CITY OF FARMERSVILLE

DRAFT

FISCAL YEAR 2016 – 2017

PROPOSED BUDGET

For City Council Work Study Session:

JUNE 6, 2016

FISCAL YEAR 2016 – 2017

BUDGET MESSAGE

TO: HONORABLE MAYOR GOMEZ AND CITY COUNCIL

FROM: JOHN JANSONS, CITY MANAGER

STEVE HUNTLEY, FINANCE DIRECTOR

DATE: JUNE 6, 2016

A Message From Your City Manager:

It gives me great pride, yet mild trepidation, to present to you a proposal for anticipated revenues and planned spending in Fiscal Year 2016-2017.

The pride is a result of the exemplary City Staff you have that have not only produced these budget documents; Finance Director Huntley, Finance Manager Ashoori, and Finance support staff Amezcua and Haro, but for all the hard working and dedicated employees in every department who delivered you, and our community, great success and service in this passing year. Each and every employee has done more with less, worked to identify ways to economize and maximize our precious funds, and have never wavered in their commitment to provide excellent customer service with the resources available to them.

You don't have to look far to see that progress in Farmersville is active and constant. From the major infrastructures projects near completion (Sports Park and Roundabouts) to those ready to start construction this summer (water meter installations and drought response landscaping, the Visalia Road Improvement Project, and the opening of our new Library) Farmersville continues to *move forward.*

My concerns for the coming year are twofold in that property tax and sales tax revenue are growing at a slower rate than status quo service delivery costs and that the City of Farmersville continues to depend heavily on one time grant funds and contracts that are transient and unreliable in place of adequate and consistent revenues for municipal service delivery at present or desired levels.

As you read on, you will see that Mr. Huntley and I have presented you with more detailed concerns in several areas, a conservative estimate of revenues and a sensible spending plan to maintain existing service levels. The extreme austerity and reductions in force and service are no longer necessary as we heal from the Great Recession, but vigilance and care is key to maintaining a sustainable spending plan. With the current need to replace lost grant funding for Fire services, we hope for a renewal of SAFER funding (will know later in June), but in the absence of an infusion of grant funds, utilizing reserve funds to make up the difference in expenses versus revenues going forward is unstainable and will lead to eventual insolvency.

To avoid this fate, unpleasant cuts will need to be made effecting all departments and all services. No single department is large enough to absorb reductions to fill the gap left by the loss of SAFER funding. Any reduction in any department due to current minimum staffing levels, would be felt far and wide resulting in reductions in service not acceptable to staff and very likely, the community.

Serious consideration of immediate revenue enhancement is another option to consider to address this immediate problem, or the same problem is very likely to reoccur in another two years should SAFER be awarded and then not renewed in future. Potential strategies to address this could include a tax increase proposed to the voters of Farmersville for either sales or property tax increases, or a utility user's levy for general government services or dedicated to public safety. Any effort to increase revenues in this away will require costs for professional advisors and require substantial staff resources which would necessitate suspension of other projects and initiatives given our current resources levels.

So it is with these concerns in mind that we anxiously await good news of the restoration of SAFER funding and begin the discussion of the road ahead and what we believe to be a realistic budget proposal for Fiscal Year 2016-2017.

Again, I want to thank all of our dedicated staff for all their hard work throughout the year and to the Finance Department and all departments contributing to this budget presentation.

Respectfully,

John Jansons

City Manager

Introduction and Purpose

City staff is presenting the City of Farmersville budget for the Fiscal Year 2016-2017 (FY 2017) for your review, consideration, and adoption. Staff presented a mid-year review on February 22nd and a Third Quarter Update on April 24th to keep the Council current, but this budget report aims to provide a further update of the City's financial status and present a clear image of where we are headed for the next year.

Once again, staff has put many hours of hard work and research to develop a budget that reflects the direction and priorities of the City Council and City Manager, the best interests of the City and all City Departments. The City has come a long way financially in the last few years which is encouraging. As an update to last year's budget report and the mid-year review for FY 2016, this report will also cover potential challenges that lay ahead for the FY 2017 period.

Like prior years, the goal of this document is still to present a thorough, yet straightforward, report to allow for clear understanding in a format that is friendly to those less familiar with municipal finance. This year the City continues in that pattern.

Budget Assumptions

There are certain assumptions that must be in place before any changes or updates are made to the City budget. First, forecasting is a critical and essential piece of the budget process. Forecasting is a combination of reviewing current year actual amounts, analyzing historical data, economic trends, and information from other agencies and resources. No two years will ever be the same even though some revenues and some expenditures are the same from year to year; so careful analysis must be done.

Revenues and Expenditures (the money the City collects and spends) are both closely monitored and forecasted conservatively. The underlying philosophy in our policies and procedures stay the same, which is to practice prudent budgeting and fiscal management. This can be a painful experience some times, but making the right choices now will pay off for the City in the long-run. The City hopes to accomplish this by keeping current in financial reporting and creating open communication with the City Council, the community and all City departments.

Accomplishments & What's New This Year

The last year proved to be an interesting one with some accomplishments worthy of mentioning. Most significantly, the City received an unmodified audit opinion and had no findings as reported by the auditors. This is a significant step that the Finance Department is proud of since it represents so much work from FY 2012 where the City did not even receive an opinion because of the adverse situation it was in.

Each year, however, presents a renewing challenge and it is anticipated that the FY 2016 audit will be completed on time before December 2016 and presented to City Council. Financial stability in reporting and processes are now becoming regular for the City, which is essential to keeping all the other aspects of the City successful. The Finance Department continues to complete all bank reconciliations on time and balanced, the upgrade of the City's accounting software was successfully completed, and some overhead expenses were eliminated which should increase efficiency.

The Finance Department is proud of the all the work that has been done to solidify the footing of the City, but will not rest on those laurels. This does not mean that the challenges in the environment are gone, but now the City is in a better position to handle them as they present themselves. As Finance Director, I would like to personally commend the finance staff again this year for their excellent work.

As mentioned last year, the City is entering a unique period this year filled with the opportunities and challenges associated with multiple, major infrastructure projects under construction at one time. This busy trend will continue in the years ahead as more projects proceed through development.

The accomplishments and changes are something to celebrate, but also represent some of the challenges to face in Fiscal Year 2017.

Budgetary Concerns & Key Points for the Future

At the mid-year review in February 2016, Finance Staff presented key points that will be critical for the FY 2017 budget period. These issues have persisted and are appropriate to review with the budget presented this year. Currently, the City Manager has given approval to submit this draft budget that while, balanced as a whole, has significant deficits that should be reviewed in both the General Fund and the Water Utility Fund. So, in addition to reviewing the key points from the mid-year review, this section will summarize the changes to the budget leading to deficit positions for two significant funds within our organization.

The key points to review from mid-year are:

A. Potential Revenue Losses

At the FY 2016 mid-year review, two easily identifiable threats to General Fund revenue were identified. The most obvious and largest revenue challenge facing the General Fund to date is the SAFER funding for two Fire Department positions. This grant is the only funding source available to provide viable revenue to support these positions at this time. When the grant was accepted initially in 2014, finance staff had been informed that this was a three year grant period with payment from FEMA to cover the first two years. Through good planning and the controlling of expenses, the City does have enough set aside to pay for our obligation for only the third year.

However, the City has since learned that the grant is only a two year requirement and that the City has applied for another SAFER grant but the potential award notice is still pending (notice arriving in June).

The recommendation from finance staff, is to accept the grant, should it be awarded later this month. Given that we project that it would only be possible to preserve these positions without additional funding for one year at most, the acceptance of the grant should only be done if accompanied with immediate action to determine how to find another revenue stream to pay for these positions. If additional revenue is not found within that time, the City will need to significantly scale back expenses. These positions cost approximately $245,000 a year (or about 11% of revenue).

The second large revenue challenge for the General Fund is the lease hold contract with Tulare County for County Fire Administration at 907 W. Visalia Road. This lease expired in August of 2015 and is now in month to month hold over status. The City Manager has engaged the County, its Chief Administrative Officer, Fire Chief and the Real Estate Division to gain more certainty about the County's intentions and timeline to little avail. Recently, the City has been informed that the County may discuss this issue with the Board of Supervisors on June 14, 2016 to reveal the County's plan for activating the Cigna Building in Visalia where it has been speculated that County Fire might relocate, but no time table has been revealed to date. This agreement currently represents approximately $122,608 in unobligated General Fund revenue annually (about 6% of revenue). Given the limited information provided by the County, and the large endeavor it is to reallocate a County Department, the lease revenue has been budgeted with the assumption that it will continue uninterrupted for all of FY 2017.

B. <u>CalPERS Unfunded Accrued Liability (UAL)</u>

Regarding the UAL, no significant changes have occurred since the mid-year report. The City is still on track to pay the required annual amount, but paying upfront will save the City 3.55% immediately. The FY 2017 payment due, per CalPERS actuarial reporting, is $99,820 which is up $9,146 from last year. FY 2018 will be the last year of significant increases with the final payment of $109,434. The payment for FY 2019 will be down significantly to $50,020, saving the City $59,414 from FY 2018.

Paying a lump sum at the beginning of the year is still recommended since these payments are required by CalPERS annually and the cash cannot be safely invested for a yield equal to the savings gained by paying upfront. The payment must be sent by 7/31/16 in order to save the $3,674 (3.55%).

C. <u>Compensated Absences and Vacation Accrual Caps</u>

Outstanding balances of accrued vacation time remains a threat to the City's financial position. As reported by the FY 2016 mid-year review, as of 6/30/2015, the audited unfunded liability of employee accrued annual leave was $696,201. Currently, this figure continues to grow (and about 74% of this liability is owed from the General Fund). Staff will propose strategies to address this in the coming year which could include a cap of vacation leave accrual for all employees coupled with a buy down program or establishment of a liability trust fund established for this purpose.

No action has been taken yet toward a solution for this issue in the budget for FY 2017 so as to not inflate the deficit position further, but the firefighter's labor agreement approved this year by City Council begins to set precedent for addressing this liability. Staff continues to recommend that vacation accrual be capped and suggests working with bargaining groups toward creating a compensated absence trust fund to house assets to offset this liability going forward. In order to do this, agreements and/or payouts must be in place with the existing employees over the cap amount. The Finance Department is ready to assist the City Council and City Manager and in determining the direction to go with this concern.

D. Human Resources, Salary, Benefits and Risk Management Cost Increase Growth

As highlighted in the FY 2016 mid-year review, salary and benefit growth are consistent across years. There are some natural fluctuations through attrition and other changes but most growth, up until this point, has been covered by grant-related income. While this is a good way to expand services without running into deficits or otherwise addressing inadequate General Fund revenues available for desired service levels, relying on grant funds is precarious and volatile should funding be eliminated and force the City to act drastically to address losses of grant revenue.

Most salary and benefit costs in the General Fund have increased across the board. Keep in mind that the die was cast with last year's budget, which for performing employees, effectively set in motion increases of most salaries by over 8% once the Cost of Living increase, City payment of FICA, and 5% step increases for most employees took effect.

An additional expense seen in FY 2017 is the City Council approval to convert the City Clerk position to full-time in order to address work load and staffing needs in the City Manager's Office. The annual additional cost is budgeted at net increase of $18,657.40 to the General Fund.

Other human resource and risk management expenses are projected to rise and these include, membership in the Employment Risk Management Authority (ERMA) as approved by City Council ($16,500) and anticipated unemployment insurance payments attributed to employee terminations ($9,701). The combined total is approximately $28,000 in FY 2017.

E. Enterprise Fund Performance

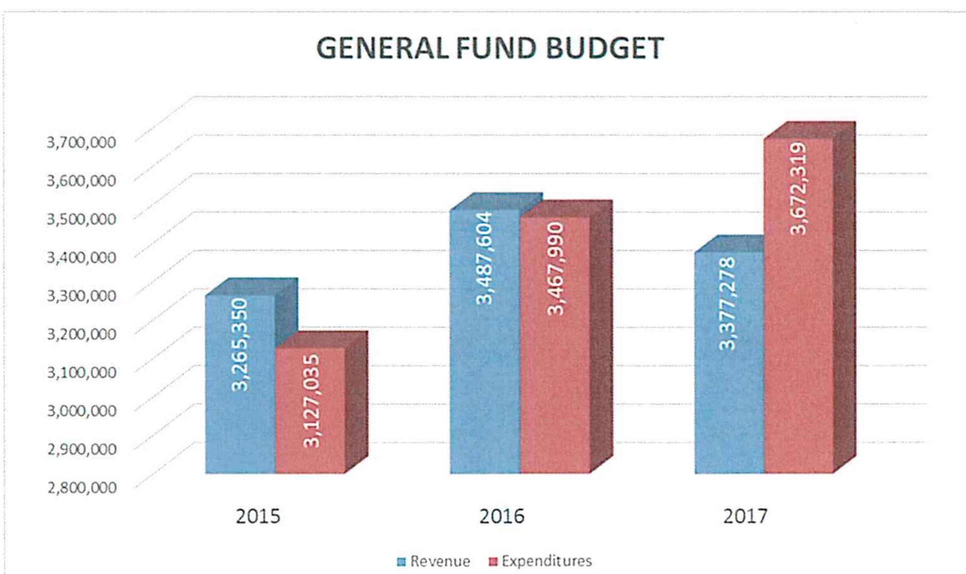
Although the Water Utility Fund is still budgeted to be at an operating loss this next year, as it was the last several years, the City has acted in line with Finance recommendations to take action on utility rate changes and/or metering of residential usage. Since then, the City has accepted the award of the Water Energy Grant (to install radio-read meters) but limited progress has been made since then. The deadline for the Water Energy grant work to be completed in December 31, 2017. Since this project is wide-reaching in scope, the City will likely be pressed for time and needs to make faster progress. After consulting with the City's Engineer, Quad Knopf, this project has been estimated and budgeted to be completed in FY 2017, but this will need to be evaluated again at mid-year.

Additionally, City staff is still awaiting the results of a water rate study from City Engineer Quad Knopf. Much of the delay is caused by the tenuous legal position created by the determination made regarding tiered rates in a City of San Juan Capistrano legal suit.

However, until both the grant work and the rate study are completed, our hope for a significant turnaround in this fund must again be delayed now to late FY2017 or FY 2018. The water fund operated at a loss starting in FY 2010 which persists to date. The losses have mounted because costs have naturally risen over time, but the revenue is insufficient because of an antiquated flat-rate fee structure which has not been increased since before 2010. This fund is simply not bringing in enough revenue to support the services delivered. In 2013, the operating loss was $92,441, in 2014 it was $100,399, and in 2015 it was $117,566. Currently, we are on target to meet or exceed our anticipated loss for 2016 of $90,358, but the budget for FY 2017 projects the loss skyrocketing to $169,969.

Focus on the General Fund

An Analysis of the deficit position with the General Fund reveals a number of small changes punctuated by a couple of large issues that are almost entirely outside of the control of City staff or the Council. Some significant changes to revenue (as indicated above) as well as some significant expense changes (separate from Salaries & Benefits) have made an impact this year.



After reviewing the changes made this year, we feel the following are the most pertinent:

A. General Revenues (Sales Tax, Property Tax and VLF) are forecasted to increase by less than 1%. Overall, total General Fund revenue is forecasted to decrease by $110,326 or 3.2% due mostly to losses of grant revenue. The end of FY 2016 will see a modest increase in sales tax and property tax but we cannot budget with this increase in mind as it is a direct result of the unwinding of the “Triple Flip” (please see Attachment 3 for more detailed discussion of the “Triple Flip”) . This is a complex process initiated by the State that pays Economic Recovery Bonds with sales tax generated by local cities and counties. Cities are repaid the missing sales tax with property tax originally intended for schools, and schools are made whole through reimbursement from the State General Fund.

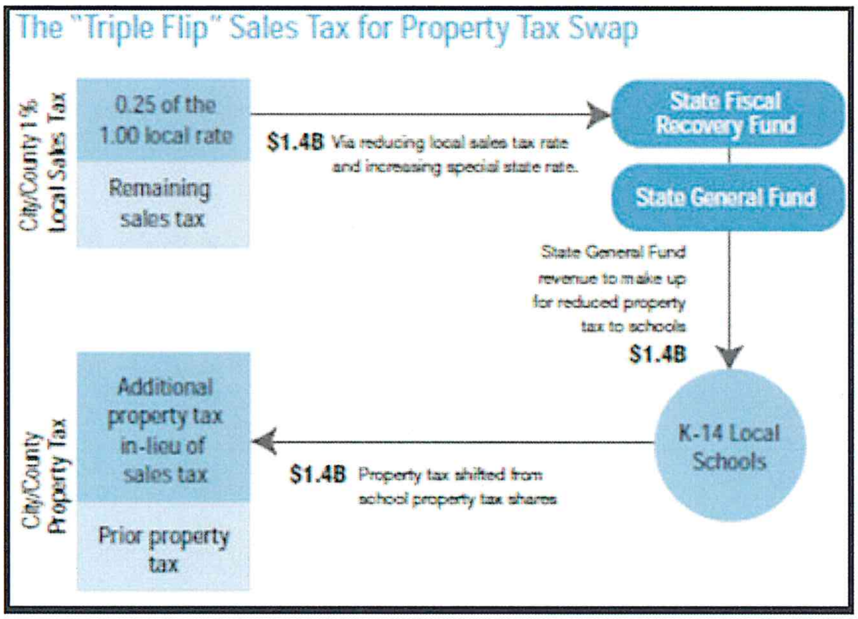
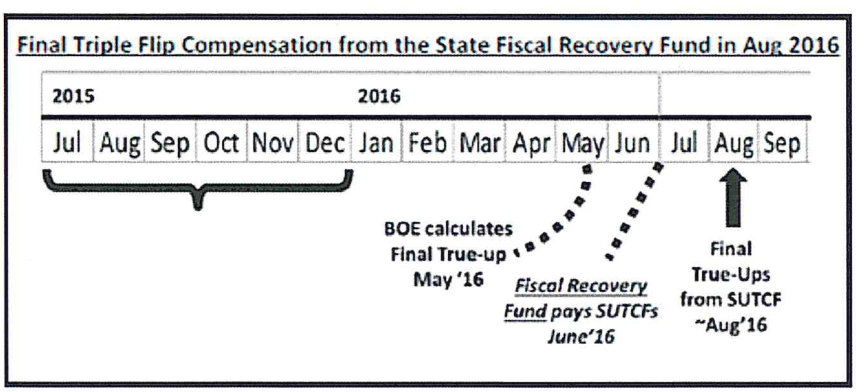


Image credit to Michael Coleman californiacityfinance.com

Now that the bonds are paid off, the last reimbursements from the State are squeezed closer together because, when this started in 2005, there was a three month delay in the first payment which will finally get caught up in this last year.



To complicate things further, the over-advancing of sales tax from the end of FY 2015 by the Board of Equalization (BOE) to Farmersville means a reduction in City revenue payments this year to compensate and correct the State's error. It is difficult to say for certain if this bump due to the end of the "triple flip" and decrease in revenue from the BOE will offset completely or not as the last payments for the year won't arrive until August 2016. Either way, these adjustments are one-time in nature, and in light of lower gas prices over this last year, it has compelled Finance Staff to scale back earlier estimates of FY 2017 revenues.

B. Overhead expenses are increasing and offsetting overhead revenue is decreasing simultaneously. Overhead expenses are anticipated to rise to higher levels as seen in previous years due to increasing trends with legal fees and other administrative costs.

   Overhead revenue (money transferred to the general fund from the enterprise funds to pay for administrative functions and costs) will likely be lower since the margin by which revenue for refuse collection services that we bring in and expenses we pay our trash hauler could decrease in FY 2017 pending a final interpretation of the current contract and any further negotiations with the hauler. Conversation with the City's trash hauler about certain increases has already begun and this may lead to a contract amendment or other results that are unknown at this time. Although this is a function of the Refuse Fund, any additional funds, or lack thereof, directly impact the General Fund as they are closely linked.

C. Police expenses are increasing and revenues decreasing simultaneously. In addition to some increases with repair, maintenance, and other professional and contractual costs, there is a growing trend in overtime (OT) expenses year to year (nearly doubling in cost from 2013 to 2015 even though slightly less OT hours were worked).

   Overtime costs are difficult to budget because, most often the need for overtime happens unexpectedly as result of an unplanned absence, sickness, or critical situation. Overtime is seldom the result of planned vacations due to Police Department policy and practice to avoid this. However, overtime continues to be a regular, and on-going expense and has been incurred every pay period (for various reasons) over the last several years. Since FY 2013, overtime hours worked averaged over 2,100 annually, and while the amount of hours worked are relatively consistent, the cost associated with these hours has quickly grown and should be addressed in order to normalize this expense.

   Another sizable cost, the police vehicle purchase plan, calls for expensing $59,000 annually toward new vehicle purchases to smooth costs over time. This cost was shifted to a Police revenue allocation outside the General Fund to avoid impacting the General

Fund this year. The next scheduled purchase of vehicles is in FY 2018 per the purchase plan approved by Council. The last purchase of vehicles was in early FY 2016 but purchases could be approved in FY 2017 upon a demonstrated need by the Police Department and approval by City Council if warranted, which would advance the purchase plan by one year. These purchases are currently not budgeted for FY 2017.

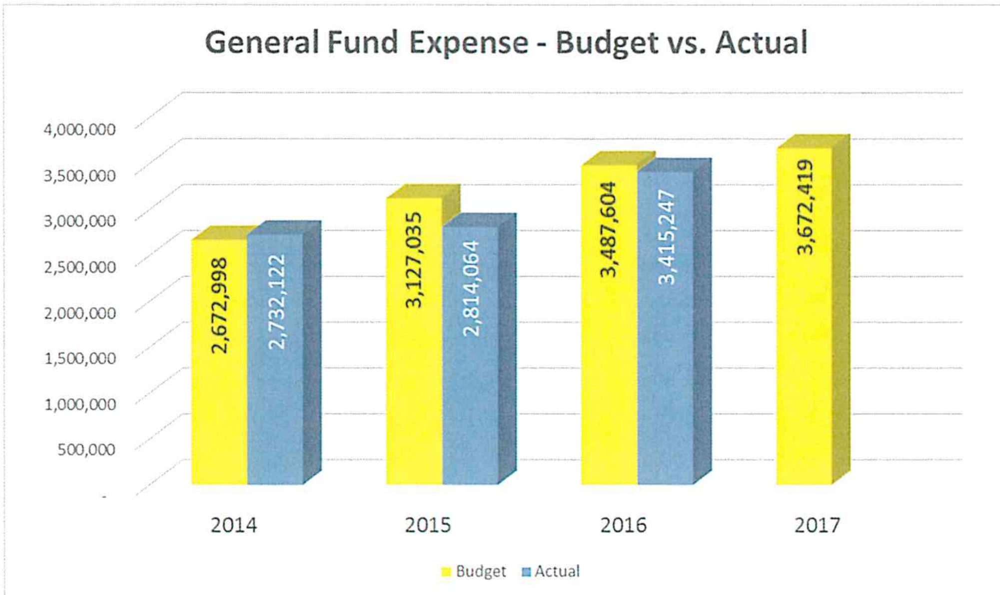
Most revenue in the Police Department directly offsets some kind of expense (usually staff expense or equipment purchase grants). As grant or other allocations of funding end, they create a dramatic decrease in revenue visible in the budget. The COPS funding source is one example. The revenue stream ends as anticipated and then the "pick-up" period begins in order for the City to honor the original grant acceptance terms. If not managed carefully and thoughtfully, this can create dramatic deviations in revenue and expenses and these swings in funding that could have lasting effects on the bottom line and employees.

D. Community Development expense increases are largely due to grant consulting fees and a proposed increase to the City Sponsorships including the Recreation Fund. The more grants we apply for, accept, disburse and manage the greater the cost in this program area. We are currently at an all-time high with nearly 20 different grants and funding sources either applied for or in process.

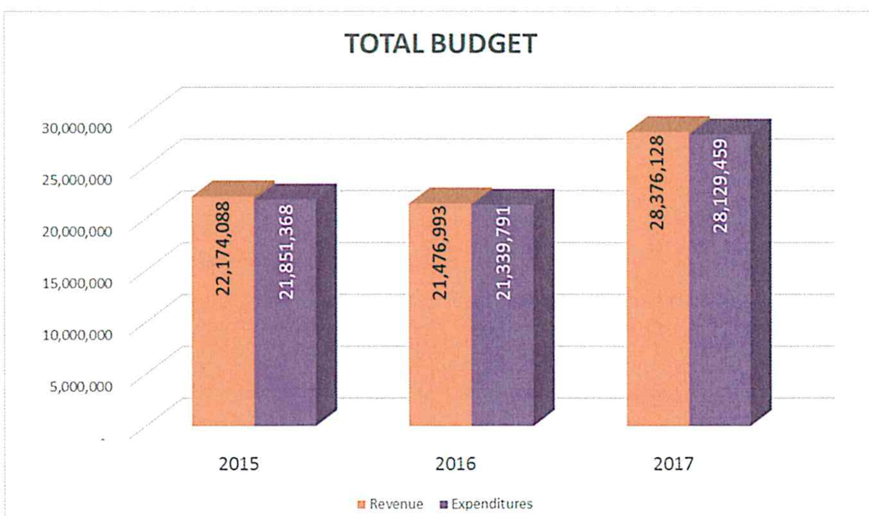
E. Fire expenses are increasing and revenues decreasing simultaneously. Aside from the challenges posed by losing funding through the end of the Staffing for Adequate Fire & Emergency Response (SAFER) grant for two of our fire positions, as previously discussed, there is a City expense to use VFA grants funds for equipment purchases, since the VFA only reimburses at 50% of purchase, but the alternative would be a purchase at 100% of cost without VFA or no purchase of needed life safety equipment.

While many of these expenses are problematic for us this year, these expenses are not a surprise or unexpected. Costs continue to rise each year, even when service levels are held static.

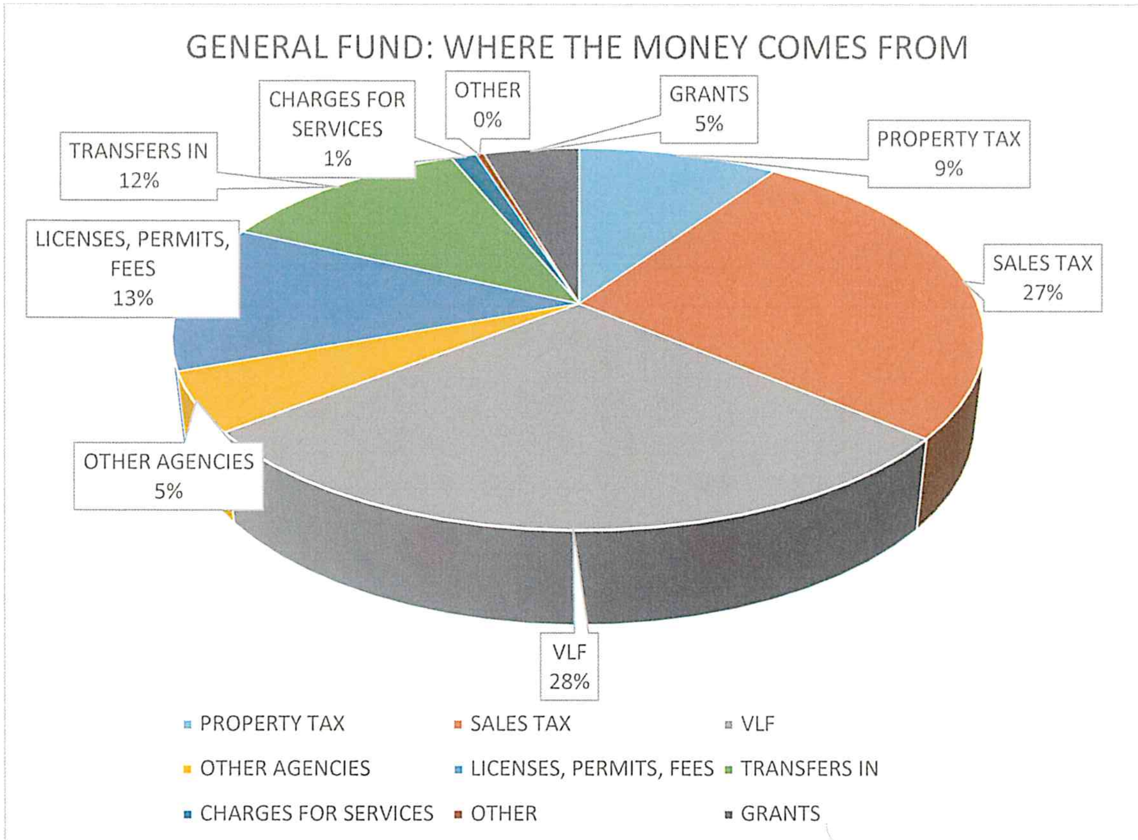
The substantial dip in revenue for this year is concerning, but explainable and, for the most part, was anticipated. However, if our two revenue issues explained earlier (SAFER grant ending and rental income interrupted), were to suddenly not be an issue, this budget for the General Fund would still be in a deficit of only approximately $50,000. As discussed earlier, deficit spending quickly becomes unstainable and City Staff needs to continue to take decisive action toward reversing this trend.



The general fund budget increased in FY 2015 by 17% and in FY 2016 by 11.5%. The increase proposed for FY 2017 is 5.3% or $184,815. Spending for FY 2016 is estimated to be under budget by 2.1% or $72,357 but final numbers won't be available until September when the books are closed and the audit is completed. This continues to be a good sign that spending is largely consistent with the budget overall. There is always room for improvement and the City Staff will continue to practice thrifty and sensible spending in the coming year.



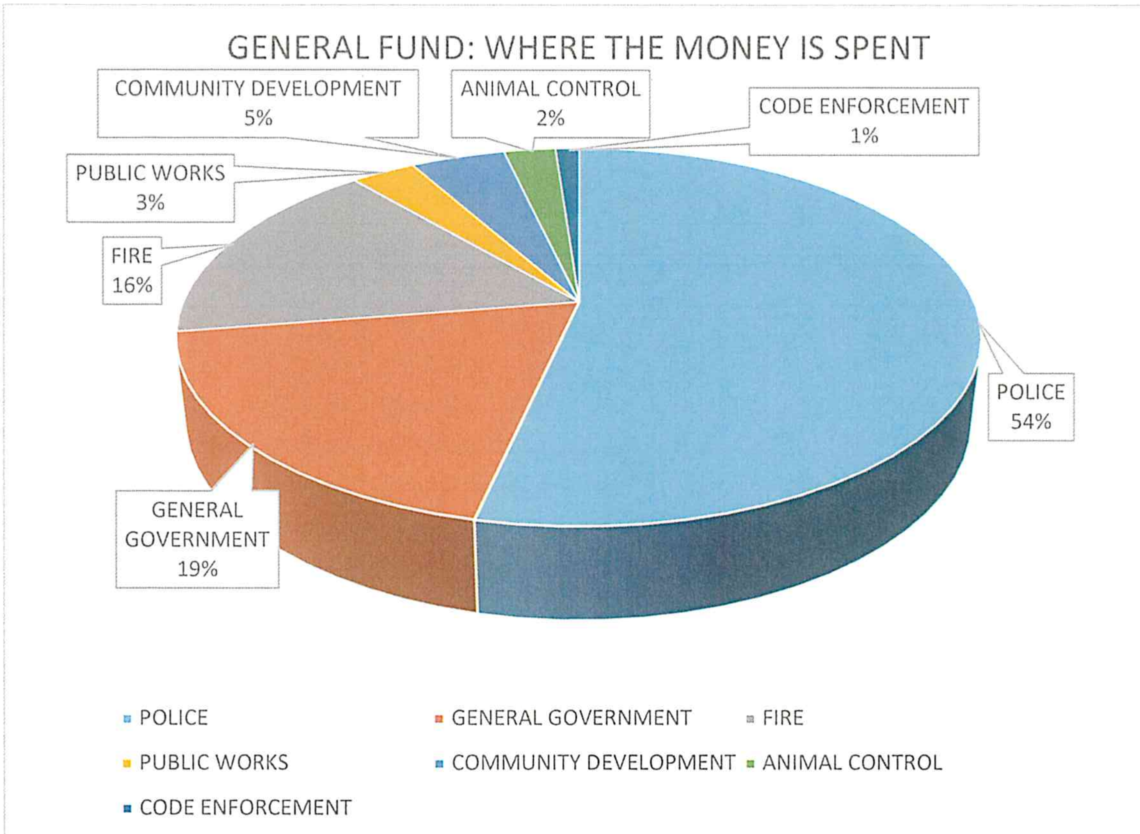
Total Budget figures remain inflated due to large projects initiating in this year. As projects are completed the budget will decrease in size.



GENERAL FUND: WHERE THE MONEY COMES FROM		
REVENUE SOURCES	AMOUNTS	PERCENT
PROPERTY TAX	312,035	9.4%
SALES TAX	882,549	26.7%
VLF	930,455	28.2%
OTHER AGENCIES	165,904	5.0%
LICENSES, PERMITS, FEES	414,088	12.5%
TRANSFERS IN	394,935	12.0%
CHARGES FOR SERVICES	40,000	1.2%
OTHER	12,257	0.4%
GRANTS	150,055	4.5%
TOTAL		
	3,302,278	100.0%

Revenues are forecasted to decrease slightly from last year; expenses to be covered with reserves.

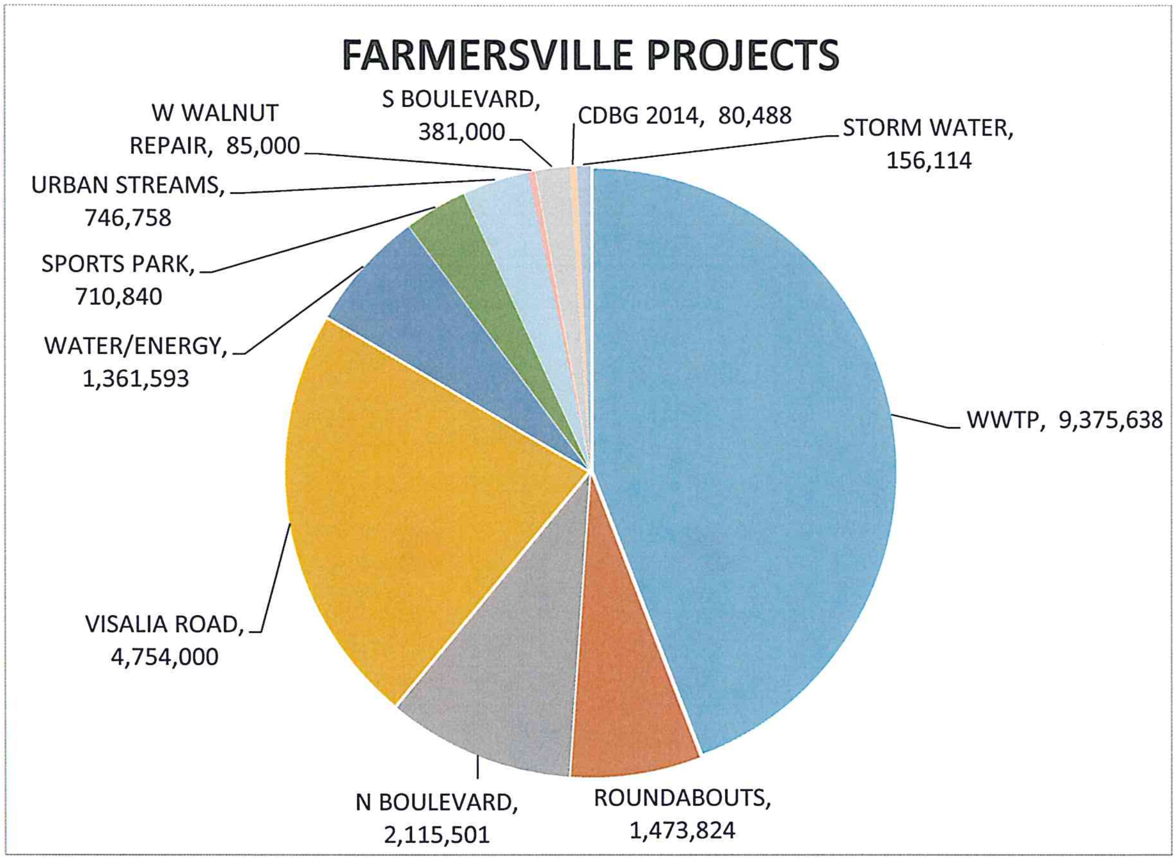
Revenue is forecasted to decrease next year by $110,326 or 3.2% for the General Fund. This is due to a slight decrease in franchise fees from SoCal Gas, and the potential loss of grant revenues (specifically SAFER and COPS).All other revenue sources outside the general fund, are all budgeted to have matching expenses or less except for the Water Utility Fund.



GENERAL FUND: WHERE THE MONEY IS SPENT		
APPROPRIATIONS	AMOUNTS	PERCENT
POLICE	1,963,892	53.5%
GENERAL GOVERNMENT	698,029	19.0%
FIRE	597,914	16.3%
PUBLIC WORKS	114,088	3.1%
COMMUNITY DEVELOPMENT	165,500	4.5%
ANIMAL CONTROL	90,958	2.5%
CODE ENFORCEMENT	41,938	1.1%
TOTAL		
	3,672,319	100.0%

Expenses continue to rise for a variety of different reasons this year.

There are $3,672,319 budgeted in expenditures and $3,302,278 in revenues resulting in a deficit position of $370,041 for FY 2017 which will be covered with cash from reserves. Most of this deficit is due to covering Fire Department positions no longer supported by SAFER grant funding. This will be a significant strain on the fund unless another revenue source is found. Expenses are up from last year by $184,815 or 5.3%.



FARMERSVILLE PROJECTS		
PROJECT	AMOUNT	SOURCES
WWTP	9,375,638	2
ROUNDABOUTS	1,473,824	4
N BOULEVARD	2,115,501	1
VISALIA ROAD	4,754,000	1
WATER/ENERGY	1,361,593	1
SPORTS PARK	710,840	4
URBAN STREAMS	746,758	1
W WALNUT REPAIR	85,000	2
S BOULEVARD	381,000	2
CDBG 2014	80,488	1
STORM WATER	156,114	1
TOTAL	21,240,756	20

Seventy-six percent of the FY 2017 budget is dedicated to large projects and grant related expenses.

Of the $28,129,459 total budget, $21,240,756 (76%) is due to large projects and grants. All told this represents no less than 20 unique funding sources, some of which are used in multiple projects. In fact, we have two projects with four funding sources each – posing a significant administration department and financial staff undertaking. This is down from last year (81%) as spending is decreasing on projects nearing completion.

CONCLUSION

The City of Farmersville continues to forge ahead with many projects and community enhancements. This does not mean that the process is not filled with the challenges discussed. Although there are some significant revenue drawbacks this year it is hoped that they will prove to be a catalyst for more efficiency in the future and will ultimately improve the City. The City should however, move forward with caution on the road ahead as was done in FY 2016, because it is not known what external shocks could hit the City in the year ahead.

Continued prudent action and conservative planning is paramount to the success of the City's projects and future goals. I am confident that these years will be a turning point for the City of Farmersville.

Although, operating with a General Fund deficit that will be covered by fund balance is not a desirable path, it is acceptable to use resources in this way for one time situations. Caution should be heeded when these appropriations of reserve funds are used for ongoing salary and benefits or other reoccurring operational costs because this quickly becomes unsustainable and will lead to unacceptable reductions in force or services and ultimately, insolvency.

The attached spreadsheet to this report is the proposed budget document. Finance staff respectfully submits the budget document for review and approval by the City Council for the Fiscal Year 2016-2017.

The Finance Department has put many hours of hard work to try and produce a readable document clearly illustrating the budget requests of the various City departments. The goal is to produce a report, in combination with proposed budget information to be presented in a clear, unbiased, and transparent way to express and review the opportunities and threats to the City in the coming year.

In conclusion, staff is prepared to take direction from the City Council regarding the proposed Fiscal Year 2016-2017 draft budget.

Respectfully submitted,

Steve Huntley

Finance Director

ATTACHMENTS: 2

1) Proposed Draft Fiscal Year 2016-2017 Budget Document (Spreadsheet)
2) Informational White Paper on the "Triple Flip"