

NOTICE OF SPECIAL MEETING

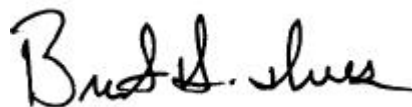
Pursuant to Section 54956 of the Government Code of the State of California, a Special meeting of the **Tracy City Council** is hereby called for:

Date/Time: **Tuesday, May 17, 2011, 5:45 p.m.**
(or as soon thereafter as possible)

Location: **Council Chambers, City Hall**
333 Civic Center Plaza, Tracy

Government Code Section 54954.3 states that every public meeting shall provide an opportunity for the public to address the Tracy City Council on any item, before or during consideration of the item, however no action shall be taken on any item not on the agenda.

1. Call to Order
2. Roll Call
3. Items from the Audience - *In accordance with Procedures for Preparation, Posting and Distribution of Agendas and the Conduct of Public Meetings, adopted by Resolution 2008-140 any item not on the agenda brought up by the public at a meeting, shall be automatically referred to staff. If staff is not able to resolve the matter satisfactorily, the member of the public may request a Council Member to sponsor the item for discussion at a future meeting.*
4. CONDUCT A CITY COUNCIL WORKSHOP TO REVIEW THE PROPOSED FY 11-12 OPERATING BUDGET
5. Adjournment



Mayor

May 12, 2011

The City of Tracy complies with the Americans with Disabilities Act and makes all reasonable accommodations for the disabled to participate in public meetings. Persons requiring assistance or auxiliary aids in order to participate should call City Hall (209-831-6105), at least 24 hours prior to the meeting.

Any materials distributed to the majority of the Tracy City Council regarding any item on this agenda will be made available for public inspection in the City Clerk's office located at 333 Civic Center Plaza, Tracy, during normal business hours.

AGENDA ITEM 4

REQUEST

**CONDUCT A CITY COUNCIL WORKSHOP TO REVIEW THE PROPOSED
FY 11-12 OPERATING BUDGET**

EXECUTIVE SUMMARY

The proposed FY 11-12 City Operating Budget is attached. Staff will present specific budget information at the workshop. City Council is requested to provide feedback to Staff. The budget is scheduled to be adopted on June 7, 2011. No action will be taken at the workshop.

DISCUSSION

The City's FY 11-12 proposed Operating Budget has been prepared. At this workshop various details of the Operating Budget will be presented. Council Members will have the opportunity to discuss the budget and ask questions as well as to provide feedback regarding the proposed Operating Budget.

Only the Operating Budget will be presented at this workshop. The proposed Capital Improvement Plan (CIP) for FY 11-12 was previously presented at a City Council workshop on March 15, 2011.

Both the Operating Budget and the CIP will be included in the FY 11-12 City Budget to be adopted by the City Council after the completion of a public hearing scheduled for June 7, 2011.

A summary of the significant City Operating Budget issues can be found in the City Manager's transmittal letter at the beginning of the budget. The transmittal letter is also attached to this Staff report.

FISCAL IMPACT

The FY 11-12 City Operating Budget provides a full analysis of the City's fiscal position.

RECOMMENDATION

Conduct a City Council Workshop to review the proposed FY 11-12 Operating Budget. No action is recommended to be taken.

Prepared by: Zane Johnston, Finance & Administrative Services Director

Approved by: Leon Churchill, Jr., City Manager

Attachment A: City Manager's Budget Transmittal Letter



CITY OF TRACY

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Think Inside the Triangle™

May 12, 2011

Attached is the FY 2011-12 Budget for the City of Tracy. As the United States, California, and the San Joaquin Valley continue to slowly climb out of the worst recession since the Great Depression, the City of Tracy remains mindful of these economic realities while pressing for continued improvement in the community and municipal corporation. As a result, the City's budget focuses on providing core services with no additions to General Fund staffing and no expansion of programs or new programs funded by the General Fund. Within these parameters however, the budget addresses the major goals and priorities identified by the City Council for this coming year.

THE RECESSION AND EFFORTS TO DATE

Due to national, state and regional economic conditions, most notably the real estate market collapse and corresponding decline in consumer spending, the City has faced a significant decline in tax revenues. Combined property tax and sales tax peaked in FY 06-07 at \$33.4 million. In FY 10-11, these two tax revenues totaled just \$25 million. The City has responded by reducing expenses to bridge the gap between revenues and expenses.

Since 70% of the City's General Fund is devoted to the cost of personnel (salaries and benefits), these expenses must be reduced in order to achieve any kind of significant budget reductions. Department Directors were tasked with evaluating their operations and make recommendations to reduce positions in their respective departments that would result in the least amount of impact to service levels. As a result of the efforts to date, the City has now reduced its workforce to 466.84 FTEs in the FY 11-12 budget. This is a total reduction of 91.42 FTEs from the City's peak employment in FY 07-08 or a reduction of 17%. There have also been two additional full time positions added (GIS and Police CAD/RMS administrator) both of which are not General Fund positions. The CAD/RMS position however will only have grant funding for one year. Thereafter it will become a General Fund position. Both of these positions have been added to the Finance and Administrative Services Department.

The following is a history shown by department for all funds of authorized City staffing for the last 4 fiscal years in addition to the staffing level proposed in the FY 11-12 budget.

Department	Authorized FY 07-08 FTEs	Authorized FY 08-09 FTEs	Authorized FY 09-10 FTEs	Authorized FY10-11 FTEs	Proposed FY11-12 FTEs
Police	154.44	154.94	151.94	129.44	128.44
Fire	83.95	83.95	83.95	78.45	78.45
Public Works	150.00	147.50	142.50	129.90	127.90
Parks & Community Services	53.30	56.92	44.82	39.75	34.95
Development & Engineering Services	59.18	55.18	47.68	41.10	42.10
City Council	1.00	1.00	1.00	1.00	1.00
City Attorney's Office	4.00	4.00	4.00	4.00	4.00
City Manager's Office	15.03	14.15	23.75	13.25	13.25
Human Resources	8.46	8.46	7.71	6.00	6.00
Economic Development	2.00	2.00	6.00	7.80	6.80
Finance & Administrative Services	<u>26.90</u>	<u>25.90</u>	<u>24.90</u>	<u>22.95</u>	<u>23.95</u>
TOTAL	558.26	554.00	538.25	473.64	466.84

Note: When reviewing the history of allocated positions by department some departmental increases are due to reorganizational changes. For example, the increase in FTEs allocated to the City Manager's department is offset by the decrease in FTEs to the Parks and Community Services Department due to the transfer of the Grand Theatre operations to the City Manager's Office from the P&CS Department. The FY 09-10 Economic Development increase of 4 FTEs reflects the transfer of Redevelopment to this department from the Development and Engineering Services Department.

Although significant reductions were made to the number of total City employees, the City made every effort to try not to affect service levels to the community. This was accomplished through the de-layering of management levels, reducing service overlaps, outsourcing some services, and implementing technology. With these changes, the City reduced its actual General Fund expenditures from \$52.2 million to an expected \$46.6 in FY 10-11.

MEASURE E

Even with the efforts to reduce General Fund expenditures, revenues have declined faster thereby resulting in a structural deficit of approximately \$5 million. In order to reduce this deficit, significant cuts to essential services would have to be made. Tracy voters however, approved Measure E on the November 2010 ballot which provided for a new half cent sales tax in Tracy. This tax started on April 1, 2011 and will conclude (unless extended by the voters) on March 31, 2016. It is estimated the tax will bring in about \$4.6 million in revenue during the first year.

Measure E will allow time for the City to continue to make changes to its operations over the next 5 years without having to take draconian actions to cut the budget – actions that likely would have resulted in the service level impacts to essential services such as public safety. Even though this new tax has just begun its 5 year period, preliminary plans have been developed to chart a course that will result in the City achieving a balanced budget by 2016 without the need for Measure E revenue. Such plans can begin to be put into action over the next several years which upon their full implementation will result in the goal for the City to not have to rely upon Measure E revenue. The following is a listing of these plans:

1. New labor contracts

The current contracts (MOUs) with the Teamsters Union, Mid-Managers Unit, and the Fire Union all expire on June 30, 2011. The resolution governing the Technical and Support unit expired on September 30, 2010 and the resolution governing the Confidential Mid-Managers expired on March 30, 2011. The resolution governing Department Heads expires on September 30, 2011 although practically speaking it may be amended at any time. The contract with the Police Union expires on June 30, 2012.

With each new contract there is the opportunity to negotiate pay and benefit terms. 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.

A second tier retirement formula has already 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.

2. Contracting of services – Service redesign

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 be examined for potential savings.

3. Continued change to the City's organizational structure

As previously noted, the City has already reduced its work force by 91 FTEs. 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 and/or other exit 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. Specifically organizational changes resulting from any targeted retirement incentive are expected to be concluded by November 30, 2012 (18 months).

4. Reduced number of City Departments

The number of City Departments will be reduced. Departments will be merged and there will be fewer department heads resulting in significant savings to the City. These plans may be implemented in conjunction with the organizational changes resulting from targeted retirement incentives. However, some may occur more rapidly.

5. 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 can be made on identifying an expenditure offset at the same time consideration is given to the increased expenditure. For example, in Police if additional efforts for gang prevention is deemed necessary, such resources might come from reallocating resources from elsewhere in the department (such as from traffic enforcement) or even from another department.

6. Elimination or reduction in non-essential services

Ultimately to supply City services in a post Measure E Environment, will also require the identification of programs which may be considered for elimination or reduction. When funding was more widely available for City functions, such programs were often nice things to offer to the community. But with City revenue far more restricted, programs of non-essential value may have to be eliminated or reduced. Periodically, specific programming will be presented to City Council for appropriate consideration to eliminate or reduce.

7. Technology

Technological advances may also create some operating savings to the City over time. Such savings must also recoup the initial investment in the technology. An example of this is the City currently examining the use of new street lights that use less electricity. The City will save on annual electrical costs but must also finance the acquisition costs of the bulbs. Possible savings to the City could begin in five years even after debt service on the new bulbs is included.

8. Improved Economy

It is anticipated in the next few years that there will be modest growth in revenues. Because property taxes lag actual reflection in current market conditions it is unlikely that during the next five years that the City property tax revenue will grow to its former level 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. At present the City's five year fiscal forecast anticipates sales tax (without Measure E) revenue in FY 15-16 at approximately \$11 million. However, sales tax revenue to the City peaked in FY 06-07 at \$13.3 million. As such, the five year forecast is very conservative in that it does not project the City to return to even the 06-07 level. But continued economic growth could easily outpace this conservative estimate by as much as \$1 million per year. 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.

FISCAL YEAR 11-12 BUDGET IN DETAIL

First let's start with some good news for a much needed change over the economic woes during the past three years. The local economy appears to be moving again as evidenced by an increase in sales tax. The Christmas 2010 holiday season was stronger than anticipated and

the City has been trending upward in sales tax for the past several quarters. Sales tax from 4th quarter 2010 compared with 4th quarter 2009 was up over 12%. As a result of these trends the FY 11-12 budget anticipates sales tax (non-Measure E) of \$10.9 million as compared to the FY 10-11 adopted budget figure of \$9.4 million. Note that the \$9.4 million figure in the FY 10-11 budget will likely be surpassed by nearly \$1 million when all accruals are posted to this fiscal year.

In the past three fiscal years the City has experienced a decline of 27% in property tax as a result of declining property values. Although this trend has slowed from FY 09-10 when values fell 19% to a decline of 2.6% in FY10-11, values have not yet bottomed out. Unfortunately, based upon preliminary information from the County Assessor, the FY 11-12 budget anticipates property tax will decline another 2.5%. This will be the fourth year of decline with property values falling a total of 30% over the four years.

An adjustment of \$2,000,000 has been included in the budget as likely savings from gross expenditure figures thereby leaving a net expenditure budget of \$48.4 million. This represents a combination of the following:

- a) savings that historically have resulted because departments do not spend 100% of every budget line item
- b) savings of one half of a fiscal year from the first wave of employees taking early retirement (those retiring by December 31, 2011)
- c) savings from negotiated concessions at the bargaining table since most employee groups have expired contracts as of June 30, 2011.

The exact amount of savings from these three areas and where they will be allocated is not known at the time of the presentation and adoption of the FY 11-12 Budget. However, such savings can be anticipated in the FY 11-12 budget with net expenditures reduced accordingly.

As the result of a slightly improved economy as well as the receipt of the first full fiscal year of Measure E revenue, the FY 11-12 budget for the General Fund expects \$47 million in revenue while expenditures are budgeted at \$48.4 million resulting in a budget deficit of just \$1.4 million to be drawn from reserves. This is the lowest budget deficit in over 4 years. The City has made good progress in eliminating the structural deficit and more has to be done so that a balanced budget recurs on a regular basis.

CONCERNS NOW AND MOVING FORWARD

Although the spirit of this budget is one of guarded yet renewed optimism, there are a number of factors currently facing the City now as well as moving into the future which remain as concerns or challenges.

1. State Budget Action

The preparation and adoption of the City's budget is done in advance of the State taking final action to adopt a State budget. Rarely does the State meet its statutory deadline to adopt a budget – if it did so the City would know the consequences of action by the State before the City's budget was adopted. The City proceeds with its prudent timeline for budget adoption despite the State's failure to do so.

With the passage of Proposition 1A and most recently Proposition 22, the State is constitutionally prohibited from further redirecting revenue from local government to the State. The State raids on local government revenue prior to the enactment of these Propositions already result in a loss of over \$3 million annually to the General Fund through the redirecting of property tax. In addition, the State launched a two year diversion of redevelopment funds which would not have additional protections offered by Proposition 22. The State took approximately \$3.2 million in May 2010 and another \$800,000 in May 2011. This taking is however the subject of current litigation.

The FY 11-12 City and Community Development Agency (CDA) budget does not anticipate any further takings from the State. Unfortunately, in an effort to blatantly circumvent Proposition 22 and the will of over 60% of California voters who voted in favor of this proposition, the Governor has simply proposed the elimination of redevelopment agencies. While this effort has not initially received enough votes for emergency legislation, it already enjoys majority support. The City and Agency counsel believe such attempt is unconstitutional, and certainly litigation is bound to occur in this matter if enacted.

The FY 11-12 budget contains \$250,000 in personnel expenses funded by the CDA redevelopment fund and \$340,000 in personnel expenses funded by the CDA housing set aside fund. If the State is successful in eliminating redevelopment agencies, this funding is in jeopardy and action would have to be taken to eliminate these expenses, or absorb them into the General Fund and expand the structural deficit. The City Council will ultimately have to decide what traditional CDA services should continue in the near future as part of General Fund operations.

Other actions by the State which are likely to affect the City's budget include the elimination of funding for "COPS" grants (currently \$100,000 per year to the City) plus the elimination of the funds counties use to pay for jail expenses that otherwise would be billed to cities in the form of "booking fees". The proposed FY 11-12 budget anticipates approximately \$130,000 in a new General Fund expense for this purpose and does not anticipate any COPS grant funds.

2. PERS Employer Costs

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 City 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 losses these rates reflect actuarial demographic changes – most notably 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% but this is 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. PERS has identified the following for the City's employer rate for the next three years as follows:

<u>Plan</u>	<u>FY 11-12</u>	<u>FY 12-13</u>	<u>FY 13-14</u>
Public Safety	+3.2%	+0.5%	+2.0%
Misc. Employees	+2.2%	+0.3%	+1.4%

The employer rate for the public safety (police and fire) group is increasing faster than the rate for miscellaneous employees. This is of critical importance to note because 80% of General Fund taxes are spent on public safety.

Additional expenses for the PERS employer rate in the FY 11-12 budget (all funds) total about \$960,000. Public Safety comprises \$521,000 of this total.

Per the above during the next few years there will be additional pressure on the PERS employer rate as the FY 08-09 losses are absorbed. However, there is no looming pension crisis as it relates to the City of Tracy. The above actions will quickly place the pension plan within actuarial sound funding status. Most of the news media reports on pension crisis in state and local government is due to the lack of previous funding set aside to cover other post employment retiree costs most notably that of health insurance. Recent governmental accounting rule changes require governments to compute the cost of supply paid medical to their retired employees. The City of Tracy does not have paid medical insurance for its retired employees and therefore does not have this looming unfunded cost. It is important to separate unfunded liabilities associated with some government's labor contract obligations to fund all or a portion of the health insurance for retired employees from normal actuarial adjustments to retirement plans associated with one year of bad investment returns.

3. *Shaky Economy*

Moving forward, the nation's slow climb from the "Great Recession" is already precariously balanced and could falter and stutter along for many years to come. The upward consumer spending trend already experienced by the City through increased sales tax could dissipate if there is a prolonged uptick in fuel prices. Consumers hit with higher gas prices at the pump will begin to change their habits thereby cutting back on other spending. Sky high gas prices in 2008 were a contributing factor to recession which followed.

4. *Fire Department Budget*

Through the organizational structure of the South County Fire Authority, the City provides fire services to Tracy Rural Fire Protection District and to the Mountain House Community Services District (MHCSS). Fire Department costs were budgeted at \$14.6 million in FY 10-11. Costs are split to the City, Tracy Rural, and MHCSS according to a cost sharing formula. In FY 10-11 this would result in Tracy Rural needing to pay approximately \$4 million to fund its share of fire services for the year. Unfortunately, Tracy Rural has experienced declines in property values resulting in only having about \$3.8 million to fund services uninterrupted. The District throughout the FY 10-11 has been downsizing staffing at Fire Station 93 from three people to two people when leave vacancies otherwise would have resulted in overtime to bring the staffing back to three people. Through this effort as well as not setting aside funds for fire engine replacement, it is anticipated the District will meet its obligation.

Primarily due to the rising employer PERS rate for FY 11-12, the Fire Department budget has increased from \$14.6 million in FY 10-11 to \$15.3 million in FY 11-12. Tracy Rural's share of this increase is approximately \$170,000. It is likely the District

will not have any growth to its revenues to cover this cost increase. Even with continued down staffing of one its stations continuing in FY 11-12, the District would be in a position of not being able to meet its obligations. Recognizing this, the Chairman of the Tracy Rural District Board of Directors in a letter directed to the City Manger has requested that the "City take whatever means necessary to reduce personnel costs provided to the Authority, and ultimately the District during the upcoming labor negotiations."

At time of budget adoption it will not be known what if any savings can be achieved through the negotiation process with the Fire Union so none have been included in the FY 11-12 budget. In addition, FY 11-12 revenues for the District will not be fully known until September 2011. Because of these two factors, the Fire Department budget as approved by the City Council may have to be amended before its adoption by the South County Fire Authority. To the extent that negotiations for a new labor contract with the Fire Union beginning July 1, 2011, result in salary or benefit concession, the budget could then be reduced accordingly. It is recommended that negotiations be concluded and District revenues be fully identified before presenting the FY 11-12 Fire Department budget to the South County Fire Authority.

FREQUENTLY ASKED QUESTIONS



ABOUT THE BUDGET

WHY IS THE CITY EXPERIENCING FINANCIAL CHALLENGES? AREN'T TAXES ALREADY HIGH ENOUGH?

The City of Tracy like almost all cities in California is facing challenging financial times due to loss of tax revenue. Combined General Fund property tax and sales tax peaked in FY 06-07 at \$33.4 million. This figure fell to just \$25 million in FY 10-11. This means tax payers of the City of Tracy are paying about \$8.4 million less in taxes going to the City than they did just four years ago. Since most of the City's General Fund tax revenue goes to fund police and fire operations, balancing the budget without reducing these services is very difficult when matched with significantly less tax revenue. Cities throughout California are experiencing this same problem and many have had to reduce police or fire expenditures by cutting the number of police officers or firefighters serving their community.

Fortunately, Tracy had strong reserves going into this prolonged and deep recession. The City has been using reserves prudently while at the same time continuing to implement changes to the organization necessary as a result of significantly reduced funding. This has been done while preserving the services most essential to the community. The City will continue to make efforts in this regard.

The City budget consists of three components: the Operating Budget, the Capital Budget, and the Debt Budget.

This table compares the City budget by these components to prior fiscal years' adopted and amended budgets and year-end actuals as well as the current fiscal year budget and estimates.

	<u>Operating Budget</u>	<u>Capital Budget</u>	<u>Debt Budget</u>	<u>Total Budget</u>
FY07-08 Adopted	\$113,657,060	\$25,758,000	\$24,725,280	\$164,140,340
FY07-08 Amended	\$117,792,883	\$95,762,035	\$24,977,690	\$238,532,608
FY07-08 Actual	\$106,780,466	\$36,332,413	\$27,296,786	\$170,409,665
% of Amended	90.7%	37.9%	109.3%	71.4%
FY08-09 Adopted	\$120,944,140	\$81,106,770	\$24,082,080	\$226,132,990
FY08-09 Amended	\$122,372,820	\$106,073,314	\$24,757,615	\$253,203,749
FY08-09 Actual	\$110,114,627	\$30,635,002	\$35,842,765	\$176,592,394
% of Amended	90.0%	28.9%	144.8%	69.7%
FY09-10 Adopted	\$119,113,260	\$102,414,128	\$24,856,700	\$246,384,088
FY09-10 Amended	\$120,641,424	\$101,175,458	\$24,856,700	\$246,673,582
FY09-10 Actual	\$106,067,586	\$30,636,673	\$25,482,576	\$162,186,835
% of Amended	87.9%	30.3%	102.5%	65.7%
FY10-11 Adopted	\$110,349,000	\$37,783,040	\$24,936,100	\$173,068,140
FY10-11 Amended	\$113,086,891	\$111,577,752	\$24,936,100	\$249,600,743
FY10-11 Estimated	\$105,657,110	\$38,944,000	\$24,685,800	\$169,286,910
% of Amended	93.4%	34.9%	99.0%	67.8%
FY11-12 Adopted	\$111,782,350	\$43,698,390	\$26,259,100	\$181,739,840
% over Prior Year Adopted	1.3%	15.7%	5.3%	5.0%
% over Prior Year Amended	-1.2%	-60.8%	5.3%	-27.2%
% over Prior Year Estimated	5.8%	12.2%	6.4%	7.4%

A LOOK AT RESERVES

During the past 4 fiscal years the City has utilized reserves to balance its General Fund Budget as the City's tax revenues have severely deteriorated during this time. Reserves are often used to bridge economic cycles so that community services can continue to be supplied uninterrupted. This economic cycle has been deeper and longer than originally anticipated and the City has

responded by using reserves prudently while also taking short and long term action to cut expenses. The FY 11-12 budget will require a small draw on reserves but through the City's prudent financial management the City retains healthy reserves.

Total reserves are projected to be \$26.4 million as of June 30, 2011 and \$25 million on June 30, 2012.

	<u>FY 08-09</u>	<u>FY 09-10</u>	<u>FY 10-11</u>	<u>FY 11-12</u>
General Fund Balance	\$18,578,589	\$17,923,473	\$18,985,106	\$18,985,106
Reserve for Economic Uncertainty	<u>\$17,938,924</u>	<u>\$16,878,312</u>	<u>\$10,550,972</u>	<u>\$7,424,722</u>
Subtotal Reserves	\$36,517,513	\$34,801,785	\$29,536,078	\$26,409,828
Deficit	(\$1,715,728)	(\$5,265,707)	(\$3,126,250)	(\$1,430,230)
Ending Total Reserves	\$34,801,785	\$29,536,078	\$26,412,828	\$24,979,598

Economic Conditions and Outlook

Critical to any budget planning are the current economic conditions and outlook for the Nation, the State, and the City.



National

The City of Tracy uses banking services from Wells Fargo. The following comments related to the national economy are taken from the bank's economic outlook.

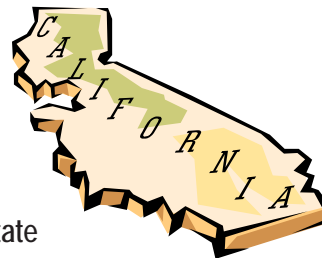
Every economic recovery has a different story, both in overall pace of growth and its component parts. For the year ahead sustained growth will reflect the influence of continued improvements in consumer and business investment. Spending will not be as strong as in the past corresponding phase of earlier recoveries, but will be positive nonetheless.

This economic recovery begins with four main challenges. First, unconventional monetary policy tools have been employed on a massive scale in an attempt to prevent a deflationary spiral, a process responsible for deep recessions in the U.S. in the 1930's and in Japan in the 1990's. Second, we are limited by the policy decisions of the past forty years which have levered our government to unsustainable levels. Third, both the public and private sector fueled a bubble that blinded households and investors alike to the true value of assets in the housing market. Today, with continued government intervention and oversupply, the market still cannot indicate the true value of real estate. Finally, the pace of globalization continues to present challenges to economic actions due to path dependence.

Household wealth has been battered by the housing market correction and the corresponding equity correction. The knock-on effect for state and local revenue has created massive headaches for governments that have enjoyed relatively stable finances. Slow economic growth, depressed consumer spending and low inflation in the short to medium term will put a vice grip on government budgets

going forward, which have already suffered setbacks in revenue deprived from the housing market. The hard choices for all levels of governments are just beginning.

Despite these challenges that face the nation, the most arduous portion of the journey is behind us. The corner has been turned and the nation is emerging from the deepest recession in half a century. The road ahead looks to be a long, uphill climb. This recession's legacy of damaged consumer balance sheets, experimental monetary policy and fiscal imbalances will add considerable mileage to our journey towards renewed economic vitality; however, the American economy will continue growing mile by mile, quarter by quarter.



State

Comments are taken from Scott Anderson, Senior Economist, Wells Fargo Bank. California's economic recovery, for the most part, will remain painfully slow. While California's economic performance is expected to improve by a touch in 2011, the state will continue to perform somewhat below the national average. California's employment growth should accelerate to 1.0 percent in 2011, following a 1.5 percent decline in 2010. Private sector service employers are expected to create more jobs in 2011. Moreover, the drag from construction payroll declines will finally begin to dissipate. Not that California's housing market is gearing up for a roaring revival, but there is little scope for further double digit construction payroll declines given how farm home building has already fallen across the state.

Still the legacy of the California debt/housing bubble and Great Recession remains, lurking just below the surface. The aftermath of these crises will continue to hold back economic growth in California for another year. Nowhere is this more visible than in the state's unemployment problems with a rate to remain above 12 percent in 2011, keeping the State's financial and housing problems very much front and center.

Looking for good news on the California economy, look no further than California's trade performance over the past year. California exports hit a new December record at \$13.3 billion, a 14.8 percent increase from a year ago and the 14th consecutive month of year-on-year increases. Clearly, California is getting its fair share of global growth and sales abroad. Further gains will be necessary to help rebalance the state's economy away from consumer spending and housing toward more productive drivers of economic growth going forward. California's growth in exports is comparable to what we are seeing nationally, suggesting that California has not yet lost its competitiveness against other states when it comes to its export prowess.

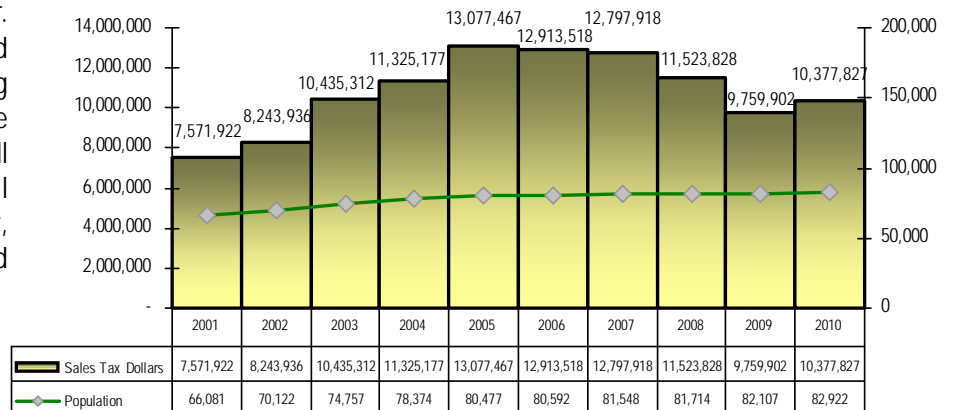
In summary, California is slowly extricating itself from the Great Recession. Private sector job growth will be more visible across the state, even in the most troubled metro areas. Manufacturing and exports will remain an important source of economic activity. Weak housing demand will continue and could intensify if mortgage rates shoot higher over the coming year. The level of foreclosures and distressed sales will remain historically high, keeping housing supplies elevated and pressure on further home price declines. Overall California will lag the national performance over the coming year, though the state's outlook has improved due to a stronger national economy.

The University of Pacific Business Forecasting Center in Stockton believes the Central Valley has turned the corner with the rest of the nation in terms of slowing coming out of recession, albeit a long and slow road yet ahead. The region has seen gains in agriculture, transportation and trade, and manufacturing, and the important housing and construction sector has clearly hit bottom according to the Center. Remaining of concern is the effect of state and local government budget cuts in the area.

POPULATION FORECAST

One of the major factors for the City's budget and a force in the local economy is the City's population growth. This graph diagrams the annual population growth for the City of Tracy.

City of Tracy
Sales Tax Growth vs. Increase in Population



City

Tracy has twin influences – that of a more diverse Bay Area economy where many Tracy residents are employed, and that of the Central Valley which has been ground zero for the construction and housing finance implosion, and as one would expect, the regional economy is in recession.

The San Francisco Bay Area continues to badly lag the economic growth occurring in other areas of the country and state. Moreover, pace of job growth appears to have slowed in recent months. The region continues to struggle with sizable net job losses in construction and financial services. Government and information, mostly publishing, shed 1,400 jobs each. The Bay Area housing market recovery is struggling, though sales appear to be stabilizing at low levels.

The State Department of Finance population estimate for Tracy as of January 1, 2011 was 83,420. We estimate this figure will increase slightly to 83,620 by January 2012. Between 1995 and 2009 the City's population grew from 43,570 to 82,107 or by 89 percent. Going back to 1988, the City grew from 28,762 in 1988 to 81,548 in 2008. Over this 20 year period, this translates to a 183 percent increase which works out to an annual population average increase of 5.4% a year (considering the rule of compounding). But now with just an increase of about 1,000 people in the last three years this previous 20 year growth boom is over. As such there are no changes to revenue projections based on population increases.

BUDGET POLICIES, ISSUES, AND CHANGES

Program Budget

The City's budget emphasizes reporting and controlling by programs within departments. A variety of programs representing major work efforts are established within each department. A budget is developed for each program in order to more accurately measure the true cost of providing services.

While, there are 10 City departments there are about 100 operating programs. Program budgeting provides much more useful information concerning the operations of the City. For example, rather than simply allocating \$22.1 million in FY 11-12 for the entire Police Department, with program budgeting we can specify the resources necessary to provide for a particular activity, such as Traffic Enforcement, Narcotics Enforcement, General Investigations, or Crime Prevention.

Base Budget

The base budget is developed for all operating programs for contracted services and commodities accounts. Normally, the base is determined by utilizing the historical spending average from the prior 2 years (but adjusted each year for an inflation factor) plus the current budget amounts. Finally this may be adjusted for specific one time items that were not considered to be ongoing.

However, as a budget cutting measure because of the City's fiscal situation, departmental budgets reduced their discretionary accounts about 30% during FY 08-09. These reductions became the base budget for FY 09-10. Then again, these budgets and the discretionary accounts were reduced another 25% during FY 09-10. These further reductions then became the base budget for both FY 10-11 and FY 11-12.

Contracted services and commodities expenses proposed for FY 11-12 are \$40,793,220, compared to \$44,597,870 adopted for FY 09-10. This is a reduction of \$3,804,650 or 8.5%. (see page E3 and E9)

Internal Services Charges

The City's budget policy provides for internal service funds for vehicle operations and maintenance (fuel and repair services), self-insurance (worker's compensation and general liability), equipment replacement, central services (copier and mail), building maintenance (custodial, repair, and utilities), and information systems and telecommunications. Direct utilities costs, while allocated as internal service costs to different programs, are charged as departmental expenses. Direct use phone costs (local and long distance), as opposed to system costs, are charged to the various operating programs.

As cost cutting measures, some of the internal services charges have also been reduced where possible both in FY 09-10 and FY 10-11. These reductions are possible because internal services programs are also being cutback or experiencing workload decreases. The downsizing in other departments reduces the workload of the internal services programs. Most charges are expected to show a 12.5% reduction in FY 10-11.

However, in FY 11-12, some increases in internal charges are necessary for self-insurance charges in order to maintain adequate reserves in the self-insurance fund. Some of the savings on building maintenance charges, due to the contracting out of custodial work, will offset the general liability portion of the increase, but not the workers' compensation portion which is treated as a personnel expense.

Also, systems charges will increase to fund the new GIS system operations and maintenance and the implementation of the Police CAD/RMS. Budget augmentations have been made to departmental budget to cover these costs.

As proposed for FY 11-12, Internal Service Charges will show a 3.0% increase over the FY 10-11 adopted budget, although this will be 13.3% less than actual Internal Service charges in FY 08-09.

Personnel Expenses

The base budget provides for inflationary increases in personnel expenses for all current positions. Where there are existing labor agreements that specify cost of living adjustments the budget provides for these, but also includes allowance for the standard 5% merit increase when an eligible employee advances to a higher step within their pay range. The status of various labor agreements affecting the City were commented upon. As previously noted the City is looking to implement a variety of unpaid furloughs for certain employees (primarily non-public safety) in order to achieve additional budget savings. This has been factored into the FY 10-11 and the FY 11-12 budgets.

An important part of any compensation package as well as a significant expense to the City is the retirement plan. The City participates in the California Public Employees Retirement System (PERS) and these costs have been included in the FY 11-12 budget.

As mentioned above, City staffing has been reduced in FY 09-10 and as proposed for FY 10-11. These staff reductions will also lower personnel expenses in FY 11-12.

Personnel expenses proposed for FY 11-12 are \$59,715,950, compared to \$64,710,010 adopted for FY 09-10. This is a reduction of \$4,994,060 or 7.7%. (see page E3 and E9)

Equipment Acquisition and Replacement

The City's budget policy provides for the annual accumulation and set aside of monies for the purposes of replacing vehicles and equipment. These amounts are budgeted as internal service charges in the operating programs of City departments. These charges are then expended quarterly, and the receipts are placed into the Equipment Acquisition Fund 605, except for the Water, the Wastewater, and the Transit Funds, where the receipts are retained within those respective funds.

When preparing their annual budget requests, departments divide equipment requests into "new" and "replacement". New items have to compete for funding with other requests for new funding throughout the City operations. However, replacement items may be replaced from available funds within the Equipment Acquisition Fund 605. Starting in FY 09-10, a new Vehicle Acquisition Fund 606 was started to separate the funding, assets, and outlays for vehicles and rolling stock from other equipment.

Occasionally for larger ticket items, it may be more feasible to obtain debt or lease financing. If this is done, then the annual lease payment or debt payment then becomes payable out of the respective department's annual set aside. Proposed equipment purchases for FY 09-10 are detailed further in the Equipment Acquisition Program 593x of the non-departmental group in the Operating Budget section of this budget document. Major lease payments are budgeted in the Debt section.

As a cost savings measure, the internal services charges for equipment and vehicle replacement will be cut to 50% for FY 10-11 and FY 11-12. This will mean operating programs will have to utilize their equipment and vehicles a bit longer than before. Replacement funds will not be as available as in prior fiscal years. The projected annual savings for this proposed action is \$1,161,000.

In FY 08-09, the City completed a fleet utilization study and about 20 vehicles were deleted from the City fleet. So, in FY 08-09, there were no vehicle replacements; and 10 vehicle replacements were proposed for FY 10-11. For FY 11-12, 12 vehicle replacements are being proposed.

Fire Consolidation

On September 16, 1999, the City entered into an agreement with the Tracy Rural Fire District (TRFD) to consolidate services through a Joint Powers Authority, named the South County Fire Authority. The Authority then contracts with the City to provide consolidated fire services for both the City and surrounding rural areas. The total area served is 215

square miles, with 20.6 square miles in the City. As of January 1, 2009, the population served was about 81,714 in the City, and about 21,040 outside the City.

Revenues of the District are given to the City and recorded in the South County Fire Authority Fund 211 to pay for the TRFD's share of the joint costs. During the first 7 years of the consolidation, Tracy Rural did not have sufficient funds to pay its share of Fire costs. As a result, the District now owes the City approximately \$6 million. However, the District has had sufficient funds in the past 3 years to pay its operating obligation but the debt remains large due to accumulated interest. Currently the City and the District are in negotiations to transfer the debt owed to the City to a prepaid services agreement which will be used to offset District expenses for operation of Station 92 once the current station is relocated to a location within the Northeast Industrial Area.

FREQUENTLY ASKED QUESTIONS



ABOUT THE BUDGET

WHAT ARE THE CITY'S MAJOR GENERAL FUND REVENUE SOURCES?

The largest source of General Fund revenue is **property tax**. In FY 11-12 the City will receive \$14.3 million in property tax which is 30% of General Fund revenues. However, it should be noted that on average the City receives only about 14% of every property tax dollar paid by a property owner with property in the Tracy City limits. For a home with an assessed value of \$200,000, the homeowner would pay about \$2,000 per year in property taxes under Proposition 13 (school bonds and other voter approved additions to property tax are extra). Of this \$2,000, the City receives just \$280. The rest of the property tax goes to the County, the State, schools and other special districts. On property annexed to the City since 1996, the City receives only about 4% instead of 14% of every \$1 of property tax paid.

The City receives one cent of the 8.75 cents sales tax on all applicable sales transactions within the City. The other 7.75 cents goes to the State, County and transportation programs. **Sales tax** is expected to yield \$10.9 million to the City in FY 11-12, or 23% of total General Fund revenue. In November 2010 Tracy voters approved an additional half cent sales tax (Measure E) for a period of 5 years beginning April 1, 2011 and ending March 31, 2016. Measure E is expected to produce \$4.6 million in FY 11-12 or about 9.8% of the total General Fund revenues.

Together, property tax, sales tax, and Measure E will yield 29.9 million and account for 94% of all General Fund taxes received by the City and 63.6% of the General Fund revenues. It is important to shop within the City to help the City's revenue stream for sales tax. Those sales tax dollars help provide important services like police and fire.

INTERFUND TRANSFERS

(see page D24 for details and comparison to prior fiscal year)

Proposed interfund transfers for FY 11-12 amount to \$4,871,230. Noteworthy interfund transfers are:

- ◆ For the nineteenth year, a \$284,000 transfer from the General Fund 101 to pay the debt service on the Chrisman and civic center sites. The transfer is to Debt Service Fund 407.
- ◆ An \$889,000 transfer from the General Fund 101, will be made to pay debt service on the regional mall infrastructure. The transfer is to Debt Service Fund 408.
- ◆ A transfer of \$400,000 from the CDA Debt Fund 404 will be made to pay debt service on the CDA share of the 2008 Lease Revenue proceeds. This transfer is to Debt Service Fund 408.
- ◆ A transfer of \$1,848,000 set aside 20% of Community Development Agency property tax increment receipts into the CDA Housing Fund 281. This is a decrease from FY 08-09 as CDA property tax receipts have declined since then.
- ◆ The Airport Fund 561, will repay the Water Fund 511 \$20,000. This is for past loans for CIP projects. The \$20,000 represents the thirteenth year of a 15-year repayment plan.
- ◆ A transfer of \$1,430,230 is proposed from the Economic Uncertainty Fund 299 to augment the General Fund.

OPERATING BUDGET OVERVIEW

(see pages E9 to E12 for details)

For FY 10-11, the adopted operating budget was \$111,749,000. This was a 7.2% decrease from the FY 09-10 adopted budget. The amended budget is now \$113,550,353. It is now estimated that \$105,657,110 or 94.5% of the amended budget will be spent. So, this estimated figure is 0.4% less than FY 09-10 actual expenditures. Personnel expenses for FY 10-11 will be 96.0% of their adopted amount, which would be 5.1% less than FY 09-10 actual expenses.

The proposed operating budget for FY 11-12 is \$113,782,350, which is \$2,033,350 or 1.8% more than the FY 10-11 adopted budget. Personnel expenses as proposed will be 2.5% more than their prior year adopted amount.

GENERAL FUND OVERVIEW

For FY 10-11, the adopted General Fund operating budget was \$47,504,540. This was a 12.0% decrease from the FY 09-10 adopted budget. The amended budget is now \$48,331,033 or 1.7% more. It is now estimated that \$45,461,490 or 94.1% of the amended budget will be spent. This estimated figure is 5.6% less than FY 09-10 actual expenditures.

The proposed General Fund operating budget for FY 11-12 is \$49,283,150, which is \$1,778,610 or 3.7% more than its FY 10-11 adopted budget.

CAPITAL BUDGET OVERVIEW

(see pages F5 to F10 for details)

In FY 10-11, the City's amended capital budget totaled \$111,577,752 with 188 current projects. For FY11-12, additional appropriations of \$43,698,390 are required. These include \$37,105,690 of added funding for 21 current projects, but also \$6,592,700 for 28 new projects.

About \$2,788,000 of the additional appropriations for the capital budget in FY 11-12 will come from special revenues such as TDA, transportation sales tax, and gas taxes. \$31,058,090 will come from capital project funds and only \$1,928,000 from the City's Enterprise Funds. Grants will provide funding of about \$7,232,300 for capital projects.

DEBT SERVICE OVERVIEW

(see pages G5 and G6 for details)

For FY 11-12, the proposed City's debt service budget totals \$26,259,100 which is a 5.34% increase over FY 10-11. The City has 30 debt obligations for which payments are required during the year. Most of these payments will be made from special assessments although \$7,616,000 will be paid by CDA redevelopment revenues, \$3,942,200 by Enterprise Funds, and \$1,239,300 by General Fund revenues.

FREQUENTLY ASKED QUESTIONS



ABOUT THE BUDGET

WHAT IS THE SINGLE LARGEST GENERAL FUND EXPENSE?

By item, the largest expense is for personnel. City Government is labor intensive. Police officers, firefighters, maintenance personnel, and other workers are employed to provide services to the community and plan for our future. That is what City government is all about. Of the \$111.8 million operating budget (all funds) for the City, approximately 42% (\$47.3 million) is for personnel expenses.

In terms of operating budgets supported by the General Fund, the single largest expense is for police services. Providing a full service Police Department for the City will cost \$22.3 million in FY 11-12 and almost 100% of this amount comes from the General Fund. This is 47% of General Fund operating outlays.

The Fire Department will cost \$15.2 million in FY 11-12, and after reimbursements from the City's partners in fire service, 56% (\$8.5 million) comes from the General Fund. This is 18% of the General Fund operating outlays. Therefore, public safety comprises 65% of the General Fund Operating Budget.

Public Safety. While additional Police and Fire department staffing will not be added in FY 2011-12 both departments will retain their ability to address current and future safety threats. Gang activity is the most visible concern in Tracy and the TPD has made some modest adjustments the last few months as part of a concerted suppression plan. The plan's estimated annual costs are \$125,000 and mostly consist of overtime expenses. The City's Public Safety Strategy also suggests renewed energy in addressing nuisance issues throughout the community. Major crime continues to decline and concern now turns to the issues that could ignite an increase in crime or deeply affect the community's impressions of crime. The most notable action in this area is a \$20,000 expenditure to expand graffiti abatement throughout the City. This experiment expands very successful graffiti removal work on public property that is typically achieved within 48 hours at the most. In addition, the City provides free paint and vouchers to private property owners within the redevelopment area. The experiment expands the latter program to a citywide basis.

Another experiment in the public safety area is the introduction of the Gang Resistance Education and Training (GREAT) program at a TUSD elementary school as pilot project. The program is the natural successor to gang suppression efforts and compliments the MCYSN initiative. This modest cost is expected to be absorbed within the FY 11-12 Police Department budget. It is yet to be determined which grade will be the target audience for the GREAT program.

UPDATED CITY PRIORITIES AND SMALL EXPERIMENTS

The City Council has discussed several issues the last few months and there is a recurring theme around three essential city priorities: public safety, economic development, and fiscal and organizational health. I consider these priorities the "essential food groups" of great communities. These priorities address our basic need for security, provide economic opportunity for Tracy residents, and ensure a responsible municipal organization that delivers services in an efficient manner. The FY 2011-12 Budget contains important work in all of these areas.

The City's pursuit of continuous improvement as an organization and in the community continues. This commitment pushes against the human tendency to "hunker down" during austerity. With some encumbered funds from FY 10-11 plus a small investment of funds in the proposed FY 2011-12 Budget the City will implement some experiments that may reveal how our community will reach new heights if they are successful.

The Fire Department also proposes to increase public education and awareness. These efforts are estimated to cost \$7,500 and will address issues such as drowning prevention, fireworks safety, and household safety, among many other issues. \$7,500 toward these efforts from FY 10-11 funds will be matched with \$7,500 in the FY 11-12 budget.

Economic Development. The City's emphasis on economic development does not waver as part of the FY 2011-12 Budget. The city recently completed General Plan update and approved a Sustainability Action Plan, and infrastructure master planning is well underway with specific plans starting up. The City remains poised to help reinvestment continue at its major commercial areas, and the Downtown Specific Plan Update will force the community to re-think how improved downtown can occur. Of course, many of these improved downtown can occur. Of course, many of these efforts will be hampered with any demise of the CDA.

While utilizing FY 10-11 funds there will be a first time initiative through the MCYSN for a Summer Algebra Academy. The Academy to be held in summer 2011 is targeted to thirty 7th graders who show promise for matriculation to college, but who will not go without this intervention. The program gets them on a college track by the time they enter high school. Approximately 33 percent of TUSD students go onto college. Great, transformative communities routinely send a higher percentage of students to college. I am hopeful Tracy can get to at least 40 percent and 50 percent soon thereafter. It is important that a number of students go to college to create a critical mass and expectation among the entire student body. This type of achievement is attractive to the knowledge-based industries the City seeks in its economic development efforts. This type of achievement is also attractive to the decision-makers of those businesses. Success will be measured by what courses they register for in the 9th grade.

Another small experiment lies with a proposed expansion of downtown special events programming. \$75,000 has been included as part of the FY 11-12 Parks and Community Services for eleven more events. This initiative should simultaneously help with downtown economic activity and public safety perceptions. The approach is well-proven, but we must know whether downtown businesses will expand hours and whether programming near the future Downtown Plaza has promise.

The City of Tracy operates at its leanest in memory without significant service deterioration. This is reflected in the FY 11-12 budget containing the smallest deficit in four years, but work remains in its elimination. In FY 11-12 it is anticipated the City will continue with organizational changes as employee turnover through early retirement and/or other incentives take place. While these changes will ultimately

reduce expenses for the City, it is equally important that a process be in place to insure the orderly transfer of knowledge and duties so that services to the community continue. Funding from FY 10-11 has already been committed for the City to implement its Workforce Readiness Initiative.

CLOSING THOUGHTS

In closing, let me express my appreciation to Finance and Administrative Services Director Zane Johnston, and all department directors and staff who contributed to the preparation of the Fiscal Year 2011-2012 Program Budget. Special thanks, as usual, to Allan Borwick, Budget Officer, who deserves recognition for his dedication and professionalism.

Finally, I want to thank our hard working City employees who deliver quality services to the people of Tracy. Their continuing dedication and loyalty speaks well for the commitment of those who serve our community. This is especially the case when I ask for all employees to make individual and household sacrifices, and they respond on a routine basis. These noble actions by people doing noble work every day should not be taken for granted, and we honor them by getting better all the time.

Sincerely,

Leon Churchill, Jr., ICMA-CM, AICP
City Manager

