CITY OF LODI

COUNCIL COMMUNICATION

AGENDA TITLE: **Review and Discuss City of Lodi Budget Calendar and Proposed Financial Strategy**

MEETING DATE: **January 3, 2002**

SUBMITTED BY: **Deputy City Manager and Finance Director**

RECOMMENDATION: That the City Council review and discuss the attached proposed calendar for the 2003-05 Financial Plan and budget and that Council discuss the City Manager's proposed financial strategy.

BACKGROUND INFORMATION: Based on preliminary comments from Council Members, staff has prepared the attached proposed budget calendar for preparation of the Fiscal Years 2003-05 Financial Plan and Budget. Council should note that the calendar does not include any Shirtsleeve Sessions and it does include one proposed Special Meeting on Saturday. In addition, the City Manager will discuss with Council a strategy for the balance of the current budget year and next year's budget with regard to fiscal uncertainties.

Funding: Not applicable.

Respectfully submitted,

Janet S. Keeter

Janet S. Keeter
Deputy City Manager

Vicky M'Athie

Vicky McAthie
Finance Manager

Jsk/VM/sl

APPROVED: H. Dixon Flynn -- City Manager

MAJOR BUDGET PREPARATION MILESTONES

	STAFF	PUBLIC MEETINGS
Review of Fiscal Policies and Presentation on Bond Rating		11/19/02
Review 2001-02 Budget vs. Actual		11/26/02
Discuss Budget Calendar and Proposed Financial Strategy		1/02/03
Issue Budget Instructions to Departments	1/6/03	
Adoption of Fiscal Policies and Budget Format		1/15/03
Discussion on City Council Goals – Special Council Meeting		1/22/03
Discussion on Status of Highest Priority Projects		2/5/03
City Manager Revenue Review	2/10/03	
Departments Submit Budget Requests to Finance Department	2/17/03	
City Council Review of Revenue Assumptions		2/19/03
City Manager Review of Budget Requests	3/03/03	
City Council Review of Revenue Assumptions		3/05/03
Discuss Significant Expenditure & Staffing Requests		3/19/03
Discuss Significant Expenditure & Staffing Requests		4/02/03
Update on State Budget		4/16/03
Discuss Fund Balance – Regular Council Meeting		5/07/03
Release of Draft Budget Document		5/26/03
City Council Review of 2003-05 Financial Plan & Budget		6/04/03
City Council Review of 2003-05 Financial Plan & Budget – Special Saturday Council Meeting		6/07/03
Adopt Financial Plan & Budget		6/18/03

Fiscal Contingency Plan

- **Purpose:** Establish framework and general process in responding to adverse financial events
- **What It's Not**
    - Specific "recipe" for expenditure cuts or revenue increases; this will be determined on a case-by-case basis.
    - A detail list of reduction options before they are recommended for the following reasons:
        - If not taken seriously, quality thought will not be given to them.
        - If taken seriously, likely to result in needless anxiety; and sends a conflicting message if "times are good".
        - They would have a short shelf-life: needs and priorities change over time.

But it does set the foundation of principles and values upon which responses will be based.

Triggers

- Any adverse financial circumstances as determined by the City Manager, such as
    - Natural or human-made disasters.
    - State takeaways as in the early and mid-1990's.
    - Large, unexpected costs.
    - Economic downturns.
    - Whenever there are two consecutive quarters of adverse fiscal changes in the top four revenues: sales tax, property tax, VLF, franchise tax.

- Adverse results are:
    - Actual declines in revenues
    - Significant variances in projected revenues

Scope: General Fund

Key Elements

1. Maintain target fund balances
2. Follow other key budget policies
3. Monitor the City's financial health on an ongoing basis
4. Assess the short and long-term problems
5. Identify options
6. Prepare and implement action plans

Target Fund Balances

- First Line of Defense
  - Allows continued operations and project development while responding to short-term problems
  - Provides "breathing room" in addressing longer-term problems
  - Especially important under Proposition 218: limited opportunities to implement new revenues

Other Key Budget Policies

- Balanced budget
- Conservative investment practices
- Diversified revenues and investments
- User fee cost recovery
- Enterprise funds
- Contracting for services
- Productivity improvements

Monitoring Financial Health

- Interim
  - Reliable automated financial management system
  - Monthly reports
  - Mid-Year Budget Review
  - Two-Year Budget and Annual Review

- Annual
  - Audited financial statement

Assess the Short and Long-Term Projections

- Different Strategies for Different Projections
  - Short-Term: One-time event or downturn that is not likely to continue indefinitely.
    - "One-time" fixes appropriate response for "one-time" problems.

  - Long-Term: Ongoing downturn in revenues or increases in costs that are systemic.
    - "One-time" fixes won't work
    - Requires new ongoing revenues or ongoing expenditure reductions

Short-Term Problems

- **Hiring Chill:**
  City Manager approval required to fill vacant positions
    - Goal is not just short-term savings, but preserving future options if problem turns out to be ongoing.

- **Travel Chill:**
  Limit travel and training; City Manager approval required for all travel authorizations

- **Capital Project Deferrals:**
  Defer capital expenditures to allow continued service levels

- **Refinance Debt:**
  Explore savings in refinancing debt service based on interest rates and annual savings

- **Evaluate New Expenditure Increases for Deferral:**
  Evaluate proposed increases in expenditures to determine if appropriate for deferral or elimination

- **Fund Balance:**
  Consider use of fund balance below policy level

Long-Term Problems

- Implement "short-term" actions
- Prepare long-term forecast to define the problem
- Prepare revenue increase and expenditure reduction options tailored to problem definition via the forecast.
    - Likely to take 3-6 months to prepare plans: another 3-6 months to implement them
    - Underscores the importance of strong fund balance and short-term expenditure reductions to create the time needed to prepare and implement reasonable plans.

Identify Options

In the long-term, only two basic options

- Increase revenues
- Reduce expenditures (and related service levels)
    - In the short-term, use of fund balance is an option, but it is not a viable long-term solution

Exception
The strategic use of fund balance that reduces future year operating costs or increases ongoing revenues.

Expenditure Reduction Options

Meaningful ongoing expenditure reductions require reductions in regular staff costs.

95% of General Fund costs are for operating expenditures
81% of General Fund operating costs are for staffing
54% of General Fund staffing costs are for public safety
8% of General Fund staffing costs are for part-time and temporary staffing

General Strategy

Departments develop expenditure reduction options that are real, doable and:

- Reflect least service impacts to the community
- Are on-going
- Describe service impacts
- Are within the City's ability to do independently
- Can be implemented within three months after adoption
- Maintain essential facilities, infrastructure and equipment at reasonable levels – no deferred maintenance posing as genuine cost reductions
- Reflect participation from throughout the organization

Revenues: Limited Options

- City Council will have the lead responsibility for identifying revenue options
- It is likely that any new significant revenues will require voter approval under Proposition 218
- Election cannot be held until next regular municipal election (November of even-numbered years)
- Exceptions:
    - Emergency declared by unanimous vote of the Council
    - Two-thirds voter approval for "earmarked" revenues
- Voter approval will require time for effective preparation before a measure is placed on the ballot
- Critical Success Factor: Effective, community based group that will work hard to pass measure

Legislative Advocacy

Depending on the reason for the adverse circumstances, the City will work closely with its elected representatives and others in mitigating service reductions and revenue enhancements

Involvement and Participation

- Organization
- Unions
- Community Groups
- Communication
    - With stakeholders
    - With employees

Strategies

- Employees
    - Ongoing employee briefings with City Manager and Finance Director
    - Ongoing updates via voice mail or e-mail
    - Ongoing briefings with employee association representatives
    - Special organization-wide briefings as appropriate

- Community
    - Viewpoint articles in the Lodi News Sentinel and The Record
    - News Releases
    - Presentation to interested community interest groups
    - Web site updates
    - Community Forums and Workshops

Community Advisory Group

May form "ad hoc" advisory group depending on the circumstances with careful consideration of:

- When in the process?
- Who should be on it? (qualifications, experience, etc)
- What's their role?
- Who determines appointments?
- What is the term of the appointment?

Publications

A Primer on Proposition 98

October 1996

Since 1988, a voter-approved amendment to California's Constitution has protected K–12 education from cuts that have struck some of the other services supported through the state's budget. Proposition 98 also ensures that schools enjoy a large share of any increase in state revenues.

The calculation of the guarantee is very complicated, as is the politics of funding it. The dynamic process usually involves recalculations for previous years as well as estimates for the current year.

The Proposition 98 allocation depends on changes in enrollment, per capita personal income, and projections of state tax revenues. Despite heavy pressures on the state's budget in the early 1990s, the governor and legislature decided not to reduce the per pupil funding for schools. They did this through "prepayments" (also called "loans") against future Proposition 98 allocations. The California Teachers Association challenged the concept by suing the state (*CTA v. Gould*). A compromise solution, eventually validated by the courts, calls for education and the state to share in the "repayment." The agreement specifically states that the loan mechanism will not be used again.

As the chart shows, a strong economy has a favorable effect on education funding. For 1996–97 Proposition 98, bolstered by economic growth and the resolution of the court case, produced a windfall in revenues for K–12 schools.

Provisions of Proposition 98

Entitled the "Classroom Instructional Improvement and Accountability Act," Proposition 98 (1988), as amended by Proposition 111 (1990) and legislation, mandates that:

- A minimum amount of funding be guaranteed for elementary and secondary schools and community colleges, according to one of three tests.

  In years of normal or stronger revenue growth, the Proposition 98 guarantee is the larger of

  Test 1: the same share of the General Fund as in the base year of 1986–87 (recalculated to account for shifts of property tax revenues to schools) or

Test 2: the prior year's funding from state and property taxes, adjusted for inflation and enrollment increases. "Inflation" is defined as the growth in per capita personal income.

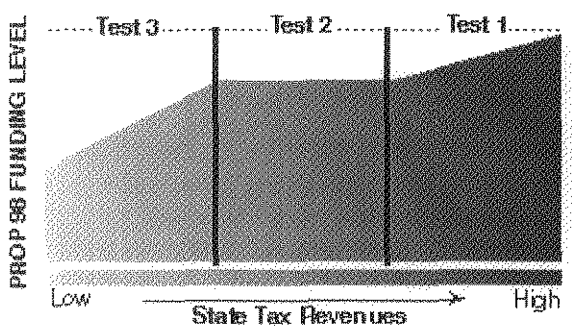
In years of low revenue growth, when General Fund tax revenues per capita increase more slowly than per capita personal income, the Proposition 98 guarantee is

Test 3: the same as Test 2 except inflation is defined as the growth in per capita General Fund revenues plus one-half percent. The difference between this amount and what Test 2 would have yielded is to be restored to education funding in years of high revenue growth.

Test 3b: any reduction, compared to the previous year, must be no worse than cuts in state spending per capita for other budgeted services.

- The state maintain a "prudent" reserve (not defined).
- Each school produce an annual School Accountability Report Card (SARC) with information about student achievement, dropout rates, class size, discipline, expenditures, programs, instructional materials, and other items.
- Suspending the provisions of Proposition 98 requires a two-thirds vote of the legislature and agreement by the governor.

PROPOSITION 98 TESTS



Proposition 98 funding levels for K-12 education are affected by the amount of tax revenues the state of California receives.

Source: Office of the Legislative Analyst EdSource 3/96

As provided by LAO (Legislative Analysts Office) December 16, 2002

Proposition 98

Overview

In the December revision, the Governor proposes to reduce Proposition 98 funding for 2002-03 by approximately $1.9 billion. The Governor's proposal would reduce funding to the estimated minimum guarantee of $44.6 billion. Figure 3 summarizes the main components of the proposal. While the Governor's proposal does not identify a total spending level for 2003-04, it does specify savings totaling $1.1 billion in the budget year.

Figure 3
December Revision
Proposed Proposition 98 Savings

(In Millions)

	2002-03			2003-04		
	K-12	CCC	Total	K-12	CCC	Total
Program Reductions						
Across-the-board	$980.9	$97.5	$1,078.4	—	—	—
Targeted	180.7	117.5	298.2	$191.6	—	$191.6
Reserve elimination	143.0	—	143.0	—	—	—
Fund shifts	349.2	7.6	356.8	—	—	—
Loans/transfers/reversions	—	—	—	870.0	—	870.0
Totals	**$1,653.8**	**$222.6**	**$1,876.4**	**$1,061.6**	**—**	**$1,061.6**

Main Features

The current-year Proposition 98 reduction of $1.9 billion consists of the elimination of the $143 million reserve and the following three components.

- ***Across-the-Board Reduction ($1.1 Billion).*** The Governor proposes reducing almost all Proposition 98 current-year General Fund appropriations by 3.66 percent. This would result in $1.1 billion in savings. Figure 4 shows the impact of the across-the-board cuts on major programs. The across-the-board reduction applies only to the General Fund portion of K-12 revenue limits (not the local property tax portion), so the reduction represents a 2.15 percent cut to total revenue limits. It is our understanding that the revenue limit reduction is a permanent one. The Governor's proposal, however, is ambiguous as to whether the categorical reductions are one-time or permanent. The proposal does not reduce any of the statutory requirements of the categorical programs.

Figure 4

Impact of the Governor's Across-the-Board Reduction

(In Millions)

Program	Reduction
K-12 revenue limits	$612.4
Special education	99.3
Community colleges	97.5
K-3 class size reduction	60.8
Adult education	20.8
Targeted instructional improvement grants	20.3
Other programs	167.3
Total	**$1,078.4**

- ***Targeted Reductions ($298 Million).*** The Governor proposes targeted reductions totaling $298 million. Most of this reduction is due to: (1) the elimination of California Work Opportunity and Responsibility to Kids (CalWORKs) Stage 3 child care, effective April 1, 2003 ($99 million) and (2) an adjustment to community colleges funding to account for improper concurrent enrollment of K-12 students ($80 million).
- ***Proposition 98 Reversion Account Swap ($357 Million).*** The Governor proposes reverting funds into the Proposition 98 reversion account from various prior-year appropriations for which the funds were not needed due to implementation delays or underutilization. Prior-year reversions include numerous child care programs ($103 million), the Child Care Facilities Revolving Fund ($22 million), Math and Reading Professional Development ($31.7 million), and various state mandates ($20 million). The proposal would use the reversion account funds to backfill $357 million of the 2002-03 General Fund appropriation for the Regional Occupational Centers and Program. This swap saves the state $357 million. A similar swap for adult education was part of the solution reflected in the *2002-03 Budget Act*.

Governor Proposes to Defer 2003-04 State Mandate Costs. In the *2002-03 Budget Act*, the state provided $125 million for K-14 education mandates and deferred approximately

$600 million in payments. The Government Code requires the state to pay interest (at the Pooled Money Investment Account rate) when paying overdue mandate claims. Thus, the current-year mandate deferral is equivalent to a low-interest loan from school districts. The Governor proposes to defer payments of K-14 state mandates for the 2003-04 budget and conduct audits of reimbursement claims, which the Governor estimates to be $870 million (we estimate that the cost could exceed $1 billion). The Legislature could reduce budget-year costs by suspending or eliminating specific mandates.

LAO Comments

Because the Governor's proposal would lower the Proposition 98 base, the state not only saves money in 2002-03, but also in 2003-04 and beyond. (While a current-year reduction down to the minimum guarantee can generate savings over several years, it does not affect the long-run Proposition 98 spending level.) Given these potential multiyear savings, we believe the Governor's goal of reducing 2002-03 Proposition 98 funding to the minimum guarantee is fiscally prudent. We also generally support the Governor's proposals for targeted reductions, the Proposition 98 reversion account swap, and elimination of the Proposition 98 reserve fund.

We do, however, have concerns with the $1.1 billion across-the-board reduction proposed in the December revision. Specifically, we believe the across-the-board cuts would have an adverse impact on direct services to students and would be difficult for school districts to absorb in the remaining months of the fiscal year. The across-the-board approach assumes that all existing programs have equal value. While relying mainly on an across-the-board reduction appears to allow school districts flexibility to determine how to implement the proposed cuts, this is not really the case. Since the Governor's approach would require school districts to continue to meet all of the program requirements of each of the categorical programs, school districts would have little ability to reduce program costs. For example, while the proposal would reduce funding for K-3 Class Size Reduction (CSR) by $60 million and special education by $99 million, school districts would still have to meet the 20 to 1 student-to-teacher requirement for K-3 CSR and provide all required special education services mandated by state and federal law. In contrast, targeting the reductions at programs that do not have a direct influence on student services would allow school districts to absorb the reductions with the least impact on students. Targeted reductions also allow programmatic requirements to be modified along with the funding.

LAO Alternative Approach. Figure 5 (see page 8) shows an LAO alternative to the Governor's $1.1 billion across-the-board reduction. It includes (1) more targeted reductions, (2) additional reversions, (3) a funding shift for Stage 3 child care, and (4) deferrals. We believe that these alternatives would allow the Legislature to minimize the impact of the reductions on the classroom by eliminating programmatic requirements along with the funding. Our approach would result in over $500 million in additional general purpose funds compared to the Governor's approach. Our approach also takes advantage of additional one-time savings and carry-over funds to generate one-time reductions in Proposition 98 General Fund appropriations.

Figure 5

LAO Alternative to Governor's Across-the-Board Reduction

(In Millions)

Program	Description of Alternative	Fiscal Savings
Instructional Materials One-Time Grants	Delay requirement that all school districts purchase instructional materials aligned to standards.	$150.0[a]
Reduce revenue limit COLA to statutory 1.66 percent	Reduce the COLA to the statutory rate of 1.66 percent from the budget act COLA of 2 percent. This option would have multi-year savings.	95.5
Backfill Stage 3 child care with one-time federal funds	Use one-time federal fund carry-over to backfill Proposition 98 funds for Stage 3 child care.	79.1
Supplemental Instruction—Remedial Programs	Revert unused portion of funds appropriated for supplemental instruction in 1998.	69.9[b]
High Priority Schools Grant Program (HPSGP)	Eliminate second HPSGP cohort. In addition, use 2003-04 Proposition 98 funds to make final 2002-03 payment since the final 20 percent will not be paid to schools until September 2003.	66.2
Math and Reading Professional Development	Delay initiation of program until future years.	63.4[a]
Immediate Intervention/ Underperforming Schools Program	Use 2003-04 Proposition 98 funds to make final 2002-03 payment since the final 20 percent will not be paid to schools until September 2003.	39.6
Reduce categorical COLA to 1.66 percent	Reduce the COLA to the statutory rate of 1.66 percent from the budget act COLA of 2 percent. This option would have multi-year savings.	25.4
CCC Part-Time Faculty	Cut part-time faculty extra compensation (as of February 1, 2003).	24.0
School Library Materials	Temporarily suspend program.	32.7[a]
Miscellaneous	Enact a combination of various reductions and reversions.	115.5[a]
Program funding deferrals	Provide funding for programs administered in 2002-03 in July	317.0

2003.	
Total	**$1,078.4**

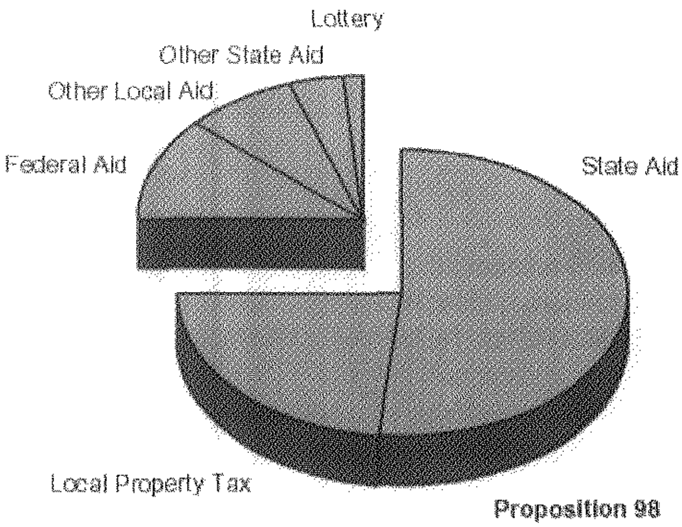
a Savings amount includes a mixture of General Fund and Proposition 98 Reversion Account funds. Additional action necessary to convert reversion funds into General Fund savings.

b Additional action necessary to convert reversion funds into General Fund savings.

Budget-Year Decisions. As noted above, a reduction of $1.9 billion in current-year Proposition 98 appropriations also reduces the 2003-04 minimum funding guarantee by a similar amount. However, to achieve these budget-year savings—and additional savings of almost $800 million—the Legislature would need to repeal specific statutory provisions related to "maintenance factor" repayments and deferrals. The Legislature could also avoid increased education costs in excess of $400 million in 2004-05 by accommodating Proposition 49-required increases in after school spending in 2003-04.

K-12 School Revenues

2002-03



- Proposition 98 is the shorthand term for the state's constitutional minimum funding requirement for K-14 education. This annual spending guarantee is met from two revenue sources: state aid and local property taxes.
- The state will provide 57 percent of all K-12 school revenue in 2002-03, while local government sources (property taxes and other local income) will contribute 31 percent. The federal government will provide 12 percent.
- The state lottery provides less than 2 percent of total school revenues, around \$138 per pupil.

As provided by LAO (Legislative Analysts Office)