project; however, the City is currently in the process of securing financing to fully offset ongoing project costs.

2. The Urban Areas Security Initiative (\$357,467) and Housing Opportunities for Persons with AIDS (\$620,956), which are fully offset by outstanding grant receivables.
3. Certificates of Participation Projects (\$992,321), Capital Outlay (\$4.6 million), and Transportation Uniform Mitigation Fees (\$1.86 million) have negative cash balances due to the timing of year-end expenditures; however, the negative balances are fully offset by grant receivables.
4. The Liability Insurance Trust Fund has a negative cash balance of approximately \$3 million, but is consolidated with the positive cash balances of the Workers Compensation Insurance Trust Fund (\$15.7 million) and Unemployment Insurance Trust Fund (\$435,000) for financial reporting purposes. Staff is implementing a strategy to return the Liability Insurance Trust Fund to an improved financial condition (cash and fund balance levels) over the next five years. In the current year, the cash position was budgeted to improve by \$1 million, however, due to increased claim expenditures the total cash balance increased by only \$500,000.
5. The Central Stores (\$362,586), which is fully offset by inventory assets that will be recouped when charged out for usage to various departments.

Quarterly Debt Report Status

The Finance Department is also charged with managing the City's debt portfolio, which includes issuing new debt and monitoring opportunities to refinance existing debt as opportunities to reduce interest costs arise. The Quarterly Debt Report (Attachment 3) summarizes the composition of the City's debt portfolio, details the revenue sources utilized to pay the debt service associated with each outstanding debt, and provides detailed information regarding the total principal and interest payments due in the current fiscal year by Fund. There are no changes to the Quarterly Debt Report for this quarter.

FISCAL IMPACT:

The Fiscal Year 2016-2018 Two Year First Quarter Financial Report projects a General Fund shortfall, largely attributed to lower than anticipated tax revenues, employee compensation and benefits, unbudgeted parks debt, and unfunded fire vehicle maintenance. The impact of the variances in General Fund revenues and expenditures amount to a projected draw on the General Fund Reserve of approximately \$3.5 million in FY 2016/17 and \$4.9 million in FY 2017/18.

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Approved by: Marianna Marysheva, Assistant City Manager
Approved as to form: Gary G. Geuss, City Attorney

Attachments:

1. FY 2016-2018 Quarterly General Fund Financial Report
2. FY 2016-17 First Quarter Investment Report
3. FY 2016-17 First Quarter Fund Financial Status Report
4. Presentation