City Council Staff Report

January 22, 2019

ITEM

Staff Report: Fiscal Year 2018 and 1st Quarter Fiscal Year 2019 Budget Review

BACKGROUND

As part of the City of National City's Strategic Plan objective to provide consistent financial reports, this staff report to City Council presents an update on the City's financial operations for fiscal year 2018 and the first quarter of fiscal year 2019.

DISCUSSION

Budgets are projections based on known and anticipated future revenues and expenditures. Throughout the year, staff monitor and analyze revenue and expenditures, develop projections, and provide periodic financial reports to the City Council, City Manager, and department directors. The totals presented herein for fiscal year 2018 are a summary of the actual revenues and expenditures, and their impact on fund balance compared to the corresponding budgeted amounts for the year. The fiscal year 2019 first quarter data reflects revenue and expenditure totals for the period of July 1st through September 30th compared to the same period for the prior year.

Fiscal Year 2018

The fiscal year 2018 budget authorized a $4.5 million use of general fund unassigned fund balance, $3.6 million of which was for operations (structural deficit) and $0.9 million for capital projects. Subsequent to budget adoption, City Council approved additional uses of unassigned fund balance, which brought the year-end total to $5.5 million. Although an overall use of $5.5 million was authorized, a combination of overall cost savings and unanticipated revenues resulted in an actual increase to unassigned fund balance of $0.8 million. The variances between budgeted and actual revenues and expenditures and the impacts on fund balance are summarized below.

Revenues

The City receives revenues from various sources, some of which, such as taxes and fees, provide unrestricted cash that may be used at the City's discretion. Other revenues are reserved for specified purposes, for example, grant funds received for capital projects. Actual general fund revenues for fiscal year 2018, listed by source in the table below, were less than their combined budgeted total by approximately $4.6 million.

Fiscal Year-End Revenue Totals

Revenue Source	Actual	Adjusted Budget[1]	Variance
Sales & Use Tax	$ 18,141,269	$ 18,627,564	$ (486,295)
District Transactions & Use Tax	11,787,204	11,507,650	279,554
Property Tax[2]	2,115,739	2,089,761	(25,978)
Property Tax in Lieu of VLF	6,425,372	6,220,229	205,143
Other Revenues	16,344,543	20,923,274	(4,578,731)
Total	**$ 54,814,127**	**$ 59,368,478**	**$ (4,554,352)**

[1] adopted budget, plus budget adjustments
[2] reflects reduction for property tax allocation to the Library and Parks Maintenance funds

Sales & use tax and district transactions & use tax revenues for fiscal year 2018 exceeded that of fiscal year 2017. However, sales & use tax revenue had a negative variance of $486,295 when compared to budget, with receipts in the autos & transportation and general consumer goods sectors falling short of expectations. The district transactions & use (“Prop ‘D’”) tax revenues brought in $279,554 more than budgeted, due to gains in nearly all sectors. In both cases, total revenues for the year were impacted by the State’s transition to a new sales tax reporting system last spring, which delayed processing of payments statewide. The delayed payments from fiscal year 2018 will be recognized as revenue in fiscal year 2019.

Property tax in lieu of VLF (vehicle license fee) revenue ended the year 3.3% above its budgeted amount. This revenue, which is tied directly to the annual reported change in assessed value, has consistently climbed over the past five years.

The “Other Revenues” category includes various accounts related to ongoing City operations, one-time events, and capital projects reimbursements. The negative variance of $4.6 million in this category is the net result of variances, both positive and negative, across multiple accounts. Significant components include the following unbudgeted or over-/under-realized revenues:

- $5.5 million in revenue from the issuance of the Clean Energy Resource Bonds for the Energy Savings Project was budgeted as revenue but, instead, was recognized as a transfer-in to the General Fund and, thus, was not included in the actuals totals above.
- $4.8 million in revenue was added to the 2017 budget as an offset to an equal amount of additional appropriations for the Westside Infill Transit-Oriented Development (“WI-TOD”) improvements capital project. In accordance with generally accepted accounting principles, these revenues are recognized as the project money is spent. During fiscal year 2017, $0.1 million was spent and recorded as revenue. Because revenue directly related to capital projects is not automatically carried forward as appropriations are, revenues for this project were not budget for fiscal year 2018. However, $1.3 million was realized, matching the amount that was spent on the project. The remaining balance

of $3.4 million in deferred revenue will continue to be recognized as expenses are incurred.

- $2.0 million in revenue was budgeted in fiscal year 2018 to offset an equal amount of additional appropriations for the Paradise Creek Park Site Remediation project. However, no expenditures occurred for this project and, therefore, no revenues were realized. This project has been carried forward to fiscal year 2019 with the revenue being classified as deferred.
- Investment-related earnings exceeded budgeted amounts by $0.3 million; and
- Overtime reimbursements for the Fire Department's strike team's participation in fighting various wildfires throughout the State exceeded the budget by $0.3 million.

Expenditures

As of June 30, 2018, General Fund expenditures totaled $57.6 million, $12.7 million less than the adjusted budget of $70.3 million. Expenditure variances are summarized by category in the table below. The most significant variance, $9.3 million, occurred in the capital projects category. This $9.3 million does not represent savings. Rather, it is the sum of as yet unspent monies on specifically authorized capital projects, the largest amounts being $2.2 million for the Energy Savings Project, $3.4 million for the WI-TOD park project, and $2.0 million for the Paradise Creek Park Remediation project. As is practice, the unspent capital project appropriations have been carried over on a project-by-project basis to fiscal year 2019.

Fiscal Year-End Expenditure Totals

Expenditure Type	**Actual**	**Adjusted Budget**[1]	**Variance**
Personnel Services	$ 35,805,541	$ 37,877,047	$ 2,071,506
Maintenance & Operations	6,410,289	7,703,438	1,293,151
Capital Projects	7,347,994	16,645,083	9,297,089
Internal Service Charges	7,990,539	8,031,978	41,439
Total[2]	**$ 57,554,360**	**$ 70,257,546**	**$ 12,703,186**

[1] adopted budget total, plus budget amendments, encumbrances, & capital projects appropriations carried forward from previous fiscal year(s)

Personnel cost savings of $2.1 million were primarily due to budgeted vacant positions. As part of the fiscal year 2019 budget development process, all positions in the budget system were reviewed and reconciled to authorized position records, resulting in a reduction in the number of positions included in the fiscal year 2019 budget projections. Consequently, the amount of savings in personnel related to vacant positions seen in fiscal year 2018is not expected to be repeated in fiscal year 2019.

Maintenance & Operations ("M&O") savings of $1.3 million were realized across various accounts but particularly in Professional Services; Contract Services; and Refunds, Contributions, & Special Payments. Under Refunds, Contribution, & Special Payments, savings occurred in the Westside Amortization and Successor Agency Property Management accounts.

Transfers In/Out

While technically not revenues and expenditures (and, hence, not shown above), transfers in and out of the General Fund contribute to fund balance increases and decreases, respectively. Actual transfers in exceeded the budgeted amount by $6.5 million. (See Fund Balance Change table below.) Of that amount, $5.5 million was due to the transfer of bond proceeds from the National City Joint Powers Financing Authority to the City to fund the cost of the Energy Savings Project. As noted above in the discussion of revenues, the bond proceeds were originally budgeted as a revenue instead of a transfer in. The remaining $1.0 million pertains to the contribution to the City's irrevocable supplemental pension trust which was incorporated into the fiscal year 2018 adopted budget. The budget established a separate fund to account for these monies; however, on the advice of the City's independent auditors, the $1.0 million was transferred to the General Fund, where it is now classified as assigned fund balance.

Transfers out from the General Fund were under budget by $1.1 million. (See Fund Balance Change table below.) The Library, Parks Maintenance, and Nutrition Center funds required a combined $730,000 less in subsidies from the General Fund than originally budgeted. In addition, the planned transfer of $363,286 to the Facilities Maintenance Fund for the first payment on the Energy Project bonds was instead, on the advice of the independent auditors, reflected as a debt service payment directly from the General Fund.

Net Impact on Overall Fund Balance

The table below combines the above revenue and expenditure tables and incorporates the transfers in and transfers out, to compare the adjusted budget's impact on fund balance to the actual impact on fund balance. Actual fiscal year 2018 revenues, expenditures, and transfers resulted in an estimated increase of $1.7 million in the overall fund balance of the General Fund, as compared to the adjusted budgeted usage of $14.0 million. This variance is primarily due to the unspent capital projects appropriations and operational (personnel and M&O) savings discussed above. As discussed further below, fund balance is divided into five categories, non-spendable, restricted, committed, assigned, and unassigned.

Fund Balance Change – Actual vs Budget (Estimated)

	Actual	Adjusted	Variance
Revenues	$ 54,814,127	$ 59,368,478	$ (4,554,352)
Transfers In	6,780,465	256,863	6,523,602
Total Revenues & Transfers In	**$ 61,594,592**	**$ 59,625,341**	**$ 1,969,250**
Expenditures	$ 57,554,360	$ 70,257,546	$ 12,703,186
Transfers Out	2,323,517	3,416,803	1,093,286
Total Expenditures & Transfers Out	**$ 59,877,877**	**$ 73,674,349**	**$ 13,796,472**
Fund Balance Gain/(Usage)	**$ 1,716,714**	**$ (14,049,008)**	
Beginning Fund Balance	**$ 48,394,090**	**$ 48,394,090**	
Ending Fund Balance	**$ 50,110,898**	**$ 34,345,082**	

In accordance with Governmental Accounting Standards Board ("GASB") Statement Number 54, fund balance is classified into the aforementioned categories based primarily on the extent to which its use of resources is constrained. The table below reflects the estimated changes in each category of fund balance within the General Fund from June 30, 2017 to June 30, 2018. The balances are dependent not only upon the results of operations, i.e., revenues and expenditures, but also upon changes in such things as liabilities accrued for employee benefits and unspent appropriations carried over to the succeeding fiscal year.

Components of Fund Balance (Estimated)

	FY 18	FY 17	Change
Non-spendable	$ 9,996,729	$ 9,963,816	$ 2,913
Restricted	555,168	616,253	(61,085)
Committed	11,085,066	11,585,066	(500,000)
Assigned	15,772,642	14,325,683	1,446,959
Unassigned	12,731,293	11,903,272	828,021
Total	**$ 50,110,898**	**$ 48,394,090**	**$ 1,716,808**

Summary of fund balance changes by category:

Non-spendable – fund balance representing assets which are not in spendable form. The increase in non-spendable was a result of gains in inventory and prepaid expense.

Restricted – category with spending constraints stipulated either "externally" by the provider of the assets or by law. For the City, the primary purpose of this category is to reserve an amount of fund balance equivalent to the subsequent fiscal year's debt service requirement. The $0.1 million decrease is attributable to a decrease in debt service requirements.

Committed – total of resources which have internally imposed restrictions mandated by formal action of the City Council. This category comprises the City's $9.1 million Economic Contingency Reserve and the $2.5 million Facilities Maintenance Reserve. During fiscal year 2018, Council approved the use of $0.5 million of the Facilities Maintenance Reserve for Tier 1 Capital Projects.

Assigned – assets constrained by the Council's intent that they be used for specific purposes but not meeting the more strict criteria for classification as restricted or committed. Of the $15.8 million total, approximately $10.5 million represents employee benefit liabilities and $4.2 million represents designated, but as yet unspent, amounts for capital projects carried forward from the prior year. The difference between the $4.1 million of assigned fund balance attributable to unspent capital projects appropriations and the $9.3 million budgeted but not spent on capital projects noted earlier in this report is $3.4 million in appropriations for the WI-TOD project and $2.0 million for the Paradise Creek Park Remediation, which, due to accounting rules, does not result in the reservation of fund balance, because they are offset with corresponding deferred revenues.

Unassigned – total of spendable amounts not allocated to the other fund balance categories and which is available for use at Council's discretion. Unassigned fund balance, which is estimated to have increased by $0.8 million, benefitted not only from the operational savings and better than anticipated revenues discussed above, but also from a decrease in employee benefit liabilities and debt service requirements. This $0.8 million increase compares favorably to the anticipated use of $5.5 million of unassigned fund balance in the fiscal year 2018 adjusted budget.

1st Quarter Fiscal Year 2019

The fiscal year 2019 adopted budget authorizes a use of General Fund unassigned fund balance of $4.3 million, $1.0 million of which is for capital projects and $3.3 million for operations. Since it is early in the fiscal year, the ability to project year-end revenue and expenditure totals and actual use of fund balance is limited. The most useful information at the end of the first quarter (July 1st through September 30th) is a comparison of the fiscal-year-to-date totals of the City's major revenue sources and expenditure categories for the period for the current and prior fiscal years. This information is summarized in the tables below.

Revenues

1st Quarter Revenue Comparison

Revenue Source	**FY 19**	**FY 18**
Sales & Use Tax	$ 1,626,387	$ 1,722,627
District Transactions & Use Tax	975,071	1,118,708
Property Tax	80,022	86,556
Property Tax in Lieu of VLF	-	-
Other Revenues	1,728,600	7,278,756.38
Total	**$ 4,410,080**	**10,206,647**

The sales & use tax and district transactions & use tax revenue amounts shown are those distributed to the City by the State in September. Fiscal year 2019 sales & use tax and district transaction & use tax revenues are slightly lower than fiscal year 2018, but are believed to be lagging because of the State's new reporting system.

Fiscal year 2019 property tax revenue is slightly lower than that of fiscal year 2018 quarter largely due to a decrease in supplemental roll property taxes. While the revenue is low for both years, this is normal at this point of the year, as the largest portions of property tax revenues are typically received in December and April, corresponding to tax payment due dates.

Because the distribution of property tax in lieu of VLF revenue occurs in January and May, no allocation of this revenue was received in the first quarter of the current or previous fiscal year. However, having received information from the County regarding fiscal year 2019 distributions of property tax in lieu of VLF, staff can report that this revenue will be $6,681,226, $19,562 above budget.

The significant decrease to other revenues compared to fiscal year 2017 is that fiscal year 2017 included the receipt of Clean Energy Revenue Bond proceeds of $5.5 million (later reclassified to a transfer in) to fund the cost of the Energy Services Agreement with Ameresco for the Energy Savings Project.

Expenditures

1st Quarter Expenditure Comparison

Expenditure Type	**FY 19**	**FY 18**
Personnel Services	$ 12,691,835	$ 10,411,876
Maintenance & Operations (M&O)	627,375	1,078,514
Capital Projects	546,761	695,366
Internal Service Charges	1,885,386	2,007,806
Total	**$ 15,751,358**	**$ 14,193,564**

Personnel costs are greater than fiscal year 2018's at the same point, due in part to the one-time lump-sum prepayment of $5.8 million in July for the fiscal year 2019 unfunded actuarial accrued liability ("UAAL") portion of the City's annual pension contribution compared to $4.9 million paid in July 2017 for fiscal year 2018 and higher normal cost contribution rates. Overtime costs in the first quarter are also above last year's amount, with the bulk of the overtime occurring in the Fire Department related to Strike Team activities, the cost of which will be offset by revenues from the State.

Fiscal-year-to-date 2019 M&O expenditures are lower than fiscal year 2018, principally due to the final $0.5 million Police Facility lease payment, which occurred in fiscal year 2018. Absent the lease payment, M&O expenditures are higher than those for the first quarter of last fiscal year, primarily due to charges under Professional Services.

Budgetary Outlook

The fiscal year 2019 planned use of General Fund unassigned fund balance is $4.3 million. The mid-year budget status report will include projections to year-end for revenues and expenditures and their combined estimated impact on unassigned fund balance.

Conclusion

While the City's general fund experienced an increase in fund balance in fiscal year 2018, this experience does not demonstrate a trend. The greatest contributors to the increase in fund balance were personnel vacancy savings, maintenance and operations savings and reduced requirements for operating subsidies for other funds. The budget for fiscal year 2019 included significant tightening in these accounts, so the same level of savings is not likely to occur.

Factors likely to affect fund balance in the future include the following:

- Actuarial adjustments by the California Public Retirement System (CalPERS) are expected to require increases in the City's employer contribution to employee pension funds into the foreseeable future. For fiscal year 2020, the City's contribution is estimated to increase over the fiscal year 2019 rate by 6.2%, from 30.235% of payroll to 32.104% of payroll, for miscellaneous employees and by 6.6%, from 50.472% of payroll to 53.803% of payroll, for public safety employees. These increases are currently estimated to accelerate pension contribution growth in the next fiscal year by an additional $1.6 million.
- An assessment of the City's deferred infrastructure, facilities maintenance, and historic and cultural assets determined the cost to the General Fund to complete all of the recommended maintenance would be at least $30 million; therefore, staff is continuing to analyze various options for scheduling and financing these projects.
- The City is currently in labor negotiations with its represented labor groups. The result of such negotiations will impact the fund balance.

RECOMMENDATION

Accept and file this staff report.