



**CITY OF LODI
COUNCIL COMMUNICATION**

AGENDA TITLE: Review Analysis of Financial Challenges in Providing Local Services
MEETING DATE: March 1, 2006
PREPARED BY: Management Analyst, City Manager's Office

RECOMMENDED ACTION: Review "white paper" analysis of financial challenges in providing local services.

BACKGROUND INFORMATION: Staff has prepared a report to provide background and context for a proposed ongoing dialogue regarding the City's fiscal condition. The preparation of this report began partly in response to a Council request to consider a City Council sponsored sales tax measure to fund Public Safety and a Greenbelt Separator. The direct response of this request will be before the Council on March 29, 2006. It is not included in this staff report.

This report by staff shows clearly that the City of Lodi faces continuing and significant challenges in providing services at the same level with diminishing resources. With the passage of various tax measures, there has been a shift from local control to State control of resources used to fund local services. For example, last year the State shifted \$2.1 million (through the Educational Revenue Augmentation Fund) from the City to the State. While staffing levels have not kept pace with the City's population growth, the gap between revenues and expenses widens, making it increasingly difficult to maintain current service levels. Since fiscal year 2002-03, the combined sales and property tax revenues have not covered the cost of Public Safety. In addition, these levels of service should not be considered acceptable for future planning purposes.

Also considered in this report are the long-term financial implications of deferred maintenance. Postponing routine maintenance may provide short-term budget savings, but as demonstrated, the eventual consequence is often a more costly repair or premature replacement. An argument and estimates for an annual set-aside for capital replacement is also presented.

These challenges as presented in the attached report will be presented by staff in a PowerPoint presentation to Council on March 1, 2006.

FISCAL IMPACT: Information only. No revenue enhancements are proposed.


 Janet L. Hamilton
 Management Analyst

APPROVED: 
 Blair King, City Manager

FINANCIAL CHALLENGES IN PROVIDING LOCAL SERVICES



PREPARED FOR
THE LODI CITY COUNCIL

MARCH 1, 2006

HISTORY

Shifts in fiscal relationships in California have affected the delivery of services that local governments provide to its citizens. Local governments (cities and counties) are responsible for the provision of direct and essential services such as police and fire, street maintenance, water delivery and disposal, flood control, and more. While the cost of providing these services increases, the agencies responsible for their delivery face increasing challenges in their efforts to identify stable funding sources.

In 1978 California voters passed Proposition 13, which cut property taxes by about 50%. As an unintentional consequence of Proposition 13, the measure gave the State government the power to allocate the remaining property tax revenues between the State and local government. Property taxes had been the primary source of local government revenue as rates were subject to adjustments by the agencies for local needs.

Proposition 98 mandated that the State maintain a minimum funding level for education. The State chose to meet its obligation to fund education through the Educational Revenue Augmentation Fund (ERAF) property tax shift that transferred revenues from cities, counties, and special districts to schools. The ERAF transfer in Lodi accounts for a \$17.5 million loss in revenue over the past 11 years (*table 1*).

The institution of ERAF has taken significant amounts of discretionary funds from counties, cities, and special districts. Meanwhile the State institutions continue to grow. While the State has provided some mitigation funds, they are earmarked for special purposes. This negatively affects the bottom line, since local governments are constrained in their choice of how to spend this money, resulting in a less than dollar-for-dollar return of shifted ERAF funds.

Amounts Deposited into the Educational Revenue Augmentation Fund by City of Lodi		
Fiscal Year	Funds Shifted to Schools	Funds Allocated Back to City of Lodi
	From City of Lodi	by AB 1661 and subsequent legislation (ERAF Backfill)
	Amount	
1993-94	1,134,344.77	
1994-95	1,139,231.85	
1995-96	1,177,282.54	
1996-97	1,200,884.00	
1997-98	1,249,092.00	
1998-99	1,288,992.00	
1999-2000	1,361,627.00	153,274.79
2000-2001	1,466,249.00	204,855.85
2001-2002	1,609,005.00	
2002-2003	1,778,116.00	
2003-2004	1,944,104.00	
2004-2005	2,171,014.00	
	17,519,942.16	358,130.64

Source: San Joaquin County Auditor-Controller

Table 1

UNFUNDED MANDATES

It may be tempting to look to past practices in order to benchmark costs and service levels but the existence of many unfunded mandates as a result of legislation and regulation make any comparison irrelevant. Most of this legislation is crafted in response to citizen demand or as a tool to protect the well-being of those citizens. While well-intentioned, the requirement to implement these standards without designating funds forces local government to re-prioritize and, at times, neglect other responsibilities.

Examples of such mandates include the Hayden Act which extends the holding time of shelter animals from three to five days. The Act, however, does not provide the funding needed for the additional food or space required for the extension.

The NPDES (National Pollutant Discharge Elimination System) permit requirements for general wastewater and stormwater discharge have further diverted resources without a mechanism for reimbursement. The program dictates an aggressive and expensive effort to reduce the amount of contaminants discharged to the waterways. It also calls for additional reports,

procedures and staff certification requirements and associated training and continuing education at the local level. Measures to keep our waterways free of pollutants are necessary and politically popular, but no additional funds have been provided to local governments in order to fulfill the requirements. Failure to abide by the legislation governing the program can result in exorbitant fines. Those fines could be levied by multiple agencies concurrently--\$36,000 per day, per occurrence by the EPA and \$10,000 by the State.

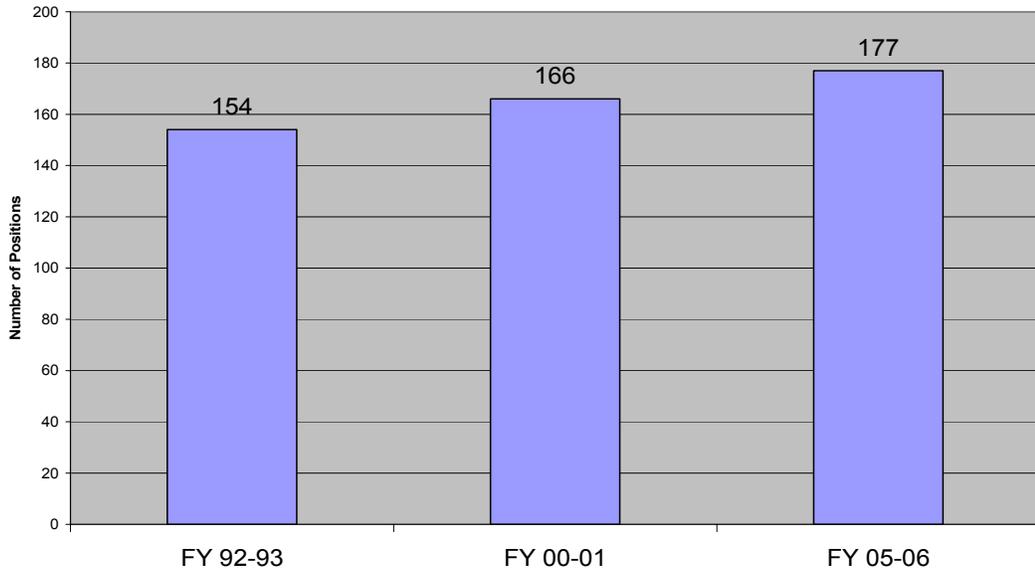
Requirements such as Harassment Awareness Training for employees, changes in street sign standards, ADA (Americans with Disabilities Act), underground tank, playground safety, and employee drug testing regulations are worthy efforts to improve service levels and overall quality of life, but they increase the burden put on limited financial resources. State-wide, police departments are mandated to provide programs such as the protocol for hearing citizen complaints, Bureau of Criminal Statistics reports on crime statistics, and DUI (Driving Under the Influence) arrests. The Lodi Police Department estimates these costs to be \$40,000 annually in staff time alone. Local governments thus feel strapped for cash and caught between providing essential services to citizens and funding mandated programs.

STATUS OF LOCAL SERVICE LEVELS

In a recent survey, Lodi citizens consistently rated Public Safety services a top priority and City leaders have responded by retaining staffing levels among the employees that provide those services (*Chart 1*). However, pursuant to Chiefs Adams and Pretz of the Lodi Police and Fire Departments, current staffing levels still do not adequately meet the needs of the City's increased population. Although maintained at higher numbers than other general fund employees, public safety staff has proportionately decreased in relation to the overall population (*Chart 4*). Despite this relative reduction, the cost of providing Public Safety services continues to consume an ever-increasing percentage of the General Fund budget. Total costs for these services now exceed revenues from both property and sales taxes combined (*Chart 2*). This in no way reflects upon

the admirable efforts of staff to keep costs in check. According to the Lodi Police Department, out of an operating budget of approximately \$13 million, only about \$400,000 is appropriated for supplies. The remainder is devoted to maintaining staff levels to ensure the public safety coverage citizens desire.

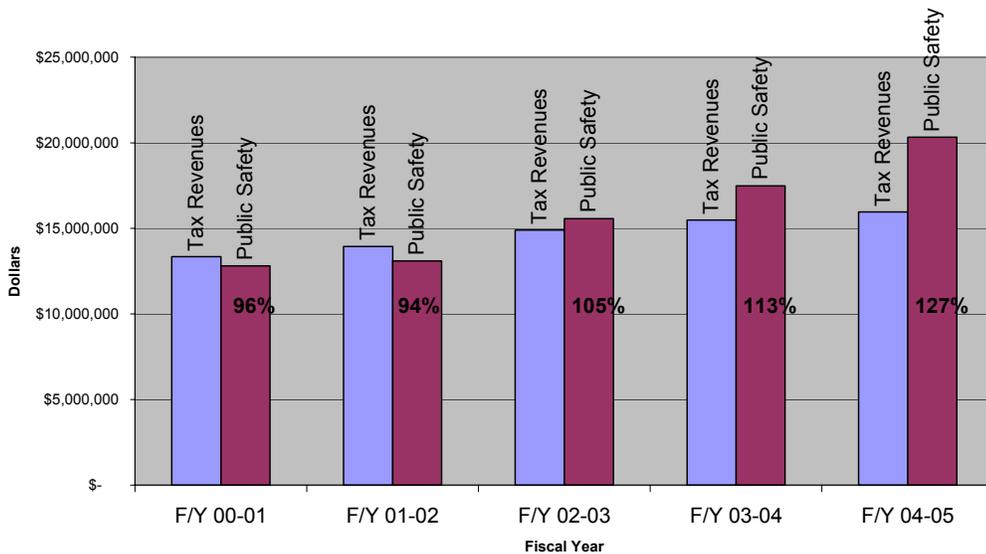
Number of Public Safety Positions



Source: City of Lodi CAFRs and Human Resources Department

Chart 1

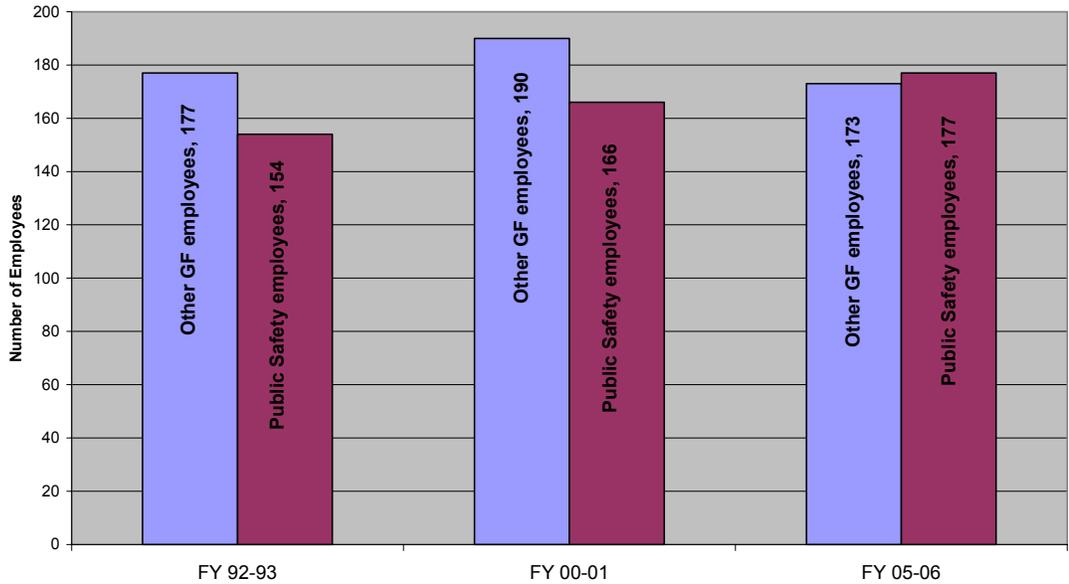
Public Safety Costs as a Percentage of Property/Sales Tax Revenues



Source: City of Lodi CAFR

Chart 2

Staffing Level History



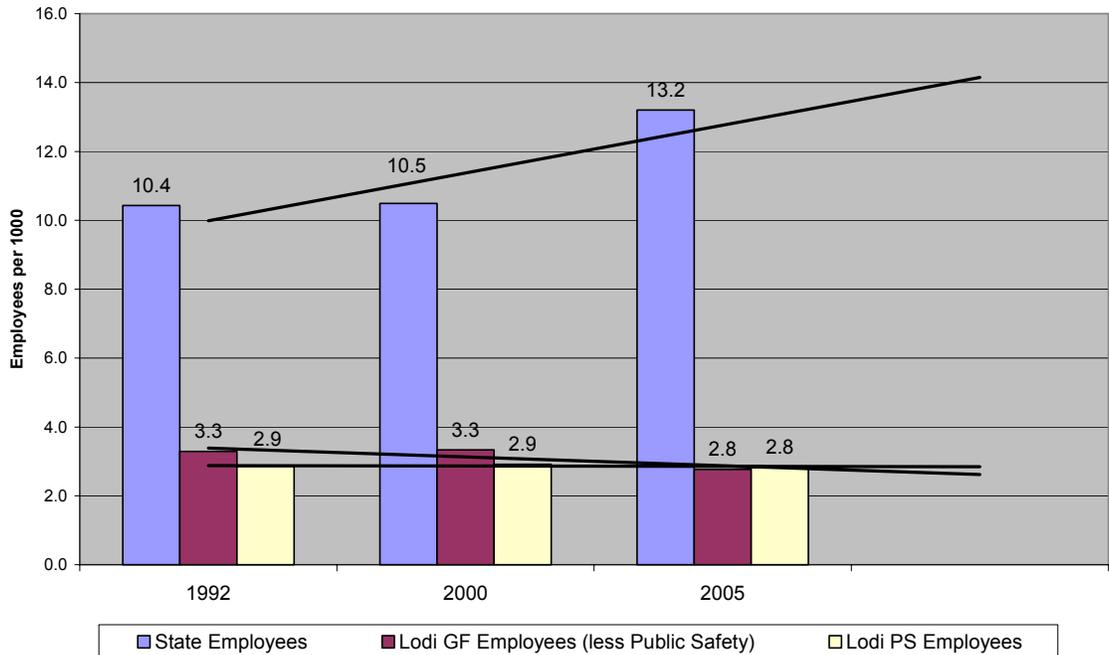
Source: City of Lodi CAFRs and Budget Documents

Chart 3

Lodi remains a safe, well-maintained community and residents have come to expect that level of service. Currently, City full-time General Fund (not including Public Safety) staffing levels are at 173—four less than recorded in the 1992-93 budget year (*chart 3*).

The same number of employees serves a population that has increased by 16%—maintaining 41 more streets than it did 10 years ago. Similarly, there are more parks, other facilities, and buses—offering more services overall. In contrast, while the employees serving 1,000 residents in the City of Lodi decreased from 6.2 in the year 2000 to a current 5.6, the ratio for State of California employees increased from 10.4 to 13.2 (*Chart 4*).

Employees per Capita



Source: City of Lodi CAFRs and Budget Documents, US Census website Chart 4

DEFERRED MAINTENANCE and FIXED ASSET REPLACEMENT

When faced with budget deficits, a common short-term solution is to defer routine maintenance or not budget for replacement costs. This approach may temporarily reduce expenses, but in many cases, the aggregate of repair or premature replacement costs exceeds the amount saved by this deferral.

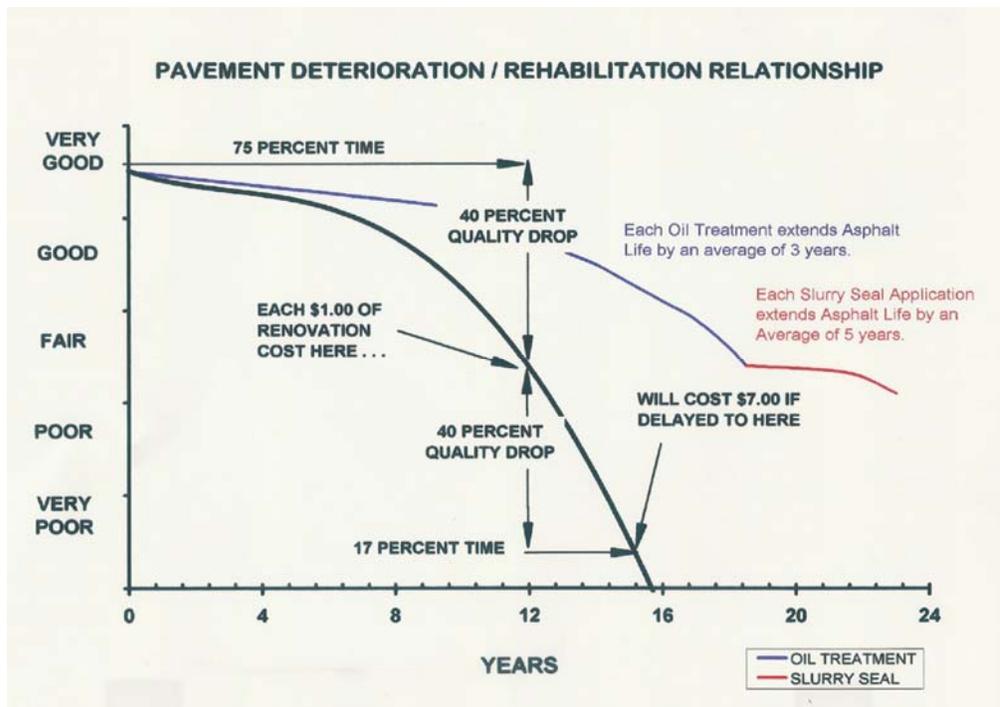
As noted by League of California Cities President Alex Padilla in the February 2006 edition of Western Cities Magazine:

“Years of under-funded maintenance work – in part resulting from the \$6 billion, multi-year state take-away of local funds through the ERAF property tax shift – left many cities with insufficient revenues to pay for even routine maintenance projects. The consequences of years of deferred street and road maintenance are most evident in older cities. But even newer communities are challenged to find the funds necessary to keep up with the demands of a growing

population for streets, parks, libraries, flood control, water delivery and other essential infrastructure.

Our residents see this problem every day, and their frustration with inadequate infrastructure undermines our ability to build new housing the state so urgently needs. When current residents are already living with potholes in the roads and poorly maintained parks, they have every reason to oppose new housing that would increase traffic or overcrowd a park.”

Street maintenance is one area that the increased cost of deferred maintenance can be illustrated. The following graphics (Charts 5 & 6) provided by the City of Lodi’s Streets Division show how various maintenance strategies can extend the life of a city street.

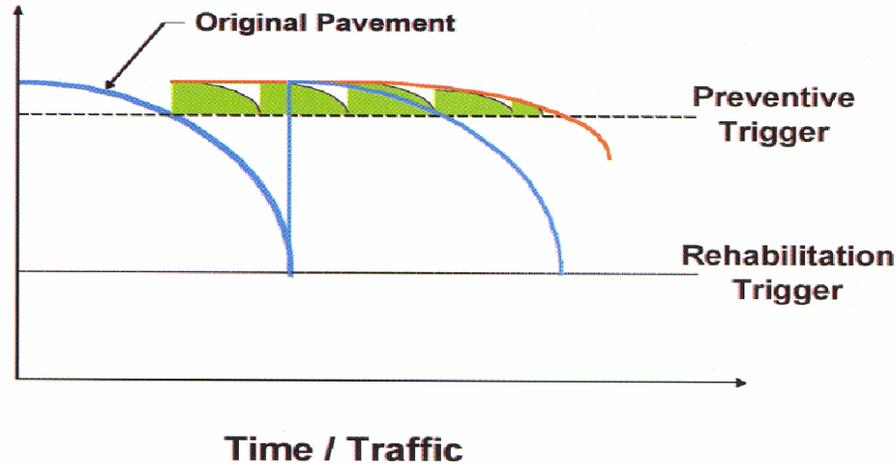


Source: City of Lodi Public Works Department

Chart 5

PAVEMENT PRESERVATION CONCEPT

The pavement preservation concept is that an agency can apply a relatively low cost treatment to a pavement surface while it is still “good.” After treatment, the pavement will be improved and its life extended for some period of time. Pavement preservation requires a commitment by the agency to apply the preservation activities before significant pavement failure occurs.



Source: City of Lodi Public Works Department

Chart 6

The estimated cost to maintain pavement in order to maximize its life cycle is \$1.01 per square yard per year. Total area for the City of Lodi streets currently stands at 4,319,700 square yards, requiring \$4.36 million in labor and materials annually for proper maintenance. In order to achieve optimal maintenance levels, the amount allocated in the 2005-06 Streets Division operating and capital budgets of \$2.56 million would need to increase by \$1.8 million. Unfortunately, due to unfunded mandates, increased expenses for public safety, and slow revenue growth, the budget reductions in recent years have had a negative impact on the PCI (Pavement Condition Index) of the City's streets¹.

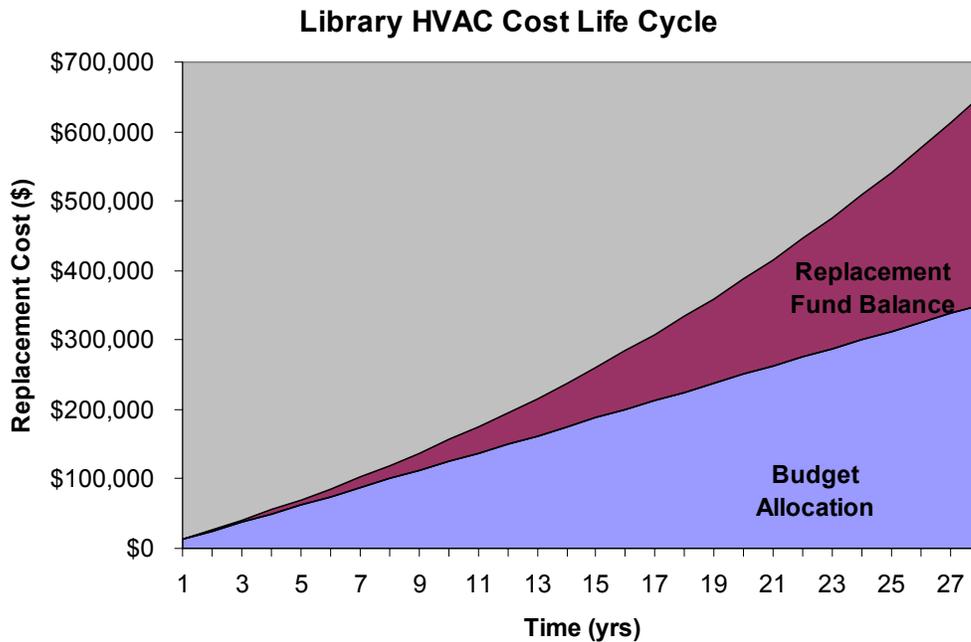
The practice of deferring maintenance for short-term savings will eventually lead to higher replacement costs in other City departments as well. Lodi Parks and Recreation Department staff has provided estimates that an additional \$1.86 million is needed in order to adequately maintain parks and facilities. Public Works Maintenance and Facilities staff (responsible for facilities

¹ The PCI is a measurement of pavement grade or condition and ranges from zero (worst) to 100 (best). An optimal PCI is in the low to mid 80s. At a PCI of 60, pavement begins to deteriorate at a rate several times faster than a PCI above this mark. The overall condition of streets has been measurably compromised, with the PCI dropping from 79/100 10 years ago to a current 66/100.

not maintained by Parks and Recreation or Hutchins Street Square) recommends an additional \$1 million be appropriated to adequately maintain facilities. This would mean total additional costs to achieve preferred maintenance levels would be \$2.86 million.

A formula for the replacement of the City's inventory of fixed assets such as City Hall, the fire stations, Grape Bowl, and parks could also be devised. As facilities age, funds could be designated for their eventual replacement. While the Police Station, Hutchins Street Square, and Fire Station #4 are relatively new and replacement is not of immediate concern, the Grape Bowl and Fire Station #2 should be replaced, yet funds for the projects have not been identified. The Parks and Recreation Department recommends setting aside \$1.8 million for the replacement of parks, facilities, and the equipment to maintain those assets. Public Works staff recommends an annual appropriation of \$2.5 million for the replacement of all other facilities (excluding Hutchins Street Square and the White Slough Water Treatment plant). While ideal, the ability of the City to set aside \$4.3 million annually for replacement of facilities in addition to the \$2.86 million for maintenance is unrealistic. A more reasonable goal for an annual replacement set-aside is \$2.1 million.

The advantage of establishing an annual set-aside (asset replacement sinking fund) is illustrated with the pending purchase of a new HVAC system for the Lodi Public Library. The aggregate estimated set-aside that would be needed to replace the HVAC system cost amounts to \$350,227 versus the replacement cost today of \$650,000. This is based on \$12,508 invested annually for 27 years at a 4% return on investment. The balance would have been earned with compounded interest earnings (*Chart 7*).



Source: Lodi Public Works Department, Facilities and Maintenance

Chart 7

OPERATIONAL REPLACEMENT COSTS

Included in the operational costs are the tools used to deliver services. While the fleet inventory has increased, the funds available for replacement have decreased. \$107,500 was budgeted for the replacement program for fiscal year 2005-06. This amount was reduced from previous allocations of between \$300,000 and \$600,000 in an effort to balance the budget. The furniture for the new Public Safety building was included in the capital cost of the project, as were those of the Community Center (Hutchins Street Square) or the Carnegie Forum remodel. Replacement of those furnishings, however, has not been considered and will need to be addressed in the annual budget process for those individual departments.

GENERAL FUND STATUS

The General Fund provides for the discretionary (non-mandated) services the City provides. Among those vital services are police and fire protection and street, park, and facilities maintenance and improvements. In order to adequately fund these services, the City of Lodi needs to ensure a stable flow of

revenue into the General Fund. It is estimated that a \$6,000,000 undesignated minimum reserve is needed. The reserve on June 30, 2005 was \$1.5 million. This reserve is an improvement over Fiscal Year 2003-04 when the reserve was \$156,650. The reserve has been increased by reducing service levels and leaving 29 positions vacant.

HOW OTHER CITIES HAVE ADDRESSED SHORTFALLS

Cities are relying more heavily on transaction (sales) and use taxes to fill the ever-increasing disparity between the cost of services and revenues. The City of Lodi currently receives 29% of its General Fund revenues from transaction and use taxes. This discretionary tax has come to provide significant amounts of local revenues. Many agencies have responded by placing local transaction and use tax proposals before voters.

A state-wide Transaction and Use tax has been in place since 1933 and currently stands at 7.25% comprised of the following components:

Rate	Jurisdiction
4.75%	State (General Fund)
0.25%	State (Fiscal Recovery Plan)
0.50%	State (Local Revenue Fund)
0.25%	State (General Fund)
0.50%	State (Local Public Safety Fund)
1.00%	Local (County/City) 0.25% County transportation fund 0.75% City and County operations
7.25%	Total

Table 2

Many local jurisdictions impose additional taxes for specific purposes. San Joaquin County has been collecting an additional .5% for the San Joaquin Transportation Authority since 1991.

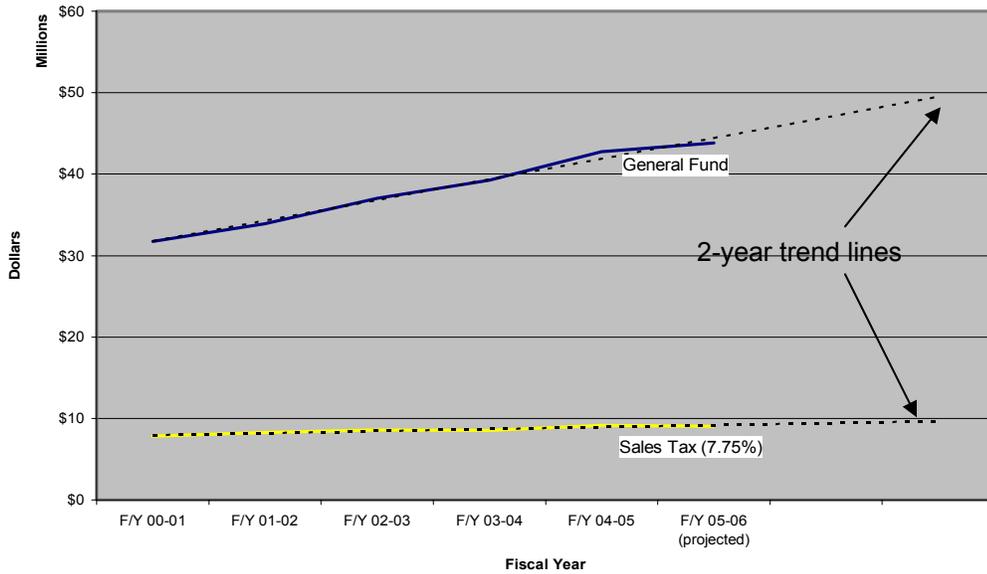
California cities have increasingly gone to the voters asking for approval of measures to increase sales tax or other revenues in order to maintain service levels. During the 2005 November elections, the cities of Delano, San Rafael, Merced, Salinas, Scotts Valley, Waterford, and Tulare won approval for a half cent sales tax increase through general tax measures. Dinuba and Porterville proposed and won special sales tax measures specifically earmarked for police and fire services. Stockton voters approved Measure W, which designates the full quarter cent increase to fund public safety services. A specific spending plan that calculated all associated costs was presented to citizens. The plan provided for the fully loaded (salary plus benefits) cost of a specific number of personnel, their vehicles, and related safety equipment. This detailed information and aggressive communication efforts gave voters the assurance that the funds would be used as presented and the confidence to support the measure.

OPTIONS FOR LODI

There are several options available to the City to resolve these shortfalls and provide support for vital City services. Various options for such a measure are available for consideration—Transaction (sales) and Use Taxes, both general and special, Transient Occupancy (hotel/motel), Utility User, and Municipal Service (parcel) taxes and bonds. Parcel taxes, special taxes, and non-school bonds require 2/3 voter approval. Revenues generated from the Transaction and Use or TOT tax may be classified as either special or general. General tax measures require only majority voter approval.

Over the past five years, the City of Lodi's General Fund expenses have increased by \$12,043,925 (27%) while sales tax revenues in Lodi have increased by \$1,205,201 (13%) (*Chart 8*).

Sales Tax/Expenditure Trends



Source: Source: City of Lodi CAFRs and Budget Documents

Chart 8

A measure to increase sales tax by .25% could provide a minimum of \$2.3 million annually in additional revenues if the current number of retail establishments remains stable. Growth in the number of businesses contributing to the base as well as an increase in sales volumes would drive the value of this revenue source higher yet.

Lodi's current Transient Occupancy Tax (TOT) rate is close to 4% lower than the 10% state average. An increase of 3% in that rate would generate an estimated \$176,000 in additional revenues annually, based on current room rates and volume. An increase in the TOT is more acceptable to local voters since it is imposed not on residents but as customers of local hotels and motels. According to PKF Consulting Vice President Ken Kuchman, hotel/motel customers do not base their choice of lodging on the TOT rate, but on the daily room rate. With the increased focus on tourism and the potential for additional hotel rooms, a measure to increase the TOT rate is an option to reconsider.

The Utility User Tax (UUT) may be imposed by a city on the consumption of utility services, including (but not limited to) electricity, gas, water, sewer, telephone, sanitation and cable television. The rate of the tax and the use of its

revenues are determined by the local agency. A UUT may be imposed as a special tax, earmarked for a specific purpose, or a general tax to be used for a variety of municipal service needs at the discretion of the city council. The tax is levied by the city, collected by the utility as a part of its regular billing procedure, and then remitted to the city.

Throughout California, the Utility Users Tax (UUT) is vital to funding essential municipal services. In some cities different rates apply to residential than to commercial users. The average rate is 6% and may be applied to a variety of utilities. Because most large cities have UUTs, the majority of California residents (over 54%) and businesses pay a Utility User Tax. On average, the UUT provides 15% of general purpose revenue in cities that collect it. In some cities, the UUT provides as much as 1/3 of the general fund. UUT revenues most commonly fund police, fire, parks, library, and long-range land use planning services, and related support services.²

In many cities, the UUTs are the result of cuts in property tax revenues, a top source of general purpose revenues. Cities responded by cutting services, deferring infrastructure maintenance, relying more heavily on debt financing, paring down reserves, more aggressively pursuing sales tax generators, and raising taxes and assessments. Within a few years of the beginning of the ERAF property tax shifts, more than fifty (50+) cities increased an existing or levied a new UUT.³

City of Lodi citizens have a variety of choices in order to preserve services levels. Each type, Transaction and Use (sales), Utility User, and Transient Occupancy (TOT) require approval of at least 51% of residents through the ballot process. It is essential that open dialogue, clear communication, a comprehensive educational process, and an understanding of processes be undertaken prior to any decision.

²Michael Coleman. *California Local Government Finance Almanac*. February 2006. Sponsored by the League of California Cities

³Michael Coleman. *California Local Government Finance Almanac*. February 2006. Sponsored by the League of California Cities