



# City Council Memorandum

City of Arts & Innovation

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**TO: HONORABLE MAYOR AND CITY COUNCIL      DATE: APRIL 11, 2017**

**FROM: FINANCE DEPARTMENT      WARDS: ALL**

**SUBJECT: FISCAL YEAR 2016-2017 SECOND QUARTER FINANCIAL REPORT, INCLUDING PRELIMINARY ANALYSIS OF MEASURE Z AND FISCAL YEAR 2017-2018 FINANCIALS, CASH AND INVESTMENT REPORTS AND DEBT REPORTS**

**ISSUES:**

The issue for City Council consideration is to receive and file the fiscal year (FY) 2016-2017 Second Quarter Financial Report, including preliminary analysis of Measure Z and FY 2017/18 General Fund financials, supplemental appropriations, cash and investment reports, and debt reports.

**RECOMMENDATIONS:**

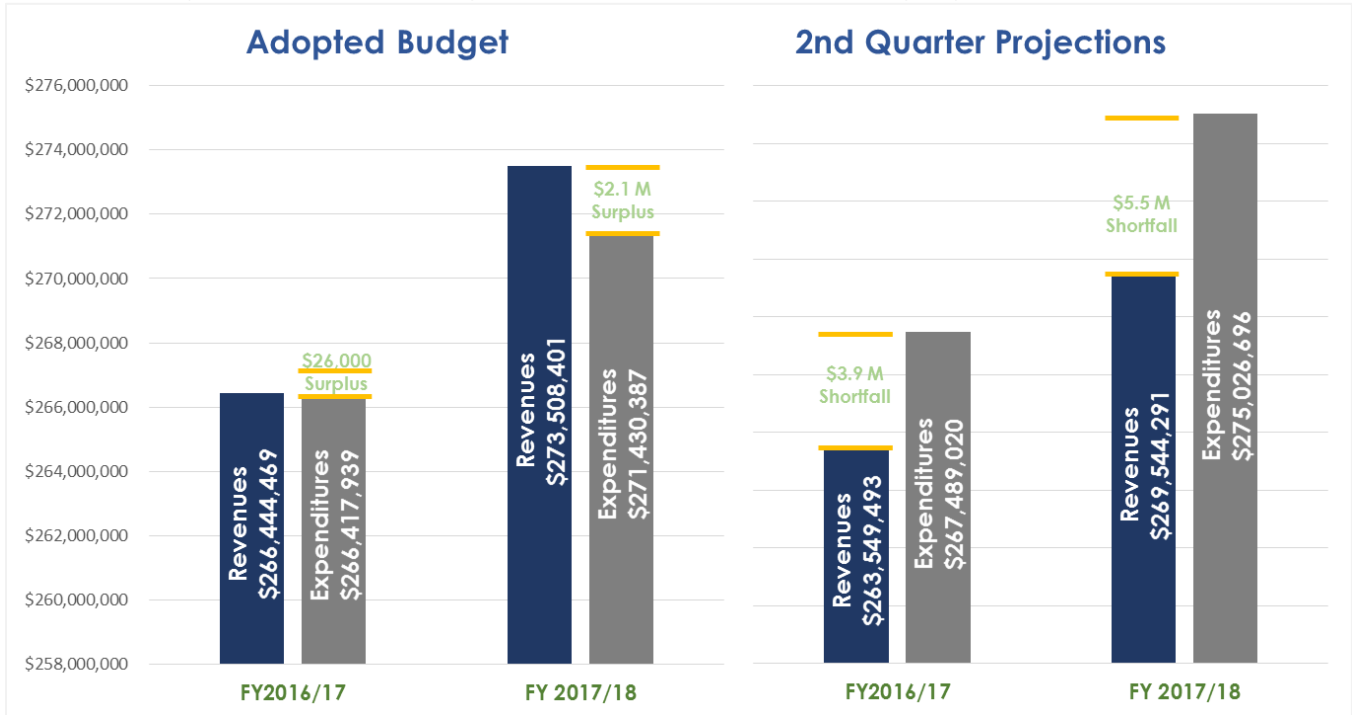
That the City Council receive and file the attached FY 2016/17 Second Quarter Financial Report for the General Fund with preliminary analysis of Measure Z and FY 2016/17 General Fund financials, as well as cash, investment and debt reports for all funds.

**EXECUTIVE SUMMARY:**

**A. Attachment A: General Fund and Measure Z Analyses**

On December 20, 2016, the City Council received and provided input on the FY 2016/17 First Quarter Financial Report that included the projected revenues and expenditures for fiscal years 2016-17 and 2017-18 based on actuals from July 1, 2016 through September 30, 2016. The FY 2016/17 Second Quarter Financial Report provides an update on the projected revenues and expenditures based on actuals from July 1, 2016 through December 31, 2016. **The difference in projections between the first and second quarters is insignificant (\$0.4 million in further deficit for FY 2016/17 and \$0.6 million for FY 2017/18), and mainly attributable to fluctuations in the sales tax revenues.**

The following charts summarize the second quarter projections as compared to the original adopted budget, followed by a high-level summary of the key highlights.

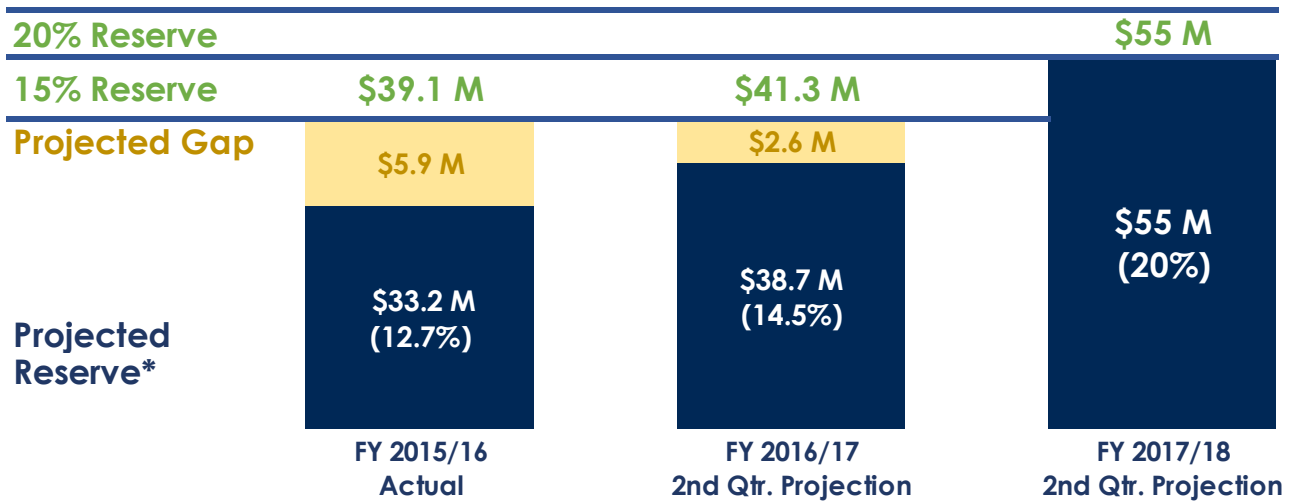


### Factors Contributing to Projected Shortfall (2nd Quarter)

	FY 2016-17	FY 2017-18
<b>Adopted Surplus</b>	\$ 26,530	\$ 2,078,014
<b>Union Contracts</b>	\$ (819,081)	\$ (3,396,309)
<b>Lower Revenues</b>	\$ (2,894,976)	\$ (3,964,110)
<b>Insufficient Funds for Parks Debt</b>	\$ (600,000)	\$ (600,000)
<b>Transfers for Sewer Claims</b>	\$ 900,000	\$ 900,000
<b>Other</b>	\$ (52,004)	
<b>Fire Department Maintenance</b>	\$ (500,000)	\$ (500,000)
<b>Estimated Shortfall</b>	\$ (3,939,531)	\$ (5,482,405)
<b>Management Action*</b>	\$ 3,939,531	\$ 5,482,405
<b>Net General Fund Surplus/Deficit</b>	\$ -	\$ -

\* Staff has recommended the use of Measure Z funds to cover the General Fund shortfalls in FY 2016/17 and FY 2017/18. Alternative options to using Measure Z funds include elimination of carryovers and expenditure reductions that limit service impact to the extent possible (e.g. spending freeze and holding positions vacant).

## General Fund Reserve Outlook (Based On Second Quarter Projections)



*\*With staff's recommendation to utilize Measure Z funding to eliminate the General Fund deficit and increase reserves, the General Fund reserve will meet the City Council's Responsible Spending Pledge "aspirational" goal of 20% by FY 17/18. Without Measure Z or alternative management action, the Second Quarter projected deficit would decrease the General Fund reserve to 10.9% (\$29.2 million) in FY 16/17 and 8.6% (\$23.7 million) in FY 17/18.*

### 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 \$2.0 million in the second year.

The first quarter financial report projected General Fund shortfalls of \$3.5 million in FY 2016/17 and \$4.9 million in FY 2017/18. **As of the second quarter, General Fund deficits are still projected in both years, of approximately \$3.9 million in FY 2016/17 and \$5.5 million in FY 2017/18.** Same as in the first quarter analysis, the projected deficits are driven by employee compensation and benefits, lower revenues, insufficient budgeted funds to pay for Parks and Recreation debt, and unfunded vehicle maintenance needs. The slightly larger deficits projected during the second quarter are due to declining revenues (mainly sales tax), as discussed below.

Staff is recommending the use of Measure Z funds or alternative management action (e.g. non-safety spending freeze and elimination of carryovers) in FY 2016/17 and FY 2017/18 to cover the General Fund deficits and increase reserves.

#### 1. Employee Compensation and Benefits (no change from the first quarter)

The two-year budget and five-year plan assumed relatively minor salary and medical insurance increases, and did not anticipate one-time payments to SEIU union members in the first two years. With all union agreements now finalized, the anticipated employee costs are higher than the minimal changes included in the baseline projections. Total changes in employee compensation and benefits from the adopted budget are approximately \$850,000 in FY 2016/17 and \$4.8 million in FY 2017/18.

## 2. Lower Revenues (**additional shortfalls** projected from the first quarter)

Changes in revenues add significantly to the projected shortfalls, and are based on the weaker performance of the Property Tax, Sales and Utility Users taxes. Specifically, the sales and property transfer taxes, franchise fees, and fines and forfeits are below the adopted budget. Compared to the first quarter, the sales and property transfer taxes are \$542,000 weaker, the franchise fees are \$353,000 lower, and fines and forfeitures decreased by \$242,000 from the first quarter.

## 3. Insufficient Funds to Pay Parks-Related Debt Service (**no change** from the first quarter)

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.

## 4. Unfunded Fire Vehicle Maintenance (**no change** from the first quarter)

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 of the aging fleet will exceed budgeted projections by approximately \$500,000.

## 5. Transfer of Sewer-Related Charges to the Sewer Fund (**no change** from the first quarter)

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 2016/17, 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 2016/17 and FY 2017/18, the total savings to the General Fund will be approximately \$900,000 per year.

Given significant budget reductions during the FY 2016-2018 biennial budget process, no current budget or service cuts are proposed to address the projected shortfalls. Instead, it is recommended that Measure Z revenues be used to maintain the essential General Fund services, such as public safety and quality of life.

### **Measure Z**

The collection of the additional one-cent sales tax authorized by voters through Measure Z begins on April 1, 2017. Based on projections from the City's sales tax consultant, HdL, the City will start receiving these revenues in May-June 2017, with the anticipated collection of \$10 million in FY 2016/17 and the entire year's worth of \$51.5 million in FY 2017/18.

The Budget Engagement Commission has been reviewing the plan for Measure Z funding, and will present its recommendations to the City Council on May 9, 2017. As indicated in this report, staff is recommending the use of Measure Z funds to eliminate the General Fund deficits and increase General Fund reserves to 20%.

## B. Attachments B-C: Investment and Debt Reports

Also included are the unaudited and unadjusted Second Quarter Investment Report (Attachment B) and the Second Quarter Debt Report (Attachment C), 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 2016/17 Second Quarter Financial Report –General Fund**

##### *The Bottom Line*

In the FY 2016/17 Second Quarter Financial Report, staff anticipates a **General Fund shortfall of \$3.9 million in FY 2016/17 and \$5.5 million in FY 2017/18**. The projected shortfalls are largely driven by the same factors discussed in the first quarter, mainly lower tax estimates, employee compensation, unfunded maintenance and unfunded parks debt.

##### *A. General Fund Revenues*

Compared to the first quarter FY 2016-2018 projections, the Second Quarter Financial Report General Fund revenues are estimated to be approximately \$468,000 lower in FY 2016/17 and \$568,000 lower in FY 2017/18. (Attachment A-3)

**Taxes** are projected to be \$3.3 million below the adopted budget in FY 2016/17 and \$4.5 million in FY 2017/18. Differences of \$200,000 or more between the first and second quarters are explained below.

- *Sales tax* is projected to be lower than first quarter projections by approximately \$321,000 in FY 2016/17 and \$336,000 in FY 2017/18. Historically, sales tax revenues have been the most subjective General Fund revenue to the economy and the hardest to predict. The decline from the first quarter to the second quarter is mainly driven by more modest sales tax growth than anticipated during budget adoption.

The City receives financial reports from both HdL and Beacon Economics, which staff uses to prepare the City's revenue projections. These reports, in conjunction with local and county sources of economic indicators provides a good information base to project revenues. Overall, sales tax receipts from the most current HdL quarterly report showed a 2.3% growth from the same period last year.

However, the outlook for the remaining half of the fiscal year is positive. Locally, the Galleria at Tyler expects growth to be similar to last year or approximately 4%. The Regional Intelligence Report of Beacon Economics indicates that consumer spending in 2016 was 3.2% above 2015 levels. The restaurants, hotels and autos categories saw significant increases in taxable sales. The auto and transportation industries reported a 5.2% year over year growth.

Beacon Economics also reports that the City of Riverside's job creation is up 3.5%, growing faster than Inland Empire that is at 3.2%. This increased the average annual wage up by 4.2% (to \$47,374). The optimistic economic indicators may translate to sustained or higher sales tax growth in the remaining months of FY 2016/17.

- *Property Transfer taxes* are estimated to be lower than first quarter projections by approximately \$221,000 in FY 2016/17 and \$243,000 in FY 2017/18, due to lower actual year to date receipts. Although economic indicators show property sales volume is up 7% to 8% from last year in the Riverside, the total value of property sales has lagged.
- *Franchise Fees* are expected to be lower than first quarter projections by \$353,000 in FY 2016/17 and \$359,000 in FY 2017/18 due to a significant decline in ATT cable franchise fees year to date as customers move from traditional cable to satellite (e.g. AT&T U-Verse to recently purchased DIRECTV).
- *Licenses and Permits* revenues are projected to be higher than first quarter projections by \$250,000 in FY 2016/17 and \$237,000 in FY 2017/18 due to a steady growth in Animal Licenses resulting from more personnel, changed enforcement measures, and public outreach.

### *B. General Fund Expenditures*

General Fund expenditures are estimated to continue to exceed first quarter projections in FY 2016/17 by \$1.1 million and in FY 2017/18 by \$3.6 million. There are no changes in the City's bottom line expenditures from the first quarter to the second quarter. (Attachment A-4)

### *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 \$51.5 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.

To date, the City Council has approved four items as they relate to Measure Z financial decisions, as listed below.

1. Approved the establishment of Fund 110 on December 20, 2016 to track all expenditures and revenues relating to Measure Z. This facilitates transparency and efficient accounting of Measure Z revenues and expenditures.
2. Approved the estimated Measure Z revenues for the current two-year budget (from July 1, 2016 through June 30, 2018) on December 20, 2016. This appropriates the Measure Z revenues from which the offsetting expenditure appropriations for specific programs can be budgeted.
  - July 1, 2016 – June 30, 2017 (FY 2016/17): \$10 million
  - July 1, 2017 – June 30, 2018 (FY 2017/18): \$51.5 million
3. Approved the reinstatement of the budget for a Fire Squad that was reduced during the recent budget adoption process. Approved on December 20, 2016 as part of the First Quarter Financial Update, this is critical to address response times for the Fire Department.
  - FY 2016/17: \$450,000
  - FY 2017/18: \$800,000

4. On January 31, 2017, staff presented a five-year Measure Z Proposed Spending Plan to the City Council, which included funding to eliminate the FY 2016-2018 Two-Year Budget deficits and increase reserves to City Council's "aspirational goal" of 20%. The City Council provided commentary and directed staff to refine the recommendations for City Council consideration on May 9, 2017.
5. Approved the addition of a City Attorney position for staffing of the Ward Action Teams on February 21, 2017. This is critical to provide additional resources to address existing Ward specific quality of life issues.
  - o FY 2016/17: \$56,250
  - o FY 2017/18: \$225,000

#### *D. General Fund Reserves*

The City's General Fund Reserve Policy, adopted by the City Council on September 6, 2016, requires 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.

The second quarter projections of the General Fund Reserves decreased from the first quarter. Without the use of Measure Z revenues or alternative management action, the projected draw on the General Fund reserve is approximately \$3.9 million in FY 2016/17 and \$5.5 million in FY 2017/18, effectively reducing the General Fund reserve levels to 10.9% (\$29.2 million) in FY 2016/17 and 8.6% (\$23.7 million). With staff recommendation to use Measure Z funds, the General Fund reserves are projected to be 14.5% (\$38.7 million) in FY 2016/17 and 20% (\$55 million) in FY 2017/18.

#### **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 December 31, 2016, the City's pooled investment portfolio's market value was \$526 million, with the market value of investments held by fiscal agents (bond proceeds and reserve funds primarily) amounting to an additional \$234 million. The weighted average yield of the pooled investment portfolio is 1.059%. 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 B. 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 (\$11,005,869), 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 Public Parking (\$384,732), which is based on year to date actual receipts that are lower than projected.
3. The Urban Areas Security Initiative (\$138,831) and Housing Opportunities for Persons with AIDS (\$654,043), which are fully offset by outstanding grant receivables.
4. Certificates of Participation Projects (\$497,135), Capital Outlay (\$4.3 million), and Transportation Uniform Mitigation Fees (\$1.86 million) have negative cash balances due to the timing of expenditures; however, the negative balances are fully offset by grant receivables.
5. The Liability Insurance Trust Fund has a negative cash balance of approximately (\$2.6 million), but is consolidated with the positive cash balances of the Workers Compensation Insurance Trust Fund \$17.8 million and Unemployment Insurance Trust Fund \$439,803 for financial reporting purposes. Staff implemented a strategy to return the Liability Insurance Trust Fund to an improved financial condition (cash and fund balance levels) over the next five years.
6. The Central Stores (\$516,666), 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 C) 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. As of the second quarter, the City's outstanding principal balance is projected to decrease by \$99,450,795 if no new debt is issued.

### **FISCAL IMPACT:**

The Fiscal Year 2016-2018 Two-Year Second Quarter Financial Report projections are relatively unchanged from the first quarter report. There is still a General Fund shortfall, largely attributed to lower than anticipated tax revenues (not including Measure Z), employee compensation and benefits, unbudgeted parks debt, and unfunded fire vehicle maintenance. The net impact of the variances in General Fund revenues and expenditures is projecting a draw from reserves of approximately \$3.9 million in FY 2016/17 and \$5.5 million in FY 2017/18. Staff is recommending the use of Measure Z funds or alternative management action (e.g. non-safety spending freeze and elimination of carryovers) in FY 2016/17 and FY 2017/18 to cover the General Fund deficits and increase reserves. The Budget Engagement Commission is reviewing the plan for Measure Z funding, and the City Council will vote on the recommended Measure Z spending on May 9, 2017.



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Attachments:

- A. FY 2016-2018 Quarterly General Fund Financial Report
- B. FY 2016/17 Second Quarter Investment Report
- C. FY 2016/17 Second Quarter Fund Financial Status Report
- D. Presentation