TRACY CITY COUNCIL	SPECIAL MEETING MINUTES
February 15, 2011, 5:30 p.m.	
City Council Chambers, 333 Civic Center Plaza	*Web Site: www.ci.tracy.ca.us*

1. Call to Order - Mayor Ives called the special meeting of the Tracy City Council to order at 5:47 p.m.

2. Roll Call - Roll call found Council Members Abercrombie, Elliott, Rickman, Mayor Pro Tem Maciel and Mayor Ives present.

3. Items from the Audience - None.

4. CONDUCT A CITY COUNCIL WORKSHOP REGARDING CITY FISCAL ISSUES INCLUDING FY 10-11 CITY OPERATING BUDGET, 5-YEAR GENERAL FUND PROJECTION, AND PROVIDE DIRECTION TO STAFF REGARDING POLICY UPDATES TO RESERVE LEVELS AND BALANCED BUDGETS – Leon Churchill, City Manager, stated this would be the first of two, or possibly more workshops to be held over the next few weeks during which the City's strategies and priorities would be shaped for the foreseeable future. Mr. Churchill introduced Zane Johnston, Director of Finance and Administrative Services, who utilized a power point in his presentation.

   Mr. Johnston began by thanking Allan Borwick, Budget Officer, for the long hours and extraordinary effort he had contributed into putting together the City's financial statements. Mr. Johnston stated the City had won a FY 10-11 Government Finance Officers Association award for distinguished budgeting for the 23rd year in a row. In addition, only five cities in California have won more CAFRA awards than Tracy.

   Mr. Johnston stated the Council would discuss a variety of fiscal issues facing the City including a mid-year review of the FY 10-11 General Fund, a fiscal projection of where the City will be during the next five years, how the City might deal with challenges which might arise in the next five years, and some budget and fiscal policy considerations.

   FY 10-11 GENERAL FUND BUDGET AND CURRENT FISCAL POSITION - The City's General Fund Balance as of 6/30/10 was $18,985,106. Additionally, the City had $10,550,972 in the Reserve for Economic Uncertainty Fund for a total of $29.5 million in reserves as of 6/30/10. The City's adopted FY 09-10 General Fund budget was $53.8 million. Due to previous budget reduction and reorganization actions the City's FY 10-11 budget was reduced to $47.2 million. Even so, the FY 10-11 adopted budget anticipated a budget shortfall of $4.8 million as revenues were only expected to be $42.4 million. The budget shortfall would be drawn from the reserves. The mid-year budget review of FY 10-11 has been completed (see Exhibit A to the staff report). Total revenues for the year are expected to be $42,204,190 and expenses are projected to be $47,386,250. As such, the FY 10-11 deficit will total $5,182,000 which is more than the original deficit of $4,813,000 anticipated with adoption of the FY 10-11 budget.

The following explanation of revenues and expenditures will identify the combination of factors resulting in this greater than anticipated deficit.

Revenues - the amount of expected property taxes is 99.6% of the budget estimate. Measure E sales tax revenue will begin on April 1, 2011. As such there will be one quarter of Measure E sales tax that will be posted to FY 10-11. The budget did not include any revenue from Measure E. Sales tax was projected to be $9.4 million but will likely be $10.5 million due to the posting of one quarter (April to June 2011) Measure E sales tax revenue. Although there will be an extra $1.1 million in sales tax in FY 10-11 overall General Fund revenues are approximately $260,000 less than budget. There are several other General Fund revenue line items that are tracking at much less than budget estimates. Most notably engineering charges, cultural arts fee revenue, and CIP charges. Engineering charges were budgeted at $1,195,700, but are estimated to be $930,500 due to less activity in this area than assumed. CIP project management charges are paid by City capital projects to the General Fund as reimbursements and overhead charges for City and consultant staff efforts devoted to such projects. The amount charged varies depending on the progress made and staff and consultant efforts in terms of design, inspection, and program management. $3,621,000 was budgeted for these charges in FY 10-11 but the mid-year analysis indicates that $2,667,000 is likely to result from these charges. This less than expected revenue is due to a combination of factors. Also CIP staff has become more efficient which has a consequence of the City not charging overhead to consultant assistance as much as in previous years. In addition, there are currently slightly fewer CIP projects plus the earlier advancement of some projects (as part of the City's efforts stimulate the local economy) which skewed the number higher than can most likely be maintained in the current economic environment. For FY 10-11 Cultural Arts revenues were budgeted at $337,780 but are now projected to be $170,000. The economy has hurt the Arts Education Program as well as program offerings in the theatre as families have less money to spend on entertainment. 80% of seasonal rentals occur in the third and fourth quarters of this fiscal year so some ground should be made up in overall revenues. The very popular Arts Camps are also scheduled for fourth quarter.

Expenditures - Total expenses are expected to be about $108,000 more than budget. However, Police and Fire are on target to spend 100% of their budgets without any savings although other departments are operating with significant savings. With the adoption of the budget it was anticipated that City-wide not 100% of every line item budget would be spent. While it cannot be predicted in which department these savings would fall, it was expected savings City-wide would total $1.4 million. This offset was deducted from the overall operating budget. At present it is anticipated that these savings will total about $1.3 million. As line item discretionary budgets have been previously cut by as much as 55%, departments are skimming by with little unspent funds remaining in their expense budgets. Also, budget savings often resulted when employees terminated and before their replacements were hired. But due to the economy, attrition (vacancy) has slowed.

Reserves at 6/30/11 - With an estimated draw on reserves of $5.1 million for FY 10-11 remaining reserves as of 6/30/11 would be approximately $24.3 million. Although the $24.3 million in remaining funds represents a healthy 52% of General Fund Operating expenses, a continued draw on reserves in the range of $5 million a year would exhaust the City of necessary reserves within several years.

FIVE–YEAR BUDGET AND FISCAL PROJECTION - Revenues are expected to grow slightly as the economy continues a slow recovery. The big boost in revenues comes from additional Measure E revenue. With these considerations, General Fund revenues are expected to grow from the current $42.2 million to $52.3 million by FY 15/16. During the same period however, expenditures are projected to increase from $47.3 million to $55.6 million. This will result in continued annual budget deficits of approximately $4 million which has been identified as the City's structural deficit. Should this occur at the end of the five-year projection period the City would have only $8.4 million remaining in total reserves (the Economic Uncertainty Fund would be completely exhausted and the General Fund would have a balance of just $8.4 million). Measure E was projected to bring in approximately $4.6 million per year which would plug the structural deficit and enable the City to continue to offer the current level of services. In order for this to occur, the current cost of those services cannot exceed the modest growth rate in revenues, otherwise no progress is ever made toward balancing the budget. And along the way, the annual budget deficits would eat way at the City's reserves. There are several factors that contribute to increased expenses for the current level of service.

PERS Employer Rate - The huge investment losses in the stock market and real estate in 2008 and 2009 also had a dramatic effect on CalPERS investments. Due to the normal actuarial processes, these losses were included in the actuarial completed in October 2010. This actuarial becomes the basis for the July 1, 2011 CalPERS employer rate. This is the rate the City pays as an employer to fund its account with CalPERS for employee retirement. The employer rate for police and fire will jump from about 24% to 27.2%, and the employer rate for all other employees will jump from 11.6% to 13.8%. In addition to the investment loses these rates reflect actuarial demographic changes – most notably an increase in life expectancy. The additional cost due to the employer rate increase in FY 11-12 will cost the City $2.8 million in the General Fund ($3.2 million in all funds). The FY 11-12 increase will likely be the first of three successive years in which the PERS employer rate will increase. The FY 08-09 investment losses by PERS have been isolated into a three year smoothing process to begin with the FY 11-12 rate. The actual investment losses in FY 08-09 were a negative 24%, a swing of a negative 31.75% from an actuarial perspective because positive earnings of 7.75% are assumed by the actuaries as an annual rate of return. While the PERS investment returns of late have been excellent, these would have to experience a prolonged period of double digit returns to offset the FY 08-09 actual losses. The 5-year budget forecast has the estimated employer PERS rate as identified by PERS for the City for the next three years as follows:

Plan	FY 11-12	FY 12-13	FY 13-14
Public Safety	+3.2%	+.5%	+2.0%
Misc. Employees	+2.8%	+.3%	+1.4%

In addition, the PERS Board is considering a change in the actuarial assumption for investment return from the current 7.75% to 7.5%. If this change is adopted it would become effective with the FY 12-13 employer rate. The effect of this change for the public safety employer rate is estimated to be an additional 3% to 5% and an estimated additional 1.5% to 3% for miscellaneous employees. The employer rate for the public safety (police and fire) group is increasing faster than the rate for miscellaneous employees basically due to the fact that employees in public safety are mostly male. This is of critical importance because 80% of General Fund taxes are spent on public safety.

Other provisions in labor contracts - Health insurance costs also continue to rise. Current labor contract provisions place 85% of any such cost increases as the City's responsibility. These escalating costs are also factored into the 5-year analysis. A variety of other labor contract provisions can result in additional expenses each year. No current contracts call for any additional across the board wage increases. But employees not currently at E step (the last step of 5 wage steps each 5% apart) can continue to advance to the next step annually until they reach E step. While all employees except Police have taken unpaid furloughs or contribute to pension costs ranging from 3% to 4.5% those employees not yet at E step can actually experience a salary increase of the net between their 5% step increase and the offsetting furlough. Police Officers not yet at E step receive a full 5% because they do not have any unpaid furlough. As a result, the financial benefit to the City of employees taking unpaid furloughs is borne entirely by non-police City employees at E step. Education and training incentives in the current police and fire contracts can also add to expenses each year. The City offers a 5% pay incentive to fire personnel who have obtained an AA or AS degree (completion of junior college) in Fire Science. Police are offered a similar 5% incentive for a degree in Police Administration. Police can also receive successive 2.5% increases for obtaining certain POST certificates. The increase of as much as a 15% for officers qualifying for designation as Master Patrol Officer has also resulted in additional expenses.

Additional Community Priorities - The 5-year budget forecast only continues the budget priorities of FY 10-11. No additional programs, services or efforts are added in the 5-year horizon. However, community needs may result in additional expenses. An example of this may be an additional expenditure to address the issue of gangs. If such expenditure is added to the FY 10-11 budget as proposed and is an ongoing expense each year, then the figures in the 5-year forecast become more negative resulting in continued budget deficits.

HOW TO ADDRESS THE ONGOING BUDGET CHALLENGES - Measure E revenue has assisted the City in not having to take draconian actions which could have significant impact on the quality of life in Tracy. But with ongoing fiscal pressure to fund services at the existing level, the City will face continued fiscal challenges. In order to meet these challenges there are a variety of options to consider. The ultimate solution to long term and sustainable fiscal health may be some, all, or a combination of the following.

New labor contracts - The current contracts with the Teamsters Union and the Fire Union expire on 6/30/11. The contract with the Police Union expires on 6/30/12. Most unrepresented employee group contracts expire in June. The issue of increasing benefit costs will need to be addressed. A second tier retirement formula has been put into effect for the Teamsters (and all miscellaneous City employees) and for Police. This assists with long term (i.e.10 years or more) efforts to reduce benefit costs. Since both State law and a variety of judicial case law prevent the elimination of retirement benefits for existing employees, the focus of collective bargaining should be on who should pay for such benefits. Also, the City will need to examine its long term fiscal resources in setting wages for new employees. With attrition the City could migrate to lower costs over time without ongoing annual salary concessions which have been the source of much contention in other communities. Until new contracts are executed, it is not possible to identify potential savings from the current 5-year budget projection. In future Fire contracts not only will the City's continued fiscal situation need to be considered but also the fiscal condition of the City's partners in fire service, Tracy Rural Fire District and the Mountain House Community Service District.

Contracting of services - The City has recently moved to contracting out for janitorial and tree trimming services. Additional areas for contracting out of services where such services are readily available in the private sector for a lower price and of equal quality will need to be examined for potential savings.

Continued change to the City's organizational structure - The City has already reduced its work force from 560 FTE to 470. This reduction was the result of a strategic effort to maintain services while at the same time reducing the number of City positions. Specific targets of this approach were to compact layers of management, eliminate duplication of services, contract out services and invest in and utilize technology. While efforts were made to minimize layoffs, this approach did necessitate the City issuing pink slips. It will be necessary to continue to examine the organizational structure of the City and make changes where appropriate. It is anticipated that such changes can be made without the need for layoffs providing sufficient time is offered for attrition and by using targeted retirement incentives. Whereas the previous reorganization (or "right-sizing") was implemented within a short time frame, it is anticipated that additional organizational changes will be continually implemented over the next few years.

Reprioritize existing expenditures - As noted earlier, community needs may shift over time. Such needs often necessitate additional expenditures to address the issue. But this does not mean that such expenditure must always add to the bottom line. Instead, a focus should be made to identify an expenditure offset at the same time consideration is given to the increased expenditure. For example, if additional efforts for gang prevention are deemed necessary, such resources might come from reallocating resources from elsewhere in the Police Department (such as from traffic enforcement) or even from another department.

Elimination or reduction in non-essential services - The City will continue to assess its ability to fund non-essential services such as cultural arts. While efforts have reduced the General Fund subsidy to the Grand Theatre Center for the Arts, the FY 10-11 subsidy remains at $885,000. Similar arguments can be made regarding parks and community services, grounds maintenance, and others. The City could evolve into a public safety only community. However, such a trend would undermine the tenants of Measure E and the real impact on the community's quality of life.

Improved Economy – The 5-year budget forecast anticipates a modest growth in revenues. Because property taxes lag actual reflection in current market conditions it is unlikely that during this 5-year period the City will realize significant growth in this key revenue source even if new home construction begins in calendar year 2012 as allowed under Measure A. However, sales tax is much more elastic. If there is a rebound in the economy and improved consumer spending, the City's sales tax revenue could grow more rapidly than this forecast assumes. In addition, new sales tax producing establishments could add to sales tax revenue. And because of Measure E, this growth could be compounded. While it may not be fiscally prudent to include a greater growth rate in sales tax at this time in the budget forecast, there is potential that this could assist the City on the revenue side of the balance sheet. Such potential will only be known as time goes by and will be periodically examined in order to update budget estimates for this key General Fund revenue source.

Mr. Churchill discussed the City's Budget and Fiscal Policy Considerations. Mr. Churchill stated the organization has done a magnificent job of changing how it does business, including automating, consolidating and contracting out. Mr. Churchill proposed continuing to accelerate how the organization changes and evolves in an employee centric manner. Considerations include how to prepare employees, and whether to manage the transition, and whether to let it happen or to overtly manage it. The City needs to maintain the principles it has adhered to over the last few years. The organization is obsessive about continuous improvement and finding better ways to do business. Next steps include incentives to reshape the turnover. The first step is to ask employees about their future plans so that the reorganization can be put together based on that information. Mr. Churchill asked Council to allow him to pursue this strategy over the next two years, by which time the organization should be reshaped. Mr. Churchill suggested the City has healthy reserves which will allow time to accomplish the reorganization. The goal is $3 million. The estimate received from CalPERS is alarming but the City will respond. Mr. Churchill added that while revenues are beginning to bottom out, and in some cases recover, the City is beginning to be impacted by some third party costs.

BUDGET AND FISCAL POLICY CONSIDERATIONS - City Council Resolution 2009-086 adopted 13 budget principles to address the City's structural budget deficit. Several of these principles need to be examined in light of the most recent 5-year budget analysis to ascertain if they are still a desired course of action. The current "balanced budget" principle states that by the end of FY12/13 a balanced budget must be presented. This means that FY 11/12 would be the last year reserve funds could be used to bridge the gap between revenues and expenditures. A balanced budget is defined in the principles as "ongoing revenues shall equal or exceed ongoing expenditures". The FY 12/13 budget would have to be balanced without using any reserve funds. Due to rising expenses to maintain current staffing, presenting a balanced budget for FY 12/13 would require significant cuts to public safety and other essential services highly desired by the community. It may take additional time to continue to implement a variety of actions that will help the City continue to make progress toward overall reduction in General Fund expenditures while still maintaining acceptable levels of service to the community. These include labor negotiations, contracting services, and continued refinement to the City's organizational structure resulting in fewer positions, reprioritizing current expenditures, and elimination or reduction in non-essential programs. An improved economy may also assist on the revenue side of the ledger. In order to continue to transition to a balanced budget without significant interruption to desired services, it is recommended that this budget principle be amended to allow two additional years for this goal. This means reserves could be used in FY 12/13 and FY 13/14. FY 14/15 would require the budget to be balanced without the use of reserves. In conjunction with this change and to assure the public that the City continues long term prudent fiscal management, it is recommended that the existing 15% reserve level be increased to 25%. This means that if the City adopted a General Fund operating budget of $55 million that $13.25 million would be required in reserves. The reserves at the end of FY 10/11 (June 30, 2011) are projected to be $24.3 million. As such, no more than approximately $11 million could be used in reserves over the next three fiscal years (FY 11/12, 12/13, and 13/14). Increasing the reserve level has the self trigger mechanism of requiring the City stay the course toward a balanced budget with the FY 14/15 budget. An additional budget principle could also be considered which would provide additional fiscal fortitude toward the long term goal of balanced budgets. This requirement would be that anytime additional funds are sought through either a General Fund supplemental appropriation (additional monies after the adoption of the budget for the fiscal year), or through a General Fund augmentation (adding funds to the previous base budget for program expansion, new programs, etc., when the budget is adopted), that such action be accompanied by a corresponding action to reduce the General Fund budget in another area. There is also an existing budget principle that states “beginning in FY 12/13 or when conditions permit, begin building up the Economic Uncertainty Fund.” As noted, this is not realistically possible by FY 12/13. It will be a major accomplishment to get a balanced budget by FY 14/15 let alone add to reserve levels. It was recommended this provision be eliminated because the recommendation to increase reserves to 25% and maintain them should suffice to provide the City with prudent ongoing reserves.

Mr. Churchill referred to Resolution 2009-086 and suggested some revisions are necessary to the current budget principles which show the City reaching a balanced budget in FY 12/13. Mr. Churchill stated he did not believe this would be attainable without extraordinary pain and damage to the organization and to services. Mr. Churchill recommended moving the deadline to FY 14/15. Also, since the economic recovery is uncertain and because of the poor relationship local government, including Tracy, has with the state Mr. Churchill recommended increasing the current 15% minimum reserve to 25%. As far as unexpected expenditures, any time there is a new expenditure there should be a direct response in the form of reduced expenditures elsewhere, or identification of new revenues for the service to be provided. Finally, Mr. Churchill suggested eliminating the principle related to building reserves in FY 12/13.

Mr. Churchill suggested the Council complete a graph indicating their expectations of when revenues should equal expenditures. The second part of the exercise required Council to determine to what level the City’s reserves should be drawn down.

Mayor Ives invited Council to ask questions.

Mayor Ives stated the results of the exercise where not definitive or directional. Mr. Churchill agreed.

Mr. Johnston indicated a $15 million expenditure budget with 25% reserves meant reserves could not go below $12.5 million. Mayor Ives asked why 25% was recommended rather than the standard 15% reserve. Mr. Johnston responded in order to allow for some self correcting since there is a recommendation that the City extend for two years a budget that would have more expenses than revenues.

Mayor Pro Tem Maciel stated maintaining $12.5 million as a 25% reserve against the current reserve allows the City approximately $4 million per year to play with over three years, assuming everything else stays the same.

Council Member Elliott inquired why the City wanted to eliminate the principle regarding building up reserves. Mr. Churchill responded the City cannot build up reserves unless revenues exceed expenditures, and that is not possible in FY 12/13. Mr. Elliott suggested leaving the recommendation as is so that whenever conditions permit reserves could begin to build up. Mr. Johnston suggested eliminating the precise fiscal year, since raising the percentage from 15% to 25% addresses the real impact. Mr. Johnston stated it is unlikely the City would be able to add to the reserve in FY 12/13.

Council Member Elliott stated the City anticipates balancing the budget in FY 12/13 with the help of Measure E. At the end of the five year period the budget will have to be balanced without Measure E. Rather than change that the City ought to balance the budget with Measure E in FY 12/13, or add another year, and then move toward balancing it without Measure E by the time it expires.

Mayor Ives inquired what would be a reasonable assumption related to revenues. Mr. Johnston suggested that Council focus on property tax and sales tax which are expected to increase approximately 3% per year. Property tax is harder to predict. However, sales tax is showing a 4.5% increase this year. Mr. Johnston referred to FY 14/15 when $15.5 million in sales tax is anticipated, minus $5 million for Measure E, leaving $10.5 million. Three years ago the one cent the City receives from sales taxes resulted in $13.5 million for the City. Mr. Johnston stated the figures are conservative.

Mayor Pro Tem Maciel clarified that Measure E would expire at the end of he third quarter of FY 15/16.

Mr. Johnston referred to the results of the exercise which indicated a balanced budget by FY 14/15, meaning expenditures would equal revenues and there would be no further draw on reserves, and the City would still have about 25 percent in reserves.

In response to a question from Mayor Ives related to PERS, Mr. Johnston responded the City had received the PERS employer rate for July 1, 2011, and estimated increases for the next two years. PERS is doing better, but in order to recoup what was lost in 2008 and 2009 PERS would need double digit rate returns for three to five years to reduce the numbers considerably.

Mr. Johnston stated the overall message is that the Council does have time to make changes toward getting the organization to a point where it could continue past FY 15/16. Mayor Pro Tem Maciel suggested that by the time Measure E expires the City should have revenues exceeding expenditures by $4.5 million. Mr. Johnston responded without Measure E it would need to be between $4 and $5 million.

Mr. Churchill gave a breakdown of the results of the exercise completed earlier by the Council and indicated that in general the Council was in consensus regarding when expenditures should equal revenues and how far the City should spend down its reserves.

Mayor Ives indicated he was in favor of getting to the point where the Council could articulate some policies or resolutions relative to the City’s expectations for the future.

Council Member Abercrombie asked if the Council was being unrealistic in setting the expenditure level at $45m when the City’s figures showed $50m. Mr. Johnston responded the largest expense in the General Fund is personnel costs which are relatively unknown. The figure could be more or less depending of what is achievable through negotiations. Mr. Johnston added it is not only how much employees are paid, but how many employees are paid. There is some potential to make organizational changes over time which would result in fewer employees. Mr. Churchill added if $3m is the goal 30 positions need to be obtained over the next two years.

Council Member Rickman asked how much of the City's annual budget comes from investments. Mr. Johnston stated in FY 08/09 the General Fund earned about $3 million in interest. At that time rates were higher and the City had more money in the bank earning interest. Also, in the fall of 2008 the City was able to sell some of its conservative investments at a profit. Since then the amount of earnings has fallen considerably because of the amount that is being drawn down. In addition, the City is limited by state law as to what it can invest in, and the rate of return on those investments has fallen from 4% to a little over 2%.

Council Member Elliott reiterated that to meet a deficit of $3 million would take a reduction of 30 employees and inquired if that was the only way to eliminate the deficit. Mr. Churchill stated that was correct. The average cost of salary and benefits equals $100,000 per employee. The City will continue to look at other ways to eliminate the deficit, but the vast majority of the City's expenses are labor related. Council Member Elliott asked if other options could be used to reduce the deficit without eliminating employees. For example, if the City is able to negotiate more favorable pension and benefit agreements, and/or focus on economic development to expand the tax base. Mr. Churchill responded that is possible; it depends on how revenues are doing at that time. Mr. Johnston stated it could be a combination of a number of different things that contribute to reducing the deficit. Mayor Pro Tem Maciel stated the City is looking at a two year time period to achieve these reductions

Mayor Ives asked what was next and whether staff needed direction. Mr. Churchill concluded by stating a new set of policies will be brought to the Council in spring.

Mr. Johnston stated there was one more budget principle regarding "pay as you go." This principle requires that anytime additional funds are sought through either a General Fund supplemental appropriation or through a General Fund augmentation, that such action would be accompanied by a corresponding action to reduce the General Fund budget in another area.

Mayor Ives stated Council had been fairly clear on the fact that budget expenses need to go down each year. Mayor Ives suggested staff bring back policy statements which could be debated in the future.

5. Adjournment – Mayor Ives adjourned the meeting at 6:54.

The above agenda was posted at the Tracy City Hall on February 10, 2011. The above are summary minutes. A recording is available at the office of the City Clerk.

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Mayor

ATTEST

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City Clerk