

Financial Conditions Briefing & Implementation of Long-term Financial Planning

Introduction

- ▶ This presentation is a follow-up item from the City Council's **June 4th Strategic Planning Session** that directed staff to:
 - Identify cost reduction options
 - Recommend a financial reserve policy

Introduction

- ▶ **State of the Economy**—Serves as a background for an analysis of local financial conditions and the impact to the City of Hanford’s Budget
 - 2000s economic expansion was anemic. Last significant economic expansion was in the 1990s, and was tied to the implementation of IT in the workplace and corresponding gains in productivity.
 - 2000s economic growth was tied significantly to the housing sector, which was largely a credit and speculative driven “bubble” (e.g., easy access to credit and Wall Street speculation, such as mortgage-backed securities and other forms of derivatives). Defense and security-related industries did well as an outgrowth of the 9/11 attacks.

Introduction

- ▶ **State of the Economy**—Serves as a background for an analysis of local financial conditions and the impact to the City of Hanford's Budget
 - The housing bubble burst in 2006–2008 (e.g., number of building permits issued & planning & engineering fees collected in Hanford)
 - Housing bubble that burst set into motion a Banking and Financial Panic in late 2008 that caused the Federal Reserve to take unprecedented action by infusing \$3.3 Trillion into the economy to avoid another Great Depression.

Introduction

- ▶ **State of the Economy**—Serves as a background for an analysis of local financial conditions and the impact to the City of Hanford’s Budget
 - Today, the so-called “economic recovery” has been a largely job less recovery.
 - The continued high unemployment rate has had a significant drag effect on the economic recovery so much so that the Federal Reserve is not convinced that the recovery is “self-sustaining.” Thus, the Fed announced in early November 2010 another unprecedented action of releasing an additional \$600 Billion into the money supply to stave off possible deflation.

Introduction

- ▶ **State of the Economy**—Serves as a background for an analysis of local financial conditions and the impact to the City of Hanford's Budget
 - Other factors contributing to the current economy include: 1) the country is facing a growing Federal budget deficit, 2) the country faces an actuarial crisis in funding both Medicare and to a lesser extent, Social Security, 3) California has a significant state budget deficit, 4) Cal-PERS member contribution rates continue to escalate due to portfolio losses; 5) Kings County has an higher than average unemployment rate than California, which in turn, has a higher unemployment rate than the nation.
 - It is within this larger framework of a stagnated economy that we present an overview of the City's financial conditions and forecast for the next five years.

Introduction

- ▶ Recognition of previous City Council & City Manager for cost reduction work
- ▶ Most of the “low-hanging fruit options” with regard to reducing cost have been exhausted
- ▶ Key issue in the presentation—A large portion of the City’s revenue lags behind the economy, further delaying the City’s financial recovery.
- ▶ About Finance & Management Consultant Susan Mahoney

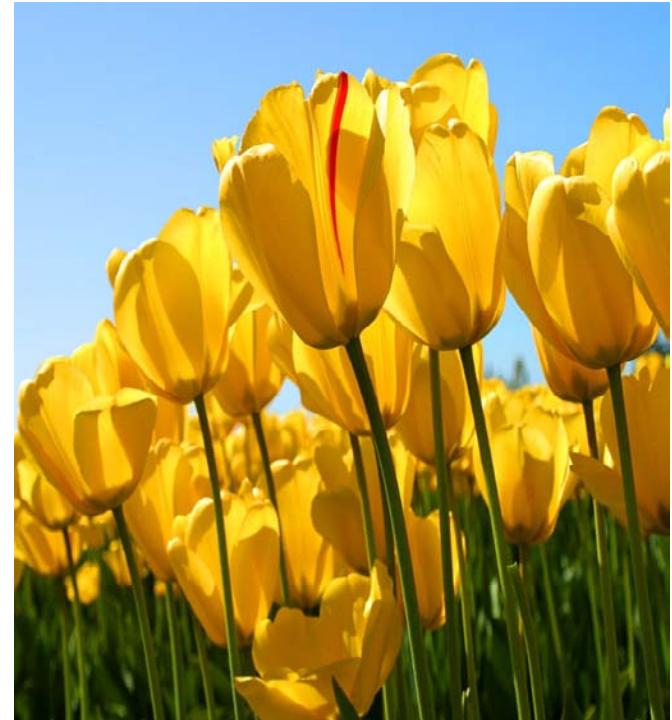
Purpose of this Briefing

- ▶ Provide an overview of “economic drivers” that impact the City’s budget and financial conditions
- ▶ Present key historical General Fund revenue and expense data
- ▶ Take a forward look at the City’s General Fund revenues and expenses using a Long-term Financial Planning Tool
- ▶ Review General Fund reserves and fiscal policies
- ▶ Conclude with a staff recommendation for next steps

Financial Planning

Key Components

- ▶ Long-term Financial Plan
 - Drives the Budget process
 - Aids in Decision making
- ▶ Reserves
 - Provides financial stability when unforeseen events occur
 - Stabilizes cash flow
 - Provides income
- ▶ Financial Policies
 - Sets the financial framework for reserves, debt, investments, appropriations, compensation, etc

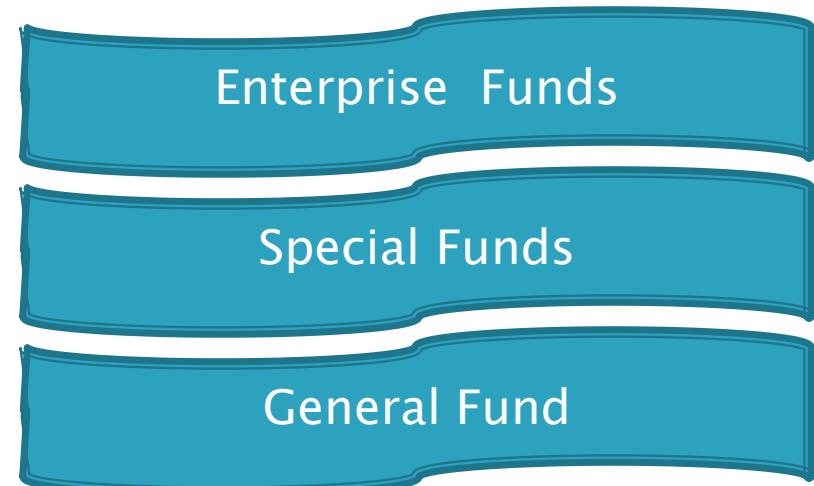


General Fund Background Information



Focus is on the General Fund

- ▶ All City revenues and expenses accounted for in “funds”
- ▶ Each fund is like a separate business
- ▶ Funds (businesses) are categorized into types



Enterprise Funds

Fee based

Fees cannot exceed cost of providing services

- ▶ Water
- ▶ Waste Water
- ▶ Airport
- ▶ Refuse
- ▶ Intermodal
- ▶ Courthouse Square
- ▶ Storm Drainage

Special Funds

Revenue can be from fees, taxes, assessments,
outside agencies

Use of revenues is legally restricted

- ▶ Grant
- ▶ Fiduciary Funds
- ▶ Redevelopment Funds
- ▶ Transportation Funds
- ▶ Landscape Assessment Districts

General Fund

If the revenue does not fit into any other fund type, it goes in the General Fund

- ▶ Use of revenues not restricted
- ▶ Only one General Fund
- ▶ Revenues are volatile
- ▶ Majority of expenses are public safety related

General Fund Revenues

► 81% Taxes

- Sales Tax
- Property Tax
- Vehicle License Fee
- Business License Tax TOT
- Real Property Transfer Tax
- Transient Occupancy Tax



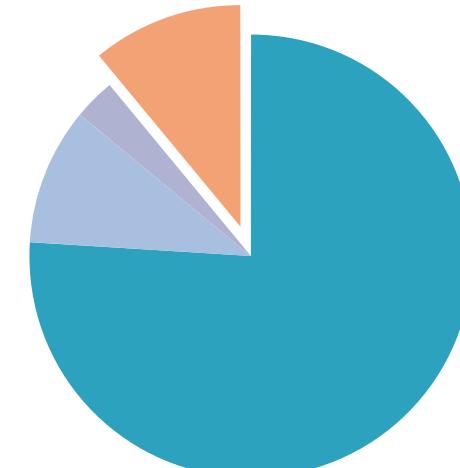
► 16% Fees

- Building
- Permits
- Rentals
- Recreation

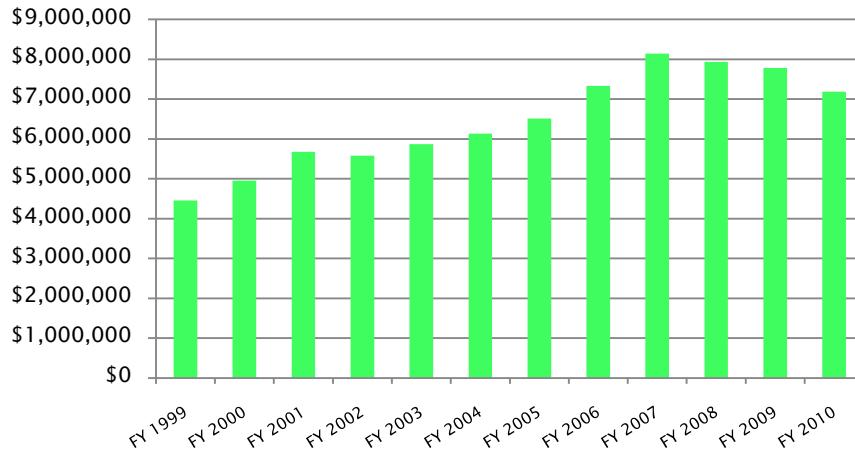


► 3% Interest

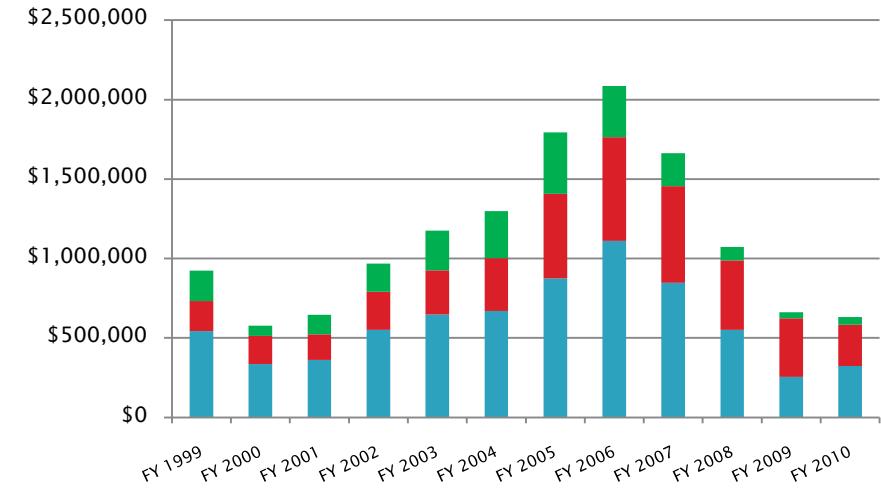
- Tax
- Building Fees
- Interest
- Other



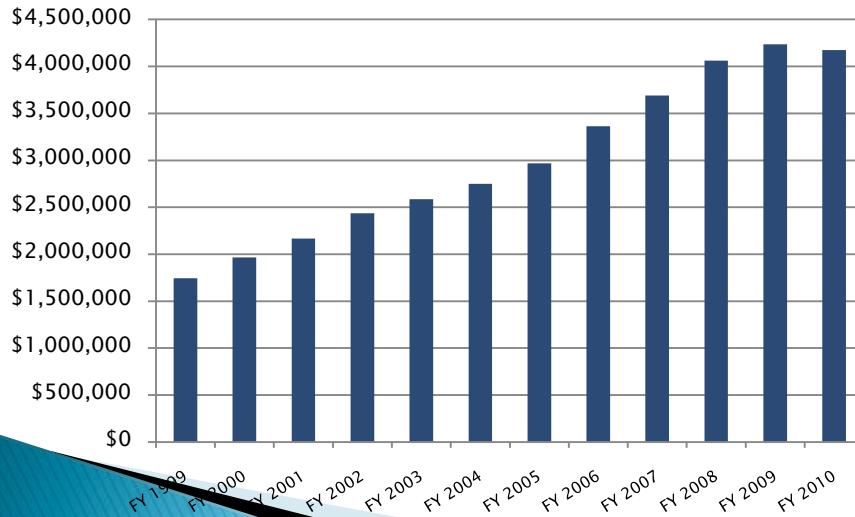
Sales Tax



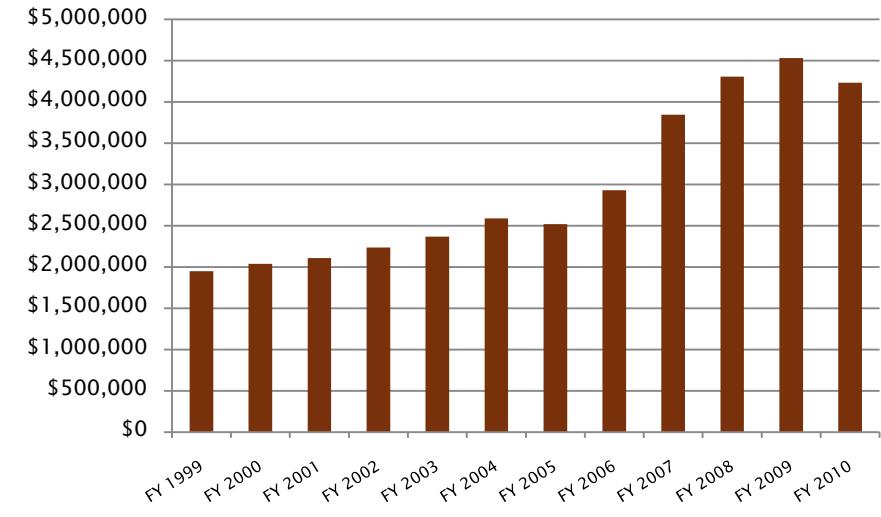
Construction Permits Planning Fees Engineering Fees



Vehicle License Fee



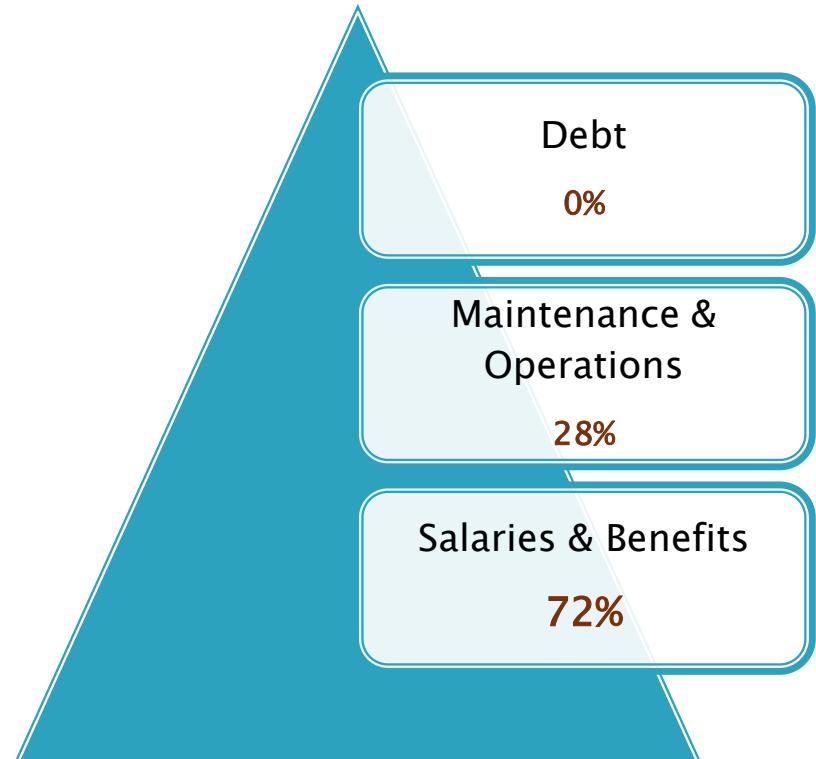
Property Tax



General Fund Expenses

Separated into Departments

- ▶ Police
- ▶ Fire } 62%
- ▶ Recreation
- ▶ Community Development
- ▶ Finance
- ▶ Public Works Administration
- ▶ City Attorney
- ▶ City Manager
- ▶ City Clerk
- ▶ Personnel



General Fund Expenses

Number of Authorized Positions

- Total Number of City Positions

296

11 vacant and unfunded



- Positions Paid from the General Fund

206

10 vacant and unfunded



- Public Safety Positions

109

1 vacant and unfunded



General Fund Expenses

Salaries and Benefits FY 2011

- \$14.9m **Salary**
- \$ 7.3m Benefits
- **\$22.2m Total**

Total City



- \$11.1m **Salary**
- \$ 5.5m Benefits
- **\$16.6m Total**

General Fund
Only



- \$ 7.0m **Salary**
- \$ 3.7m Benefits
- **\$10.7m Total**

Public Safety
Only



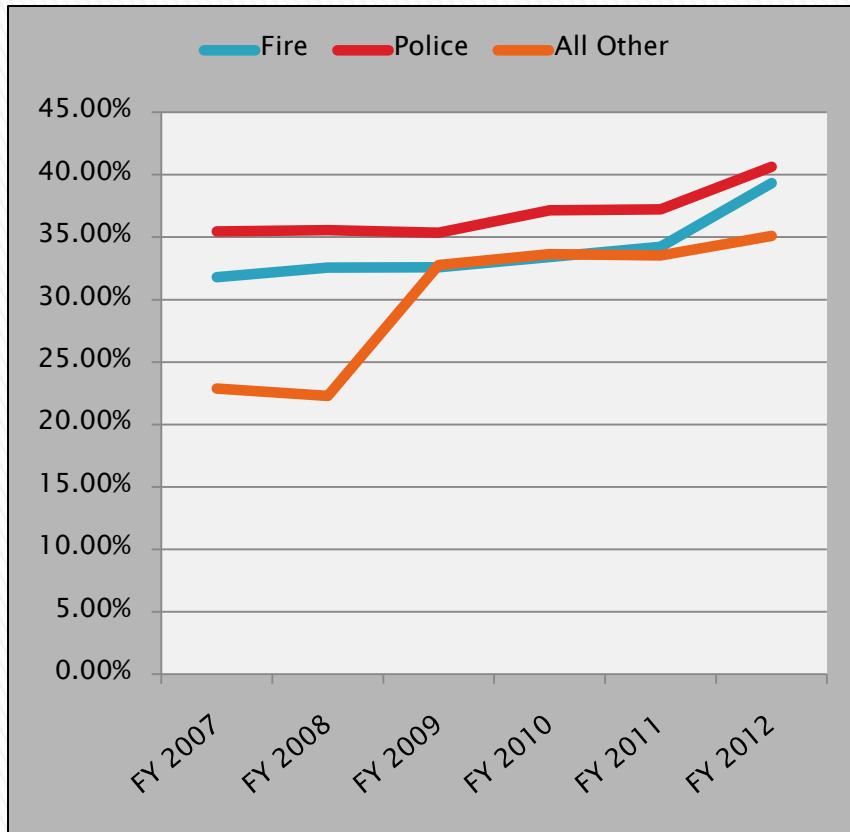
General Fund Expenses

Average General Fund Salary

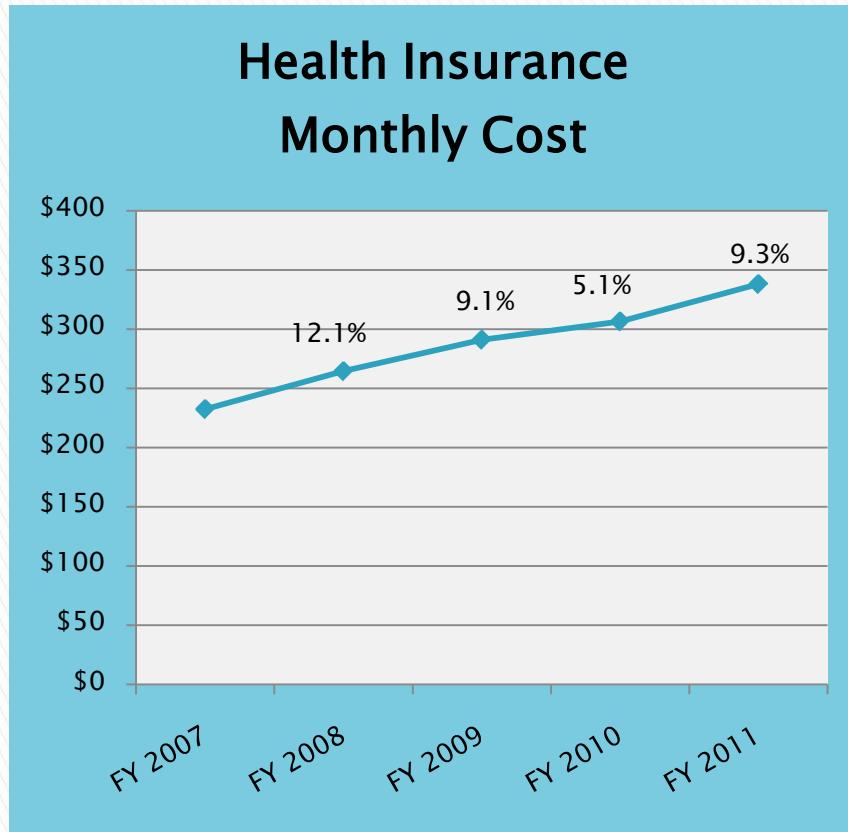
Salary	Health Insurance	PERS	Other (Tax, WC)	Total Benefits	Total Compensation
56,314	3,660	20,468	3,607	27,735	84,049
	6.5%	36.3%	6.4%	49.3%	

General Fund Expenses

Pension and Health Costs



Pension Costs as a % of Salary



Health Cost – Base Plan

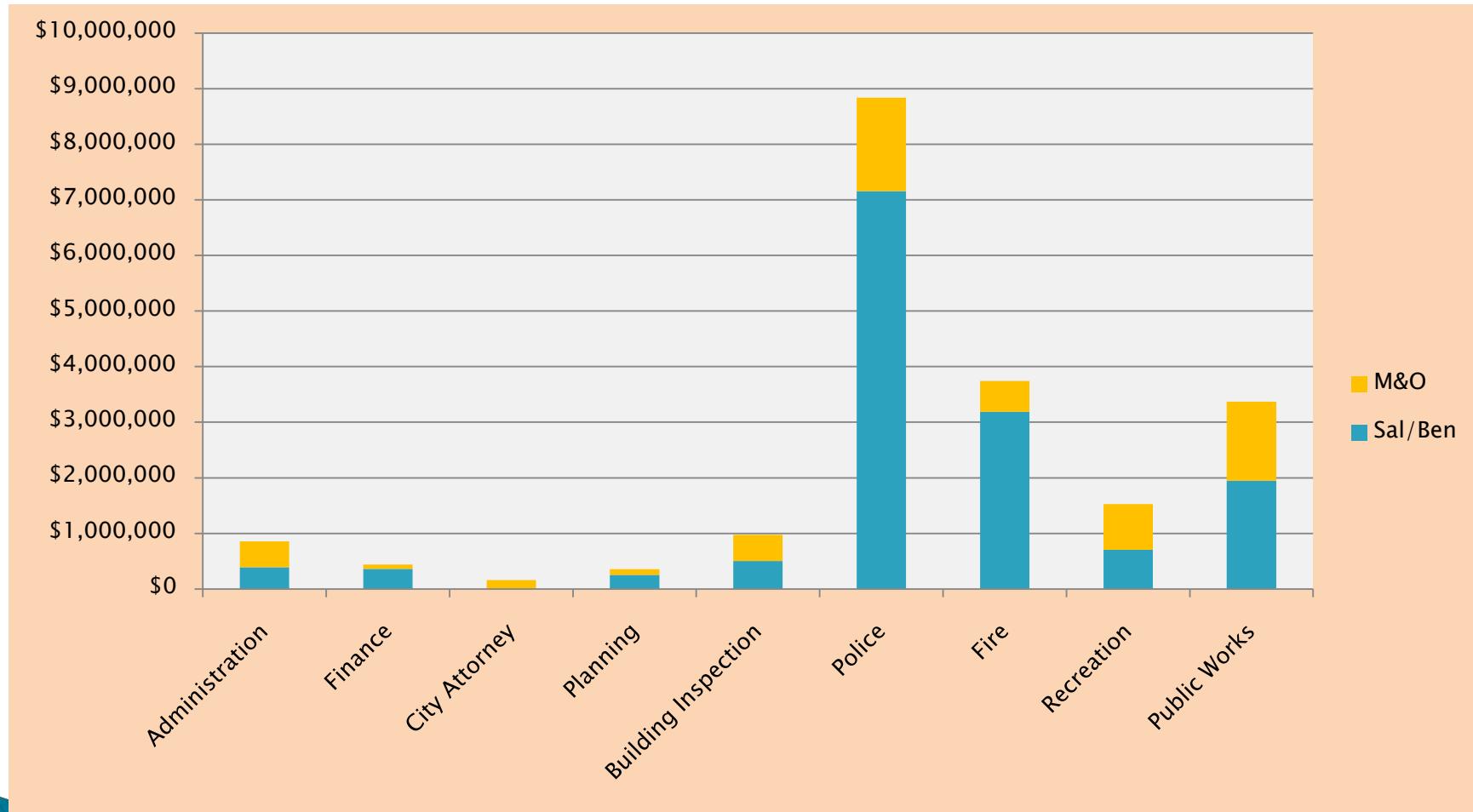
General Fund Expenses

Maintenance and Operations

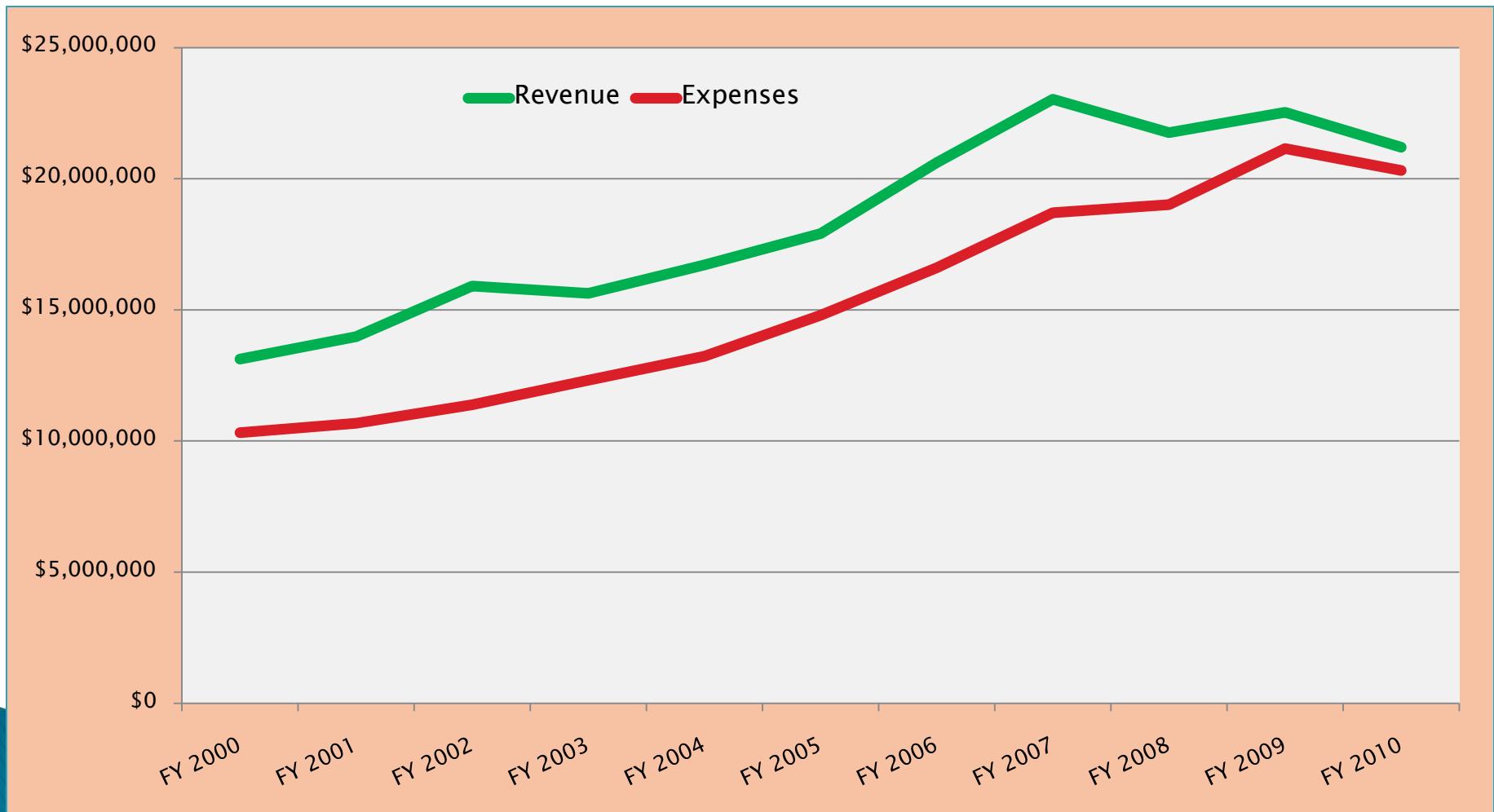
- ▶ 28% of total General Fund expenses are for Maintenance & Operations
- ▶ City has little control over cost increases
- ▶ City has some control over usage
 - Utilities
 - Insurance
 - Materials and Supplies
 - Professional and Special Services
 - Training and meeting expenses
 - Small tools and equipment

General Fund Expenses

Maintenance & Operations Costs



History of General Fund Revenues and Expenses



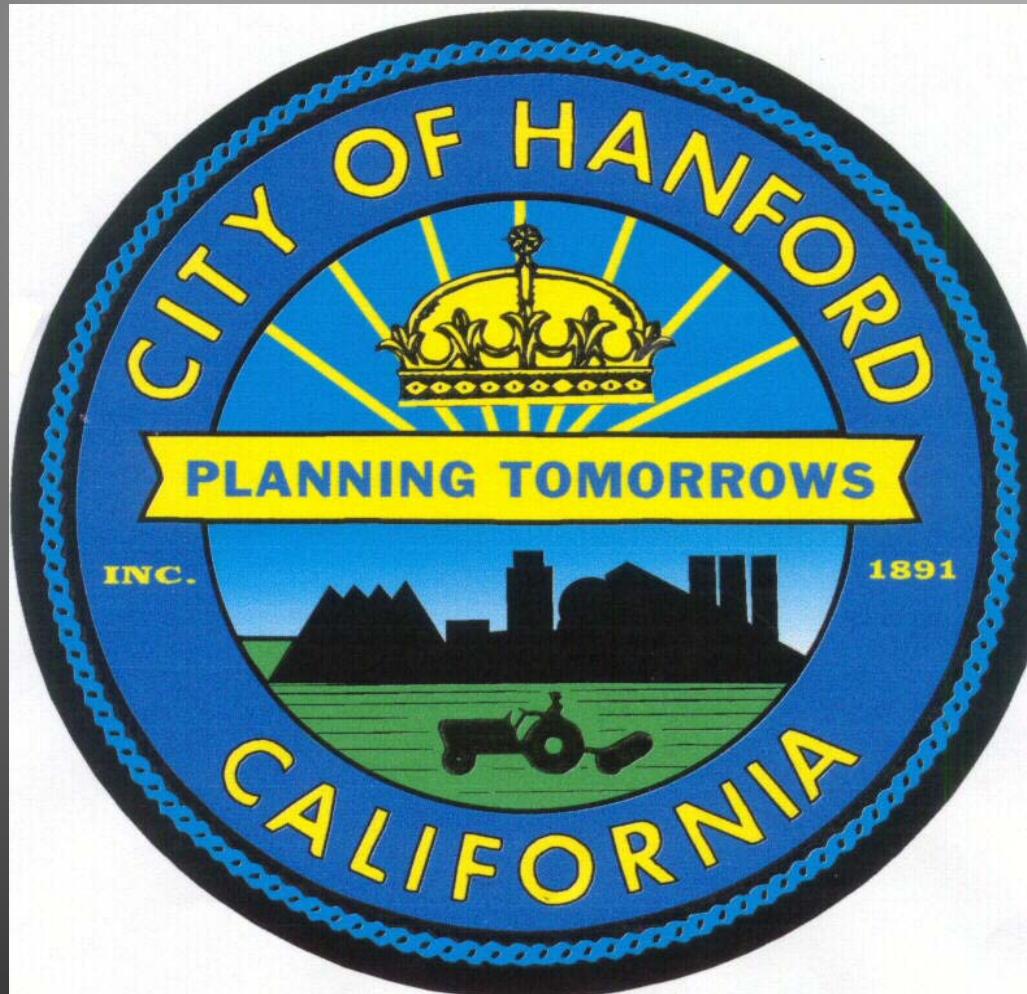
General Fund Net Income

- ▶ The excess of General Fund revenues over expenses (net income) has been transferred to various funds
 - Accumulated Capital Outlay Fund (ACO)
 - Current working capital is \$6.7 million
 - Three other Reserve Funds
 - Combined fund balance is \$6.4 million
- ▶ Net Loss
 - In the future, if there are years where expenses exceed revenues, the Reserve Funds can be used to “balance” the budget

Summary – General Fund

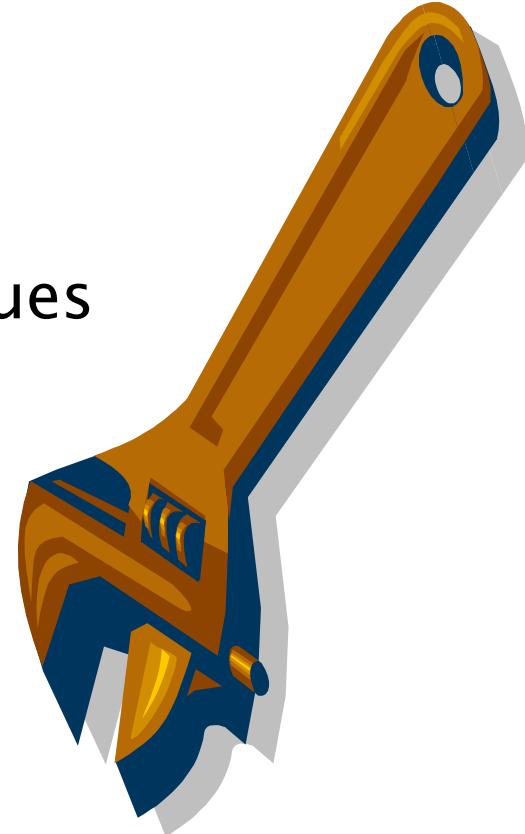
- ▶ **Revenues**
 - Sales Tax, Property Tax, Vehicle License Fees, Building Fees are 80% of GF revenue – Fluctuate with economic conditions
- ▶ **Expenses**
 - 62% are for Public Safety
 - Expenses are driven primarily by salary and benefit costs
- ▶ **Revenues have exceeded expenses for past 10 years**
 - Excess was used for capital projects or to fund reserve funds
 - Net Income has been declining since 2007 and is expected to be at approximately a break even for FY 2011

Long-Term Financial Plan



The Plan is a Tool

- ▶ It is used to project operating revenues and expenses
- ▶ It takes into consideration current and anticipated future economic conditions at the local level
- ▶ The plan does not address any future impacts from State or Federal actions
- ▶ It is based on data furnished by city staff and outside agencies



Today's Economy

- ▶ Federal monetary policy is to promote sustainable output and unemployment and to keep prices stable
 - *The feds are struggling with this*
 - *Access to credit/capital, general market instability*
 - *Job growth not strong enough to bring unemployment rate down – will take 20 years at Oct 2010 growth rate to achieve 5% unemployment* (*Economic Policy Institute*)
- ▶ The State has a huge budget deficit
 - *Borrowing billions to pay for unemployment*
 - *Benefits will run out for many*
 - *State budget deficit may cause increase in taxes*
 - *New governor promises “realignment” of state-local responsibilities*

Local Economic Climate

- ▶ Good
 - Federal and County jobs provide some income stability to the area
 - Stable work force
- ▶ Not so Good
 - Q3 2010 number of homes sold and median price lowest in 5 years (*City-Data.com*)
 - 1 in 196 homes in foreclosure in Kings Co compared to 1 in 201 homes in CA (*Realtytrac.com*)
 - Unemployment 13.1% – higher than state average of 12.4% (*EDD Oct 2010*)

Long-Term Financial Plan uses Assumptions to Project Future Revenues and Expenses

- ▶ Three different scenarios will be presented
- ▶ In each scenario, the Revenue and Expense assumptions will remain the same except for salary increases

Example

The plan applies growth assumptions to the most recent revenue and expense data

Example: In FY 2010 Sales Tax = \$7,000,000

If the growth in sales tax is expected to remain flat for the next two years and then grow at a rate of 2% per year for the following three years.

FY 2010	FY 2011	FY 2012	FY 2013	FY 2014	FY 2015
\$7,000,000	\$7,000,000	\$7,000,000	\$7,140,000	\$7,282,800	\$7,428,456

Revenue Assumptions

	FY 2012	FY 2013	FY 2014	FY 2015	FY 2016
Sales Tax <i>Finance Director and MuniServices.com</i>	1.0%	2.0%	2.0%	2.0%	2.0%
Property Tax/VLF <i>Finance Director, Uta Dorma at Kings Co Auditors office, Andrew Nickerson at HDL Corp</i>	0%	1.0%	2.0%	2.0%	2.0%
Building Activity <i>Building Official</i>	0%	0%	5.0%	10.0%	10.0%
All Other Revenue <i>Finance Director</i>	0%	0%	0%	0%	0%

Expense Assumptions

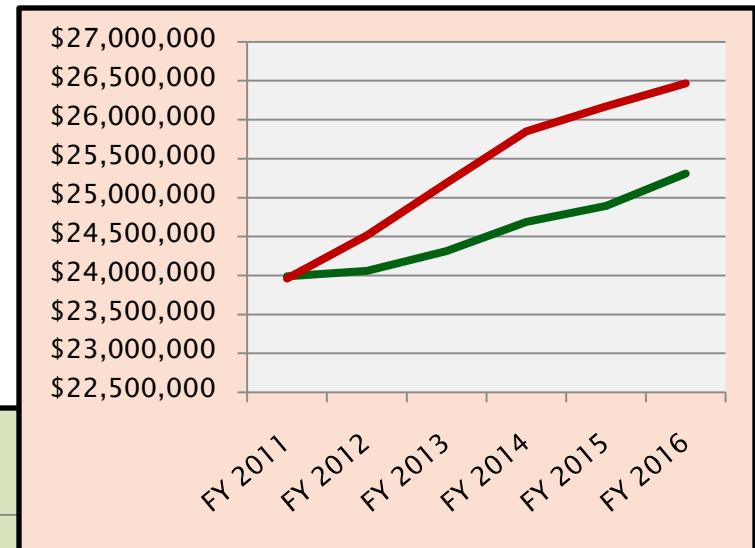
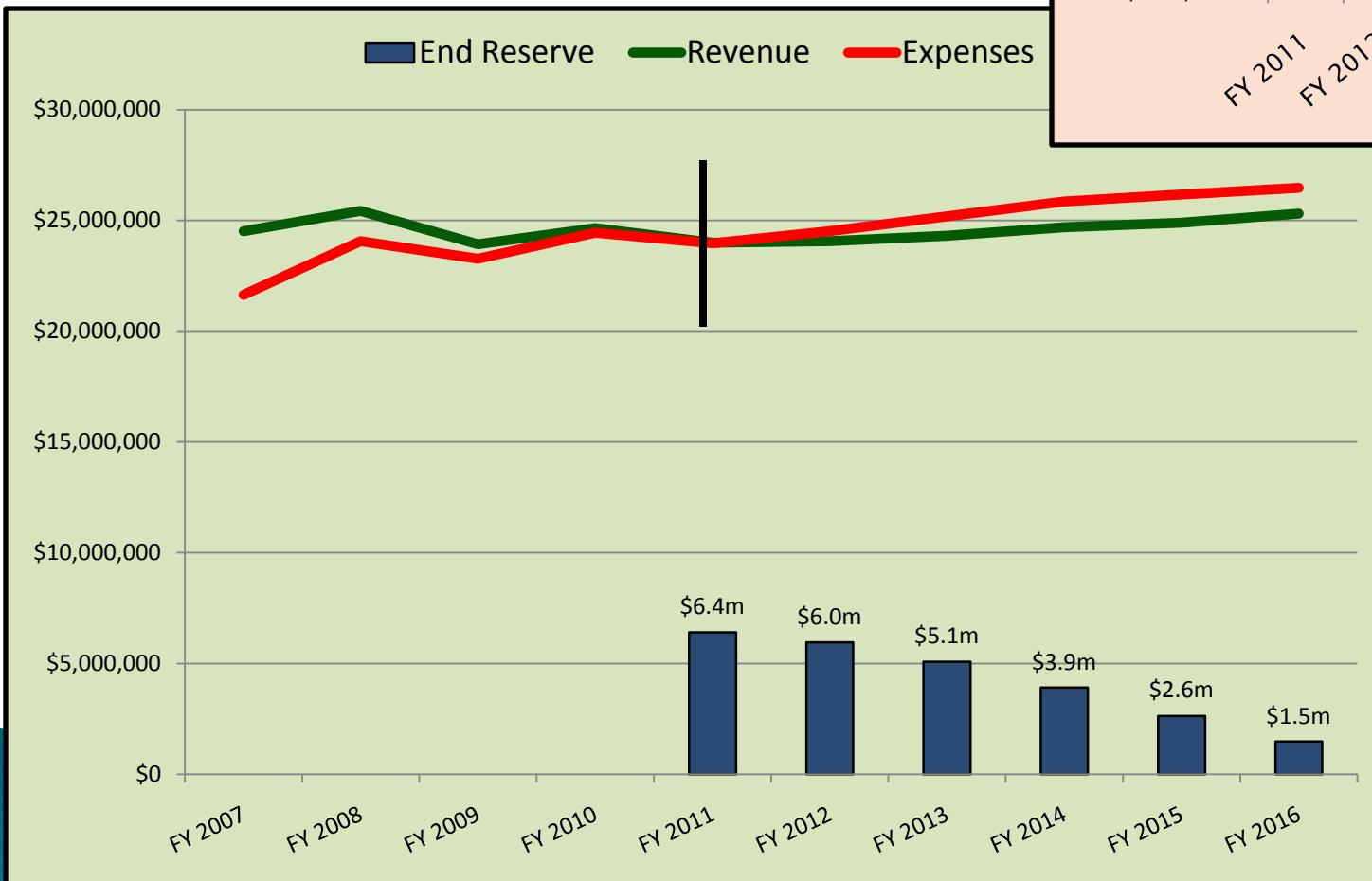
	FY 2012	FY 2013	FY 2014	FY 2015	FY 2016
Salaries	0, 2, 5%				
Scenario 1 - no increase					
Scenario 2 - 2% increase					
Scenario 3 - 5% increase <i>(based on average increase for past five years)</i>					
PERS – Misc	2.0%	2.0%	2.0%	0%	0%
PERS – Public Safety	2.4%	2.4%	2.4%	0%	0%
<i>PERS</i>					
Medical	15.7%	15.9%	14.1%	11.1%	10.2%
<i>Finance Department</i>					
Maintenance & Operations	2.4%	2.4%	2.4%	2.4%	2.4%
<i>Bureau of Labor Statistics, Financial Forecast Center</i>					

0% Salary Increase

- ▶ *numbers in millions*

	FY 2007	FY 2011	FY 2012	FY 2016
Revenues	\$23.0	\$23.9	\$24.1	\$25.3
Expenses	<u>18.7</u>	<u>\$23.9</u>	<u>24.5</u>	<u>26.5</u>
Net Income	\$ 4.3	\$ 0.0	(\$0.4)	(\$ 1.2)

0% Salary Increases

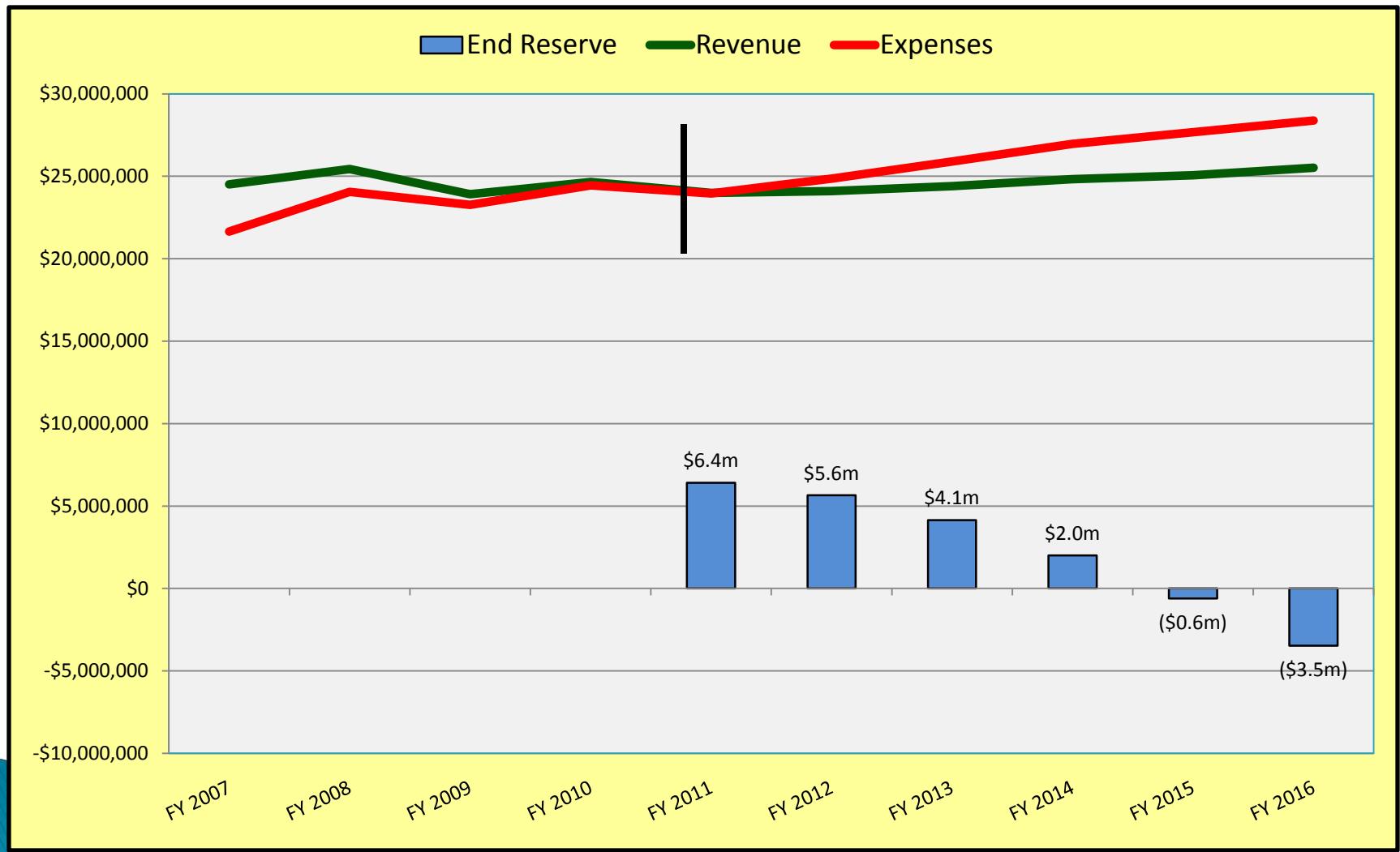


2% Salary Increases

- ▶ *numbers in millions*

	FY 2007	FY 2011	FY 2012	FY 2016
Revenues	\$23.0	\$23.9	\$24.1	\$25.5
Expenses	<u>18.7</u>	<u>\$23.9</u>	<u>24.9</u>	<u>28.4</u>
Net Income	\$ 4.3	\$ 0.0	(\$0.8)	(\$ 2.9)

2% Salary Increases

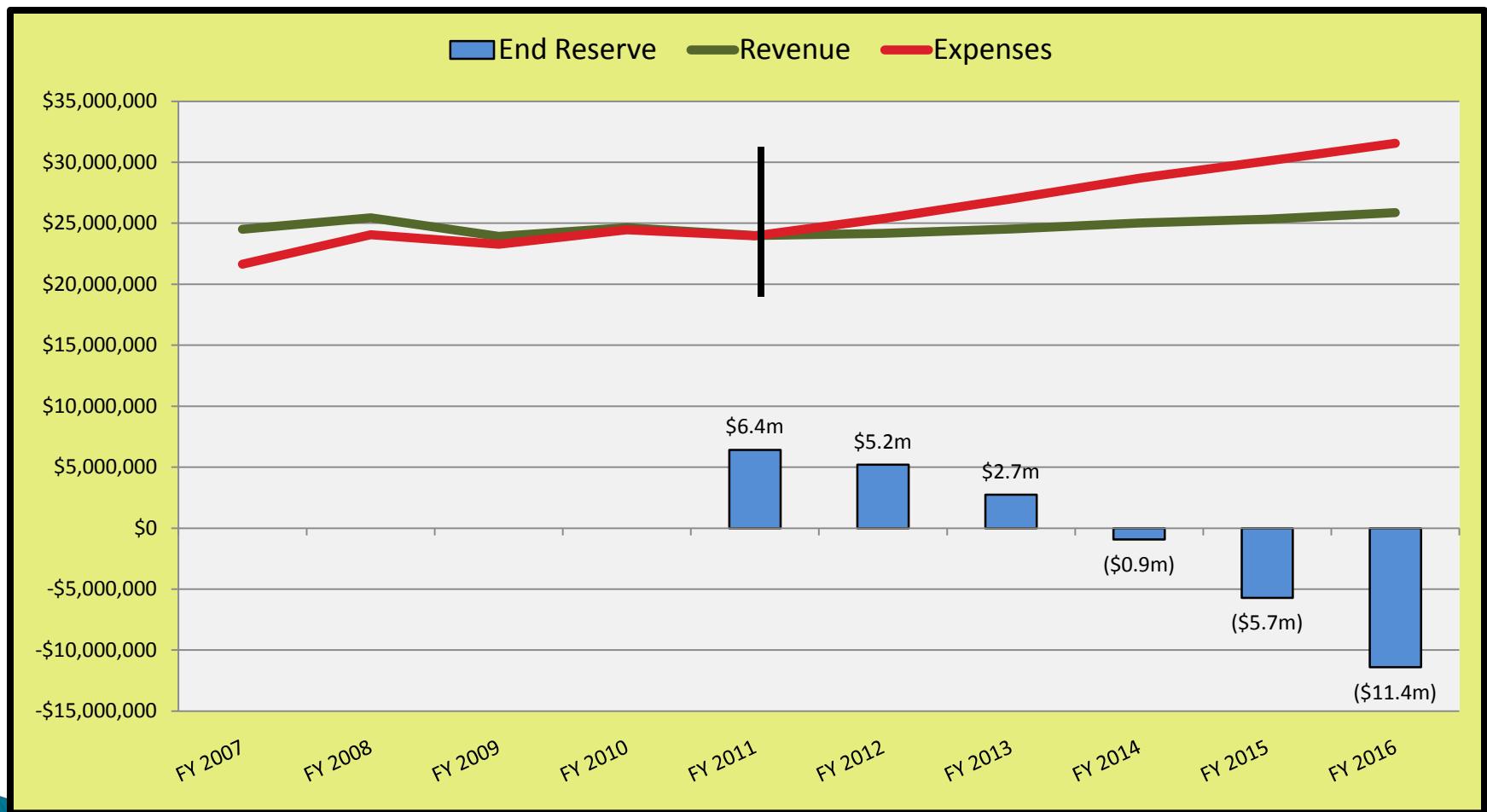


5% Salary Increase

- ▶ *numbers in millions*

	FY 2007	FY 2011	FY 2012	FY 2016
Revenues	\$23.0	\$23.9	\$24.2	\$25.9
Expenses	<u>18.7</u>	<u>\$23.9</u>	<u>25.4</u>	<u>31.6</u>
Net Income	\$ 4.3	\$ 0.0	(\$ 1.2)	(\$ 5.7)

5% Salary Increase

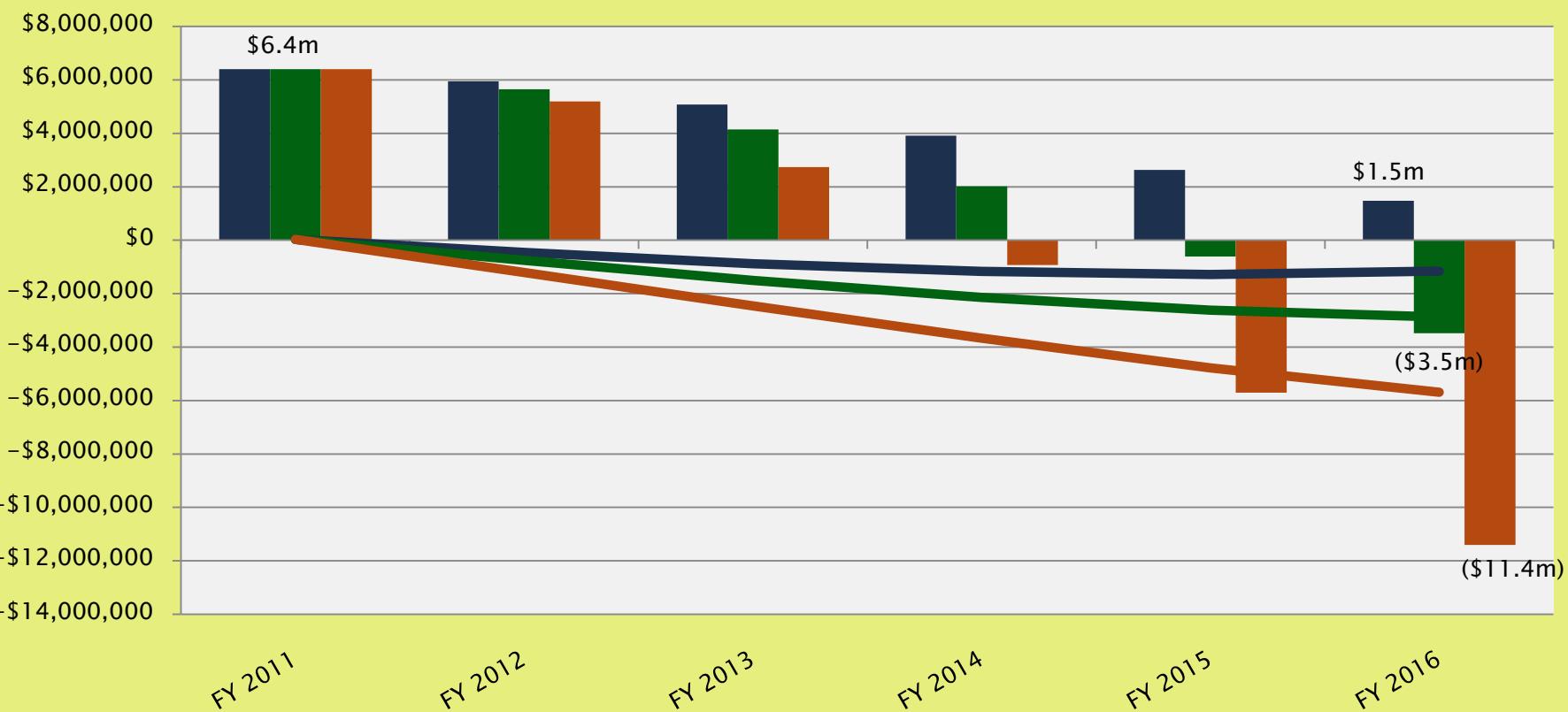


Comparison

Lines = Net Loss

Bars = Reserve Balance

—0% —2% —5%



Putting it in Perspective.....

- ▶ Changes have a **compounding effect**. Making small adjustments now could avoid large adjustments in the future
- ▶ Example – \$2,000,000 is the equivalent of
 - The sales tax revenue from three Super WalMarts, or
 - The sales tax revenue from eighty-two new drug stores, or
 - The property tax revenue from a 24% increase in Assessed Value, or
 - A 10% cut in expenses in all General Fund departments



Long-term Plan Summary

- ▶ It is a five-year projection of revenues and expenses used to evaluate the City's future financial condition
- ▶ It focuses on the General Fund due to the instability of its revenues
- ▶ **Net Loss** is projected beginning in FY 2012
- ▶ The budget can be temporarily “balanced” with **Reserve Funds**

Reserve Funds



Reserve Funds Most Common to California Cities

General Fund Economic Uncertainty Reserve – allows for the continuation of services

- Economic downturns
- Local emergencies
- Natural disasters
- Fiscal emergency such as the loss of a major revenue source
- Generates Interest Income
- Cash Flow Requirements
- In Hanford – provides a source of \$\$ for RDA to borrow from (saves RDA money and generates interest income for the General Fund)

▶ **Capital Asset Reserve** provides for capital needs

- Capital asset and infrastructure emergency repair and replacement
- Scheduled capital expenses with no other funding source

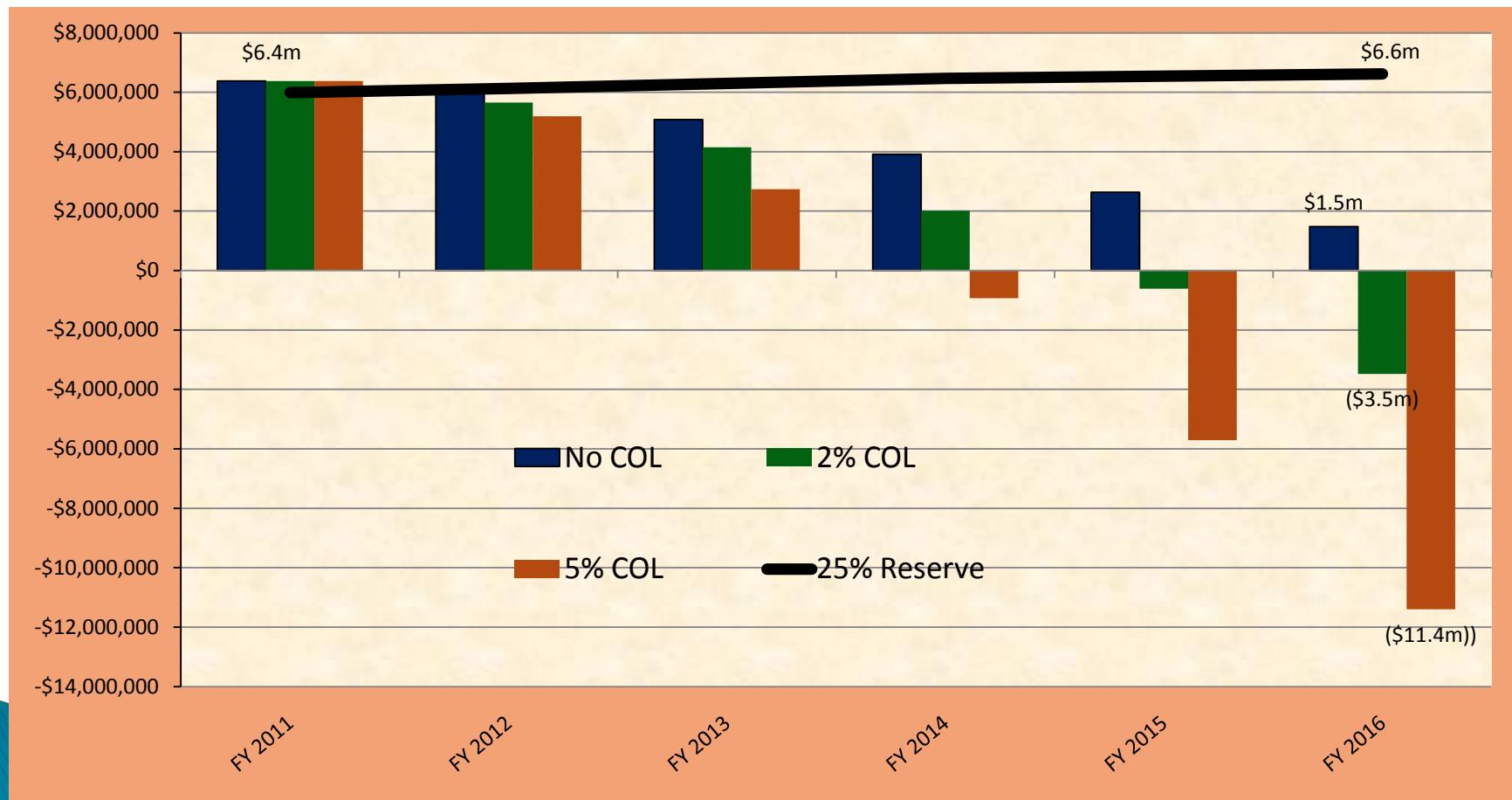
Background Information

- ▶ General Fund reserves are generally based on a percentage of recurring annual expenses
- ▶ Reserve amounts are adjusted annually, usually during the budget process
- ▶ GFOA recommends a 8%-17% General Fund reserve
 - Small cities with a less diversified tax base should be at the higher end
 - Most California Cities 20%-30%
- ▶ Capital Reserve based on Council preference

City of Hanford Reserve Funds

- ▶ **General Fund Reserve = \$6.4 million**
 - \$1.9 million – General Fund
 - \$3.5 million – PERS Retirement Reserve
 - \$1.0 million – Aquatic Reserve
 - \$6.4 million
- ▶ **Accumulated Capital Outlay (ACO) = \$6.7 million**
- ▶ These reserve funds were funded with General Fund net income
- ▶ There are no restrictions on how this money is spent

Using General Fund Reserves to Cover Net Losses



ACO Reserves

- ▶ Money was set aside to pay for capital projects that could not be funded from any other source
- ▶ \$6.7 million working capital available
- ▶ This is a buildup of funds over time. Projections show no additions to this reserve
- ▶ This money is not restricted. Can be used for:
 - Capital Projects
 - Augment General Fund revenues
- ▶ Currently \$15.7 million in identified capital projects that will require ACO funding (6yr CIP 2012-2016)

Capital Projects

- ▶ Not Included in the Cash Flow Model
- ▶ Funding Source is the General Fund
- ▶ \$ 4 million+ Facility Improvements
- ▶ \$11 million+ Street, Park, Bridge Projects
- ▶ Long-term Funding Required
- ▶ \$ 6 million New Fire Station 3
 - (estimated operating costs of \$1 million per year)
- ▶ \$15 million New Police Station
 - Should the City build – Debt Service paid from General Fund or Impact Fees

Reserves Summary

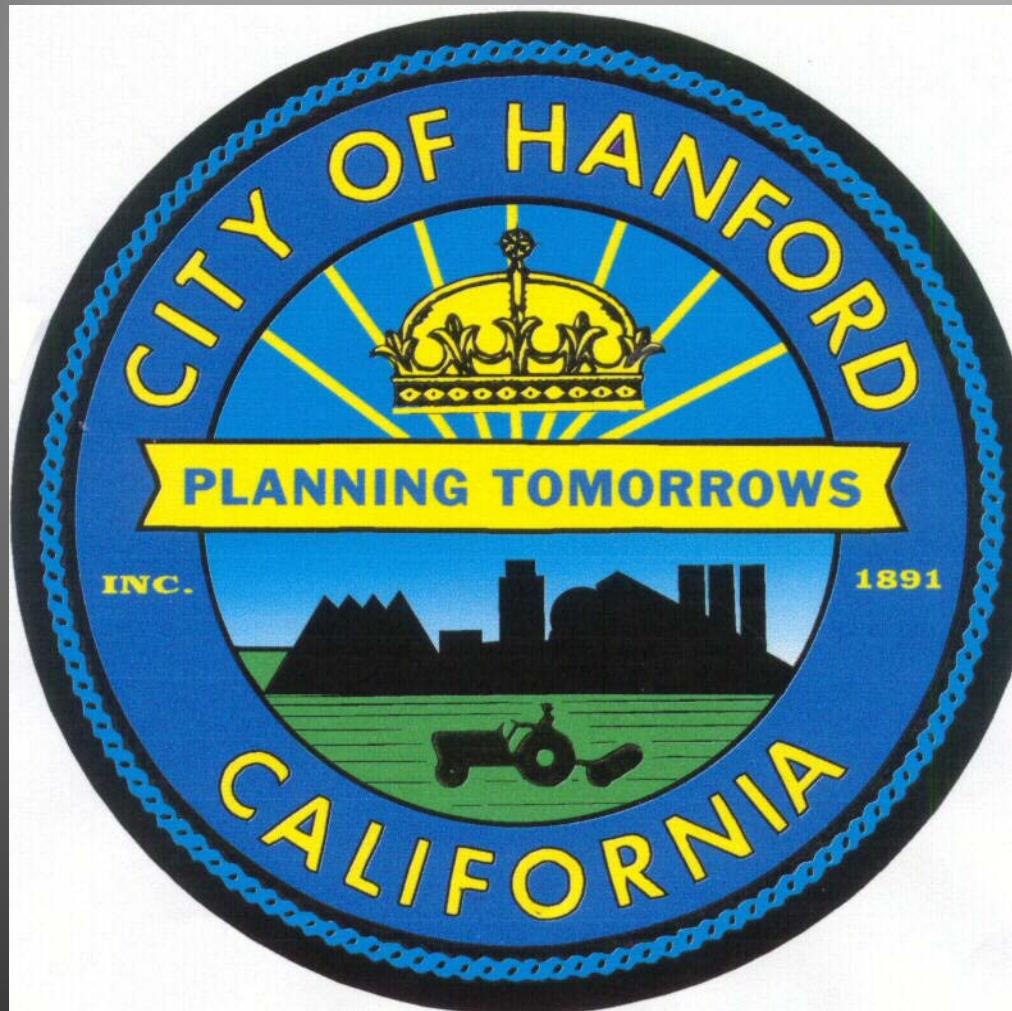
- ▶ Reserves help ensure the City can continue to deliver essential services when unknown circumstances arise

Hanford Reserves

General Fund – \$6.4 million
ACO – \$6.7 million

- ▶ Current General Fund reserve is **not adequate** to cover projected net losses
- ▶ Current ACO reserve is **not adequate** to cover identified projects

FINANCIAL POLICIES



Financial Policies

- ▶ Establishing prudent financial policies is important to ensure the long-term financial health of the City
- ▶ Provides guidelines for Council and staff
- ▶ Currently there are no formal financial policies
- ▶ Informal reserve policy = \$1.5m working capital in General Fund

Sample Policies (1 of 3)

- ▶ General Fund will maintain a X0% reserve for economic uncertainties
- ▶ General fund will maintain \$X,000,000 for emergency or unforeseen capital expenses
- ▶ The City shall maintain a balanced budget.
- ▶ Normal revenue inflation/growth will pay normal inflation/growth in expenses
- ▶ Enterprise and Internal Service Funds will have sufficient revenues to meet all operating, depreciation, reserves, and debt coverage.

Sample Policies (2 of 3)

- ▶ Appropriate reserves will be maintained for Liability and Workers Comp Insurance funds
- ▶ The City will maintain a long-range fiscal perspective through the use of an annual operating budget, a five-year capital improvement plan, and a five-year financial forecast.
- ▶ The City will use long-term financing or cash accumulated in excess of policy requirements for major capital improvements and acquisitions.
- ▶ One-time revenues will only be used for one-time expenses.

Sample Policies (3 of 3)

- ▶ The City will issue bonds or incur other types of indebtedness only if the debt service does not effect the City's ability to meet future operating, capital and reserve requirements
- ▶ The City will comply with all requirements of "Generally Accepted Accounting Principles"
- ▶ The City will strive to maintain a diversified and stable revenue base

Summary – It's The Economy

- ▶ Financial Planning will help to identify a strategy to maintain acceptable levels of service, create a prudent level of reserves, and fund a maximum level of capital projects
- ▶ Projected General Fund Losses can be eliminated with minimal organizational impact by beginning the financial planning process now
- ▶ Leadership and Team Work required



Next Steps

- ▶ Appoint an ad hoc committee to work with the City Manager and support staff
- ▶ Committee tasks include
 - Review the **long-term plan** and make budget adjustment recommendations to Council
 - Determine **reserve requirements** and make recommendations to Council
 - Review and recommend formal **financial policies** for Council's approval