



ADMINISTRATIVE SERVICES

Council Meeting Date: June 2, 2009

Staff Report #: 09-069

Agenda Item #: E1

PUBLIC HEARING: **Review of the City Manager's Proposed 2009-10 Budget and Capital Improvement Program for the City of Menlo Park; Consideration of the Revised Long-Term Financial Forecast; and Discussion of the Continuation of the Current Reduced Rate of Utility Users Tax Beyond September 30, 2009**

RECOMMENDATION

Staff recommends that the City Council discuss and provide direction on:

- the City Manager's proposed 2009-10 Budget and Capital Improvement Program and revised Long-Term Financial Forecast for the City of Menlo Park; and
- continuing the temporary reduction of the Utility Users Tax (UUT) rate beyond the 12-month period ending September 31, 2009, per section 3.14.130 of the Municipal Code

BACKGROUND

Due to the unprecedented changes in the economic environment experienced in the last year, the process to develop the City Manager's Proposed 2009-10 Budget was revised from that of the prior year.

Unlike mid-year analyses of years past, the Mid-year Report presented to Council in February recommended downward adjustments to the 2008-09 Budget to reflect the decreasing revenues wrought by a severe downturn in the economy. Specifically, declines in development permits (\$750,000) and other revenues added to the \$1 million budget deficit adopted for the fiscal year in June 2008. To offset these reduced revenues, staff recommended over \$577,000 of temporary net reductions to the operating budget, and a deferral of nearly \$1.1 million in projects, allowing for a decreased net reliance on the General Fund reserves for the remainder of the fiscal year. Included with the Mid-year Report and a subsequent 2009-10 budget process overview was a "pyramid" of budget strategy options, ranked in order of immediacy of positive savings, minimization of impact on community service levels and use of sustainable budget best practices. Toward the bottom of the pyramid were longer-term strategies such as reduced infrastructure maintenance (which would generate higher maintenance costs in the future) and staff reductions (with tangible impacts on service levels). Given the resource reductions made in past fiscal years, implementation of further net-cost reduction strategies continue to be a challenge for the City. However, a

mix of short- and long-term strategies was employed in development of the General Fund preliminary budget for 2009-10, and chosen to maintain the following elements:

- key services to the community
- the organization's ability to meet Council goals
- a long-term focus; preparedness for recovery opportunities
- existing infrastructure (to avoid higher costs in the future)
- the ability to move the City toward a sustainable budget over the next five years

The preliminary General Fund budget presented for Council's review and direction on May 12th provided a detailed look at the City's revenue forecasts, initial expenditure estimates, and use of net cost reduction strategies. A rigorous use of cost-reduction strategies allowed for minimum reliance on the City's reserves in 2009-10, with no assumed increase in the City's Utility User Tax rates. The City Manager's Proposed Budget for fiscal year 2009-10 reflects Council direction from that review, and includes some positive updates to departmental expenditures within the General Fund.

In addition, staff has updated the assumptions and projections incorporated in the City's 10-year financial forecast for the General Fund. This long-term forecast establishes an appraisal of fiscal sustainability beyond the current budget cycle, providing important context to the annual budget process. The revised long-term forecast (Attachment B) in this report illustrates the need for (1) additional on-going revenues, (2) additional reductions in costs and/or service levels, or (3) recurring, significant draws on General Fund reserves, in order to fund future year operations.

Staff recommends that the Council fund the 2009-10 budget which, per Council direction, proposes no draw on General Fund reserves other than that required to fund the 2009-10 commitment to the El Camino Real/Downtown Specific Plan. Funding for this major comprehensive planning effort is shown "below the line" – to be funded from General Fund reserves accumulated in prior years. Also, staff recommends that the Utility Users Tax rate be maintained at the current reduced rate for an additional 12-month period. By again taking a long-term perspective, major decisions regarding tax increases or service reductions that might unnecessarily impact the community and organization can be avoided. To the extent that new revenues come on line and other General Fund revenues perform within the short-term economic environment, the City's return to budgetary balance can perhaps be more measured.

ANALYSIS

Overview

The City Manager's Proposed Budget (and capital improvement program) for the City of Menlo Park for fiscal year 2009-10 is shown as Attachment A to this staff report.

In the compilation of the proposed 2009-10 resource allocation plan, many factors were taken into consideration: the impacts of prior year budget processes; the City's anticipated fiscal position at June 30, 2009; the current year economic environment; the availability and flexibility of the City's Utility Users Tax; project priorities; a number of

unmet operational needs; risk management issues; and the long-term effect of the City's revenue environment and expenditure decisions. Council will no doubt deliberate on the many other challenges that will also impact the City's long-term financial future in considering this proposed budget.

A preliminary budget which examined General Fund revenues by source and General Fund expenditures by department (provided in appendices to Staff Report #09-065) was reviewed by the Council at a study session held on May 12th. Economic conditions on a national, state, and regional level were included as part of the framework in which the budget was developed. The preliminary budget reflected the use of certain strategies aimed at achieving immediate (short-term) cost reductions, minimizing visible service impacts, preserving funding for infrastructure maintenance, safeguarding the fiscal health and appropriate utilization of the City's other funds, and limiting draws on General Fund reserves. Staff has also identified some work force reductions achievable through various internal restructurings and intermittent use of contract services. The Council examined certain revenue projections, as well as the various cost-reduction strategies utilized. Because the strategies pursued were sufficient to provide a nearly-balanced operational budget; staff felt that the implementation of strategies from the "lower levels" of the pyramid (with the associated impacts) were not necessary to meet the City's budgetary goals for 2009-10. Other budgetary options that had been analyzed but not included in the preliminary budget for 2009-10 were also reviewed.

The preliminary budget presented expenditures that outpaced operating revenues in the General Fund by \$574,805, including a \$450,000 expenditure for the El Camino Real/Downtown Specific Plan project. Acknowledging staff efforts to present a budget within the parameters stated above, Council provided specific feedback to:

- Restore the Child Care Teacher position eliminated from the Menlo Children's Center (\$72,445)
- Provide additional funding for use of temporary staff previously afforded by a vacant 0.5 FTE Library Page position (\$23,000)
- Reduce the General Fund Transfer to the Capital Improvements Projects (CIP) Fund by the amount necessary to provide a balanced budget

General Fund Summary

The following table shows the City's General Fund revenues and expenditures in fiscal years 2006-07 and 2007-08, as well as the both the adopted and adjusted year-to-date for 2008-09. (Note that the 2008-09 adjusted budget includes \$637,520 of prior year encumbrances.) The last column of the table reflects a summary of the General Fund budget in the City Manager's proposed budget for 2009-10.

General Fund Summary 2009-10	2006-07 Actual	2007-08 Actual	2008-09 Adopted Budget	2008-09 Adjusted Budget	2009-10 Proposed Budget
Property Taxes	10,727,003	11,339,649	11,785,000	11,885,000	12,366,000
Sales Tax	6,799,561	7,676,943	7,320,000	7,250,000	6,978,000
Transient Occupancy Tax	1,375,914	1,474,119	1,810,000	1,810,000	2,800,070
Utility Users Tax	641,668	1,651,479	1,075,000	1,195,000	1,232,000
Franchise Fees	1,397,335	1,428,708	1,445,600	1,515,600	1,568,800
Licenses & Permits	3,279,751	4,005,693	3,927,400	3,212,400	2,991,988
Intergovernmental	1,754,834	2,009,244	1,803,507	1,803,518	1,782,509
Fines	897,568	951,145	1,033,520	1,036,520	1,348,442
Interest and Rent Income	2,700,614	2,745,485	1,522,455	1,514,455	1,087,823
Charges for Services	4,948,444	4,564,918	4,770,693	4,495,193	4,938,220
Transfers & Other	542,613	672,193	734,944	734,944	711,074
Total Revenue	35,065,305	38,519,576	37,228,119	36,452,630	37,804,926
Personnel	22,798,667	25,471,178	27,200,261	27,086,763	27,688,195
Operating	4,490,278	4,688,423	5,253,754	5,291,702	5,339,720
Contract Services	2,124,512	2,433,891	3,247,953	3,129,190	2,501,315
Transfers Out	5,494,353	2,502,525	2,534,200	1,734,200	2,275,696
Total Expenditures	34,907,810	35,096,017	38,236,168	37,241,855	37,804,926
Net Operating Revenue	157,495	3,423,559	-1,008,049	-789,225	0
Add: Downtown/ECR Specific Plan Expenses				-380,000	-450,000
Total net draw on General Fund Reserves				-1,169,225	-450,000

General Fund Revenues - Only minor adjustments were made to the 2009-10 General Fund revenues as projected in the preliminary budget on May 12th: Utility Users Tax revenue projections were reduced nearly \$10,000 based on updated calculations for this revenue source by utility; and estimated Charges for Services were decreased approximately \$30,000 to adjust for enrollment under the existing program offerings at the Menlo Children's Center.

Revenues for the year have been projected employing the most recent data available. All told, fiscal year 2009-10 General Fund revenues are expected to increase over \$1.3 million (3.71 percent) when compared to the 2008-09 adjusted budget, largely due to the additional transient occupancy tax revenues projected from a full year of operations at the Rosewood Hotel.

General Fund Expenditures – Despite adjustments needed to restore the Child Care Teacher position at the MCC and supplemental funding for temporary staff at the Library, General Fund Expenditures (not including transfers out to other funds) are shown as *reduced* by \$26,300 when compared to the preliminary budget. This was due to a final reconciliation of the budget system with the City's personnel data base, which revealed that the elimination of a mechanic's position was not properly reflected in the May 12th preliminary budget.

In summary, an increase in citywide personnel costs in the coming fiscal year is unavoidable due to contractual wage increases and the rising cost of employee benefits. The increased salaries negotiated for police officers (both POA and PMA) last year were to have resulted in personnel costs that were \$875,000 higher than the adopted budget for 2008-09. However, significant personnel cost reductions in the Police Department – including the freezing of one vacant officer position – and a decreased Workers' Comp allocation managed to offset this increase somewhat. The costs of benefits are projected to rise in all departments due to the anticipated increase in (non-safety) CalPERS rates (to 14.597 percent from a 2008-09 blended rate of 10.965 percent) for the negotiated retirement benefit that became effective March 30th of this year.

In an effort to reduce personnel costs City-wide, no salary/wage increases were assumed in the 2009-10 preliminary budget, other than the contractual obligations noted above. This is a departure from the City's normal budgetary practices, in which some level of increase is projected for years in which labor contracts expire and are re-negotiated. In addition, a total of 3.0 FTEs (full-time equivalents) have been eliminated city-wide in order to reduce total personnel costs across all funds, and 1.5 FTEs will remain vacant (frozen) for the 2009-10 fiscal year. All of the positions impacted by these measures are currently vacant. The reinstatement of the Child Care Teacher resulted in an increase of 1 FTE in the Community Services as a whole, which was not the intent of restructuring efforts within the department to date. Over the next six months, the organization of Community Services personnel will need to be re-aligned to realize an FTE reduction. The FTE schedule on page 31 of Attachment A reflects changes made in the development of the City Manager's Proposed Budget.

Operating expenses will be held at bay despite a necessary increase in the cost of general liability expense allocated to the General Fund (the increase of approximately \$200,000 is needed to offset rising litigation expenses being incurred in the General Liability Internal Service Fund, which has carried a slightly negative fund balance for the past two fiscal years). Compared to the 2008-09 adopted budget, repairs and maintenance expenditures are cut nearly \$170,000, departmental and landscaping supplies decreased \$109,000 and employee training and travel are reduced over \$50,000 in the proposed budget for 2009-10.

Similar to the cuts incurred in the current mid-year budget adjustments, contract services will remain reduced from the 2008-09 adopted budget. Unfortunately, storm water compliance programs will necessitate significant contract resources. The impact for the first year (2009-10) of implementation of new regional permit requirements is conservatively estimated at \$100,000. Contract services will also be employed as needed in the areas of custodial services (\$44,000) and vehicle maintenance (\$60,000) to assist with work force reductions.

Operational reductions in the proposed expenditure budget resulted in an operating deficit of only \$98,500. In keeping with Council direction, the transfer from the General Fund to support maintenance of the City's infrastructure was reduced from the full \$2,163,200 (the same amount as in the 2008-09 adopted budget) to \$2,064,700. This rather minor reduction in the annual transfer to the CIP Fund is appropriate, as (1) the

economic downturn is providing good value to the construction of capital improvements and maintenance of public infrastructure and (2) federal stimulus funding will advance the City's long-term infrastructure maintenance program. Total transfers out of the General Fund are expected to decrease from the 2008-09 adopted budget due only to the conversion of the previous transfer to the Vehicle Replacement Fund to charges directly to the departments for that purpose.

The total budget for General Fund expenditures is nearly flat when compared to the 2008-09 adopted budget, and reflects an increase of only \$628,000 (1.67 percent) over the adjusted budget for the current fiscal year. Note that the proposed expenditure budget provides funding necessary for all anticipated operations, including the full normal (annual) cost of the City's retiree medical benefit plan and other allocated personnel costs, Council goals, ongoing project priorities, and maintenance of the City's existing infrastructure.

Fund Balance – As a result of prudent fiscal management, the City is fortunate to have a sizable reserve. This reserve provides a safety net for emergencies and other operational contingencies, funding for significant, non-recurring capital expenditures and enhanced investment revenue to support City programs and Menlo Park's stellar credit rating. The reserve is not as well-suited as a source of regular funding for ongoing operations.

However, the existence of adequate General Fund reserve levels provides the City with the opportunity to take a long-term approach in returning to structural balance. There has been a concerted effort in recent years to eliminate large, non-recurring items from the General Fund spending plan to provide a more reliable long-term forecast. However, caution is warranted when building the long-term forecast (Attachment B) using the 2009-10 as the base year. Many of the cost reductions utilized in this proposed budget are largely unsustainable, and the budget as a whole relies on a growth in revenues (particularly hotel taxes and property taxes) that will likely not continue at such a pace into the 2010-11 fiscal year.

In addition, the State government is grappling with enormous budget shortfalls for which there are no simple solutions. Drastic measures to solve the State's budgetary woes in the past have resulted in a grab of city and county revenues. The May revision of the Governor's 2009-10 budget calls for State "borrowing" of local government property taxes for a period of three years. The current economic environment is making it difficult for businesses to sustain the current level of activity, subdued as it may be. The recent merger of Sun Microsystems, the City's largest employer and a significant contributor of sales tax revenues, will also have impacts, positive or negative, on the City's financial picture which will become clearer as the new fiscal year progresses.

As we move forward in the new fiscal year, staff will continue to focus on reviewing areas for long-term restructuring and other effective approaches to developing a sustainable budget providing for the appropriate delivery of services.

Community Development Agency

The Community Development Agency has seen wide variations in tax increment revenues over the past five years. Beginning in 2005-06, the Agency was battered with the impact of large refunds granted by the Assessment Appeals Board for outdated or underutilized office buildings in the redevelopment area. These appeals were processed in fiscal years 2005-06 and 2006-07, resulting in refunds for prior year taxes and a downward adjustment in the Agency's tax increment of over \$300,000 in each of these fiscal years. Moving beyond these refunds and reduced assessments, tax increment revenues jumped nearly 20 percent in 2007-08 and a near 6.0 percent increase is anticipated 2008-09. However, assessed value reported by the County Assessor for the project area shows a 3.75 percent decrease in the assessed role for 2009-10.

The 2009-10 proposed operating budget for the Agency is similar to that of the current fiscal year. Although tax increment revenues are anticipated to be slightly reduced, operating costs have also decreased. The short-term municipal bond market has stabilized immensely since the restructuring of the Agency's bonded debt last year, and debt service costs should decrease nearly \$100,000 (approximately 2 percent). The largest change in the Agency's budget overall is the funding of the Kelly Park Improvements project, which will be partially funded (\$3 million) from the Agency's bond fund.

Other Funds

The City has over forty active funds, most of which are included in the annual budgeting process. Estimated year-end fund balances require careful tracking with each year's fiscal budget. Over time, dwindling fund balances may indicate a future reliance on General Fund appropriations in order to continue services, programs or projects that were intended to be self-sufficient or funded through other means. A summary of Fund Balances over time is shown in Attachment C.

Capital Improvement Projects (CIP) Fund – Maintenance of the City's infrastructure (streets, parking plazas, storm drains, sidewalks, buildings, parks and bridges) remains a high priority for Menlo Park in 2009-10. Funding for infrastructure maintenance is planned for each year as a fund transfer from the General Fund to the General Fund Capital Improvement Projects (CIP) Fund. As noted, the recommended transfer to the General Fund CIP in 2009-10 was initially \$2,163,200, the same amount provided in the 2008-09 adopted budget. However, the transfer for 2008-09 was reduced by \$800,000 as part of the mid-year strategies to reduce the General Fund deficit for the year. The impact of the reduced transfer was somewhat mitigated by the anticipated receipt of federal stimulus funding for the resurfacing of certain federal aid routes, which will serve to forward the City's pavement management program in the long term. As directed by Council in their review of the preliminary budget on May 12th, the General Fund transfer to the CIP fund for 2009-10 has also been reduced, by the amount of General Fund deficit spending in the City Manager's Proposed Budget (\$98,504).

It should be noted that the General Fund CIP only funds a portion of infrastructure maintenance needs. Several other funding sources are used particularly for street maintenance, such as the City's Building Construction Impact Fee, State gasoline taxes, and Federal grants. Each year the City Council approves funding levels for specific capital improvement projects through its project priority process. Commission requests, along with staff and Council identified projects, are developed into a list for Council consideration. Staff analyzes both financial and staff workload capacities to implement new projects in the coming year and develops a list of recommended projects. Council first considered 2009-10 project priorities on March 17th (Staff Report # 09-035). After discussion and revisions to the recommended priorities, the list was adopted on March 24th (Staff Report # 09-044).

851 - General Fund - CIP	2008-09	2009-10
	Adjusted	Proposed
	Budget	Budget
20-039 - Sidewalk Accessibility	235,096	5,956
27-033 - City Buildings (Minor)	673,527	175,000
70-044 - Investigation of Parking Structures Downtown	36,957	0
70-049 - Street Light Painting	62,425	0
25-028 - Park Improvements (Minor)	129,474	110,000
27-038 - Council Chambers Upgrade	45,347	0
20-044 - Citywide Sidewalk Master Plan	24,366	5,461
20-046 - Storm Drainage Fee Study	68,027	3,653
20-048 - Downtown Median Lights	29,105	0
20-049 - Middlefield Road Storm Drain	144,678	5,322
20-051 - AARA Resurfacing Project	940,047	19,953
20-045 - Sidewalks on Santa Cruz Ave Study	89,334	100,000
70-069 - Downtown Bike Rake Installations	10,000	0
25-032 - BH Child Development Center Playground Improvements	12,000	0
25-033 - Auto ADA Doors @ Burgess Recreation and OHCC	16,000	0
25-034 - OHCC Gym Floor	0	30,000
90-015 - Nealon Park Softball Field Improvements	56,240	3,760
20-010 - Street Resurfacing Project	2,376,228	1,782,000
20-011 - Sidewalk Repair Program	136,956	145,000
20-037 - Sidewalk Project	83,592	0
20-038 - Storm Drain Improvements and Cleaning	342,896	100,000
27-039 - Gate House Fence Repair	0	25,000
210T10 - High Speed Rail Coordination	0	40,000
Menlo/Atherton Performing Arts Center	0	1,300,000
Other	16,646	14,148
All Projects	5,528,940	3,865,253

Infrastructure maintenance represents only a portion of the approved project priority list. Through the project priority process, the City also makes funding decisions about land use studies, information systems upgrades, and new or replacement facilities (including infrastructure) that are not covered by the maintenance budget. While the City has done extensive planning for infrastructure maintenance, long-term needs in these other areas are less certain, and do not have a dedicated long-term funding source. In an initial discussion regarding the development of a reserve policy for the General Fund, a separation of infrastructure maintenance funding from other capital projects was

recommended in order to prevent the deferral of essential maintenance for existing assets. The General Fund Reserve Policy will be revisited by the Council later in early summer.

The proposed budget for infrastructure maintenance and improvements from the General Fund CIP totals \$3,865,253. Although this expenditure is greater than the proposed transfer in from the General Fund of \$2,064,696 this is an anticipated result of the scheduling of large street resurfacing projects every other year. The General Fund CIP has a healthy fund balance - projected to be over \$7.0 million at the end of 2009-10 - with which to absorb these year-to-year fluctuations. (Note that if the entire amount appropriated for the current and next fiscal years were expended, a balance of \$4.5 million would remain in the fund.)

Measure T Fund – This fund was created as the result of voter-approved general obligation bonds, first issued in April 2002 for the renovation and expansion of City parks and recreation facilities. The first phase of financing yielded \$13.2 million. The proceeds were largely expended on numerous municipal park updates and improvements, the Burgess Pool & Locker Room project, facilities at Burgess Park and the Menlo Children's Center project. As of 6/30/2008, the fund had a remaining balance of nearly \$1.2 million. Much of this balance was committed in the current fiscal year to the programming and design of the Burgess Gymnasium project. Although the majority of the construction of the new gymnasium will be funded by a local philanthropist, the City will finance approximately \$5.8 million of costs, including normal City plan-check, building permit and inspection fees, utility connection fees and completion of the environmental document for the project.

On March 31, Council was presented with the next steps needed for the second issuance of the Measure T bonds, including a credit and ratings review for the City, and approval of financing documents and bond pre-pricing in mid June. Estimated proceeds from a bond sale will generate approximately \$9.4 million.

In addition to the Burgess Gymnasium project, Measure T funds will be used to resurface the tennis courts at Willow Oaks and Nealon Parks (\$110,000).

Highway Users Tax Fund – Also known as the Gas Tax, the Highway Users Tax has been a fairly stable (though not increasing) revenue source for the City in recent years. With the economic downturn, revenues from this source are expected to decrease approximately 16 percent, to less than \$500,000 for the 2009-10 fiscal year. Use of gas tax funds is restricted by Article XIX of the California State Constitution and by Streets and Highways Code Section 2101. Generally, the tax can be expended for the research, planning, construction, improvement, maintenance and operation of public streets and highways, and the planning and construction of public mass transit guideways. The gas tax was last increased from 9 cents per gallon to 18 cents per gallon during the early 1990s. Since that time, inflation adjusted gas tax revenues have declined steadily, despite the fact that travel and the cost of street maintenance have increased significantly.

In 2007-08, the Governor authorized the delay of gas tax payments to cities and counties for the five months beginning in April 2008. The measure was taken to reduce the State's interest expense and ease cash flow issues for that period of time. The amount was repaid in September 2008. As described earlier, the State anticipates future cash flow issues, and Gas Tax payments remain vulnerable to legislated delays.

County Transportation Tax – Also known as “Measure A” funds, these revenues from the City's portion of the County-wide ½ cent sales tax are used to support transportation projects. The revenues increase or decrease with San Mateo County sales tax collections; \$690,000 is projected from this revenue source in 2009-10. Annual revenues from the fund have continued to support shuttle and other transportation programs, annual maintenance expenses, and only limited project expenses. This year, the fund is slated to provide \$300,000 of the \$4.7 million 2009-10 Street Resurfacing Project. As sales tax revenues fall, this funding source will be depleted more rapidly.

Storm Water Quality Management Fund – This fund's balance has declined steadily from a balance of \$965,000 in 2001-02 to an estimated fund balance of less than \$400,000 at June 30, 2009, and a projected decline of nearly \$100,000 in 2009-10. Council is aware of the recently developed Municipal Regional Permit (MRP), which adds numerous new requirements for storm water management programs in the Bay Area. The City's additional costs under the MRP are estimated at \$300,000 per year, much of which will be borne by the General Fund until a new funding source is pursued.

Bedwell-Bayfront Park Fund – The 160 acres located at Marsh Road and Highway 84 was used as a solid waste landfill from 1957 to 1984. In 1968, the City took ownership of the area and responsibility for the landfill and its eventual post-closure maintenance. Bayfront Park was built over the landfill in phases, starting in 1982 and completed in 1995. At that time, fees collected up to the point of the landfill closure created a “sinking fund” that is today used to fund Bedwell-Bayfront Park maintenance costs. (Conversely, the landfill's post-closure costs are funded from a surcharge on fees charged for solid waste collection and disposal.)

The fund balance of the Bedwell-Bayfront Park Maintenance Fund is estimated to be approximately \$1.2 million at June 30, 2009. Interest on the sinking fund is the only revenue source for the park fund, and maintenance operations for 2009-10 will require an additional \$190,000 draw from the fund's balance.

The eventual depletion of the park's maintenance fund balance continues as a concern. There are no provisions for capital improvements in either the current year or 2009-10 proposed budget. Ultimately, the roads that access the area and pathways that traverse the park will require major repairs. To the extent that the pathways, perimeter road and main road are needed for landfill maintenance and gas recovery operations, these improvements may be shared by both funds. However, capital expenses to the Park Maintenance fund will only accelerate the decline of that fund's reserve. Once the Park's “sinking fund” has been expended, other funding sources will need to be identified for the Park's continued operations.

10 Year Forecast Update

The updated 10-Year General Fund Forecast that accompanies this report as Attachment B was developed using the 2009-10 proposed budget as a starting point for estimating revenues and expenses of future operating budgets. This year's 10-Year Forecast was prepared utilizing the MuniCast system, a series of Excel spreadsheets that allow optimistic, most likely and pessimistic scenarios, and a different scenario for every account within a revenue or expenditure category. For example, if water franchise fees are anticipated to grow faster than electric franchise fees, these different growth rates can be part of the assumptions. The casual reader will not be able to determine these forecast assumptions by simply calculating a growth ratio, as they are presented by categories rather than by individual line items. Likewise, different revenues are forecasted to rebound with the economy at different speeds, even within the same category of revenues. The forecast shown provides only the "most likely" scenario of future revenues and expenditures. The notes to the 10-Year Projection attempt to articulate major deviations from a flat growth assumption within any category.

Salaries and Wages are shown at levels which assume all existing labor agreements are adhered to, and then grow at the "most likely" scenario level of 4%. (Note that the 2009-10 proposed budget was based on a 0% growth in salaries and wages as labor agreements expired.) The assumption will change as the multi-year contracts are up for negotiation. With respect to the short-term expenditure reductions taken to balance the General Fund Budget, it is assumed that contract expenditures will rebound with higher levels of development activity in the next few years. Operating costs are assumed to grow from adjusted levels at an annual rate of approximately 3 percent in 2009-10 and 2010-11, as the recession subsides.

Budgetary risks intensify as revenues and expenses are projected into future years. The possibility of the recession lingering long after 2009-10 could have a constricting effect on both short-term local revenues and decisions affecting the City's fiscal health in the long term. Like many other public and private employers, Menlo Park will face the challenges of recruiting and maintaining a stable and competent work force in the face of large-scale baby-boomer retirements. Conversely, improved revenues from the implementation of business development strategies in progress may provide the headwind needed for smoother budgetary times in the near future. Staff has endeavored to provide the most realistic budgetary projections possible using the most recent data available. Analysis of the long-term health of the General Fund and the City as a whole will continue throughout the new fiscal year, shaped by future economic developments and community needs.

There are notable challenges to the assumption that revenue growth will keep pace with increasing operating costs. These challenges, which are not quantified in the 10-year Forecast, include the following:

- The addition of the Rosewood Sand Hill Hotel to the City's assessed roll is largely responsible for the anticipated 4 percent increase in property tax revenues for the City in the upcoming fiscal year. With few large developments on the immediate

horizon, this growth will likely not be replicated in 2010-11. Residential property values in the Bay Area are generally in decline. Since property owners often look to the County to reassess their property values in times of flattening real estate prices, property taxes are not predicted to maintain such growth in the long term.

- With the expiration of labor contracts for each of the City's labor groups in the next two years, a reexamination of fair and competitive compensation packages will be undertaken. Although the new contracts for police officers and police sergeants (effective July 1, 2008, and January 1, 2009, respectively) proved to be very effective in addressing public safety staffing, retention and recruitment issues, they were more costly than the 4 percent multiplier used in previous long-term forecasts. The City will face additional challenges as it addresses the upcoming personnel void brought about by increased retirements at key administrative, professional and supervisory staff levels. A concerted effort to "grow" future leaders from within the organization by providing a culture which attracts and retains talented employees is underway to counteract turnover and employee disengagement issues that are so costly to the City as an employer.
- Last year, commitments were made to allow for the construction of the Police/City Service Center at the corner of Willow Road and Ivy Drive. No additional staffing resources for this new facility have been included in the 2009-10 budget.
- As noted earlier, the State of California's budget gap for 2009-10 is estimated to be approximately \$20 billion. As the State struggles with cash flows and explores every opportunity to conserve funding for vital program services, there is likely to be an impact on counties, cities, and school districts throughout the State.
- Demands on the City's Non-General funds (such as the Storm Water Quality Management Fund and the Bayfront Park Maintenance Fund) continue to increase; a shifting of funding sources to draw from the General Fund and General CIP Fund may be required.
- The California High Speed Rail Authority has approved the Caltrain corridor as the preferred alignment from San Francisco to San Jose, which would require grade separations in Menlo Park. Such grade separations could result in the need for redirected or increased transportation staffing resources.
- A number of resource additions were identified (as necessary to maintain current levels of service in the long-term) but not funded in the 2008-09 budget; these remain unfunded in 2009-10. To the extent that these needs do not dissipate, they will need to be managed within the long-term context of increasing revenue sources, or further cost reductions in unrelated services.

The bottom line long-term forecast for the City's General Fund once again indicates that budgetary deficits will persist under the assumptions noted, including the assumption of continued assessment of the UUT at the current reduced rate. Staff has endeavored to include all known liabilities and demands to be required of General Fund reserves in the foreseeable future. To the extent that Project Priorities in future years exceed the scope

of the limited number of projects approved in 2009-10, expenditure growth can be expected to exceed the assumed rate. Changes in the business, legislative or environmental climate may have a profound effect on reserve levels. Whereas the City will always experience expenditure savings because of the nature of the appropriation process, revenue assumptions come with downside risk that is difficult to assess quantitatively. The need (or lack thereof) to restore reserves following any significant draw on reserves is also a serious consideration when planning for the long-term fiscal health of the City.

Utility User Tax Rate Considerations

The impact of the Utility Users Tax, which was passed in November 2006 to provide for the long-term sustainability of the General Fund budget, is evident in the updated 10-year forecast. If the tax were to be assessed at the higher rates provided for in the UUT ordinance, projected revenues would be nearly \$1.8 million higher on an annual basis. It is also clear that elimination of the tax would exacerbate the budgetary deficits shown in the long-term forecast. Based on the magnitude of such an ongoing deficit and its potential impact on the City's fiscal position, the City Council last year made the required finding that the utility users tax was necessary for the financial health of the City.

Although it is appropriate for Council to consider modulating the tax in response to major economic changes, frequent variation in the rate is not recommended. All utility service providers must be given a sixty-day written notice of rate and other changes that result from adjusting the rate. In addition, the \$12,000 annual cap on the UUT assessed for combined electric, gas and water usage presents unique administrative challenges to staff, commercial utilities consumers and utility suppliers:

- Large commercial utility consumers must determine whether it is advantageous to apply for the UUT cap. (An increase in the UUT rate increases the number of utility customers who would benefit from the fixed \$12,000 per year cap.)
- Service providers must be notified of customers exempt from the tax due to application of the cap. To avoid duplicate assessments, which would require refunds from the City, the City should provide such notification of exemptions 60 days in advance.
- Depending on the effective date of the rate change, the annual cap would need to be applied and billed on a pro-rata basis.

Due to the administrative implications of numerous rate changes and the general confusion and uncertainty surrounding such changes, staff recommends the current (reduced) UUT rate of one percent, assessed on all utilities, be extended. Temporary tax rate reductions for a period of up to twelve months can be implemented with the specific finding provided in the UUT ordinance: "The temporary tax reduction shall not adversely affect the City's ability to meet its financial obligations as contemplated in its current or its proposed budget." Staff contends that since the proposed budget for the

2009-10 fiscal year requires no draw on General Fund reserves, such an adverse effect is not a concern.

By taking this measured approach the City would be in a better position to establish the level of tax needed for ongoing fiscal stability. Whether and to what extent the tax rate should be increased or decreased will be better known with further data on:

- the performance of the City's other revenues in uncertain economic times,
- the adequacy of the General Fund expenditure budget to support current expected levels of service,
- the capacity of the City's other funds to meet capital and further needs not provided for in the General Fund operating budget, and
- the emergence of future revenue opportunities or expenditure demands not captured in the current long-term forecast

Many of these issues will be considered in the further development of the City's General Fund reserve policy.

Budget Result Measures

Menlo Park has used the current program-based, results-oriented budget since 2001-02. Although identified and organized by "lead department," City services are carefully defined within succinct programs and are charged with specific, quantifiable results upon which the City monitors progress in meeting citizen expectations. The status of each desired result is reported, measuring the extent to which each was attained in the preceding fiscal year. In many cases, result measures have been improved based on experience gained and a better understanding of performance measurement techniques. This year, services benefited greatly from the community survey conducted in November 2008, which provided a benchmark comparison standard for resident perception of the quality of many services. Menlo Park chose to set its standard at "higher than the benchmark" in order to meet targeted results. The standard status response in all cases is that the service results were "Exceeded" (40%), "Met" (28%), "Not met" (10%), or "Data not available" (22%). In summary, the City met or exceeded 68% of the established service results.

Although the status of the service results as a whole has not varied in prior years, staff is concerned with the increase in the number of results that could not be appropriately measured. The City's service orientation often requires extensive use of both internal and external surveys to gauge "satisfaction" to the population being served. Although desired results are designed to reflect established City priorities and staff endeavors to *achieve* high levels of service, *measurement* of these results may not occupy the same level of priority. In fact, when staff resources are spread thin, measurements of service results tend to take a back seat to the actual realization of the desired results.

During the final reporting months of 2008-09, staff teams met to evaluate the performance results as presented in the budget document and to provide updates to the results and measures as necessary for continued clarity, relevance, and significance to the public as well as usefulness for internal decision-making. The merits of tracking

each result were reviewed, and staff is currently weighing alternative measurement practices for specific results that would permit data collection beginning July 1, 2009 for next year's budget document.

As identified in prior year budget considerations, cost and/or personnel reductions since 2001 continue affecting the ability of many programs to achieve the results as indicated. These outcome levels, set when City staffing included over 30 more FTEs than current levels, are often unrealistic and may be adjusted downward during the 2009-10 reporting year. All City departments endeavor to build on past efficiencies and will continue practicing budgetary restraint in the 2009-10 fiscal year. As the City's priorities evolve and new Council goals/initiatives are implemented, new result measures will be developed, and existing measures will continue to be refined in order to gauge the success of each City service.

The Budget Document

"Attachment A" is the complete draft budget document as proposed by the City Manager for 2009-10. The budget is a spending plan reflecting the City's policies, goals and priorities as a whole.

The Budget document contains expense and funding information for all City funds and Redevelopment Agency operations. The Table of Contents is helpful in orienting the reader to each section. Each program service is listed along with actual 2007-08 spending, the current year (2008-09) adjusted budgets and estimates, and the proposal for the 2009-10 fiscal year. The funding source for each service is shown. In the back of the document is information about the City's estimated fund balances and the planned Capital Improvements projects for 2009-10.

Summary

This budget is built on the basics: addressing the City's financial priorities and continuing to provide basic services as well as those programs that make Menlo Park unique. The General Fund budget was balanced through a combination of ongoing revenue and aggressive spending constraints. Under this resource plan, the City is able to adequately maintain services and infrastructure, while at the same time properly funding liabilities, meeting all debt commitments, and maintaining a high credit rating. However, some of the budgetary choices incorporated for the short term are clearly unsustainable, and a sufficient number of unmet resource needs were identified to justify concerns in the long term.

As a draw-down on reserves is not a long-term solution to budgetary deficits, options for subsequent fiscal years remain: (1) implement additional revenue through an increase in the UUT or other revenue sources; (2) cut expenditures and/or services to match revenues; or (3) a combination of these strategies. In regards to the UUT, Staff recommends the Council allow the rate to remain at its current reduced level of 1 percent on all utilities by adopting a consecutive temporary tax percentage reduction as provided in section 3.13.130.

Next Steps in the Budget Process – The City Manager’s proposed budget was prepared through a process and supporting systems enabling staff to incorporate Council-requested adjustments, re-run the budget numbers and finalize the document without requiring extensive reconciliations or re-formatting. Once finalized, staff will summarize changes and provide any additional information or discussion requested by the Council in the final budget staff report, calculate the Appropriations Limit (required by State law), and prepare the necessary resolutions for budget adoption.

The 2009-10 Budget document will be available on-line and in Council packets on the normal distribution schedule for the June 16th regular Council meeting. A resolution regarding continuance of reduced UUT rates or reinstatement of the original tax percentages as of October 1, 2009, will also be prepared according to Council direction for adoption on June 16th.

IMPACT ON CITY RESOURCES

The budget for the 2009-10 fiscal year provides for projected expenditures which are in line with anticipated revenues in the General Fund if the UUT rates remain at current levels. The 2009-10 commitment to the El Camino Real/Downtown Specific Plan project (\$450,000) is funded from the General Fund Reserves. The General Fund transfer out to the City’s CIP Fund for infrastructure improvement was reduced 4.5 percent in order to eliminate a projected \$98,500 deficit. Estimated increases or decreases to other fund balances are shown on pages 175 through 180 of the proposed Budget Report (Attachment A). Every effort has been made to identify all of the necessary and approved costs to be incurred in the fiscal period. The long-term forecast has been updated to assist decision makers in financial strategies, including the establishment of an appropriate UUT rate, for the long term.

POLICY ISSUES

Presentation of the City Manager’s proposed budget is consistent with the City’s budgeting process and represents no changes in City policy.

ENVIRONMENTAL REVIEW

Environmental Review is not required.

Glen Rojas, City Manager

ATTACHMENTS: A. [City Manager’s 2009-10 Proposed Budget Report](#)
B. [Revised 10-year Forecast](#)
C. [Schedule of Fund Balances, 2000-2008](#)