CITY OF YUBA CITY
STAFF REPORT

Date: February 6, 2018

To: Honorable Mayor & Members of the City Council

From: Finance/IT Department

Presentation By: Robin Bertagna, C.P.A., Finance Director

Summary

Subject: Financial Report for the Six Months Ended December, 31, 2017

Recommendation:
A. Approve a $60,000 supplemental appropriation to account 1210-62730 (Professional Services-Personnel Attorney); and
B. Note and File the December 31, 2017 Financial Report

Fiscal Impact: $60,000 requested supplemental appropriation to Personnel Attorney budget line item

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Purpose:

To provide City Council with a summary of the first six months of FY 2017-18 revenue and expenditures of the City's major operating funds.

Background:

Finance provides periodic Financial Reports to City Council to keep them apprised of the City's financial activities along with trends in revenues and expenditures.

Analysis:

The attached December 31, 2017 Financial Report has been prepared for City Council review. Mid-year is the appropriate time to review revenues and expenditures and evaluate if any modifications are required to the adopted budgets. Staff is requesting a supplemental appropriation of $60,000 from unallocated general fund balance to account 1210-62730 (Attorney—Professional Services Personnel Attorney). As of December 31, 2017, $73,713 has been spent from this account which had an original budget amount of $64,500 ($9,213 over-budget midway through the year). The overruns are due to ongoing costs associated with past and current labor relations, employment issues and areas surrounding risk management which continue to evolve and require the oversight of the City's employment attorneys.

Fiscal Impact:

The addition of a supplemental appropriation of $60,000 from general fund unallocated fund balance to the Personnel Attorney budget line item.

Alternatives:

Note and file financial report and do not approve requested supplemental appropriation.

Recommendation:

A. Approve a $60,000 supplemental appropriation to account 1210-62730 (Professional Services-Personnel Attorney); and

B. Note and file the December 31, 2017 Financial Report

Attachment:

1. Financial Report

Prepared By:

/s/ Robin Bertagna
Robin Bertagna, C.P.A.
Finance Director

Submitted By:

/s/ Steven C. Kroeger
Steven C. Kroeger
City Manager

Reviewed By:

City Attorney

TH by email

ATTACHMENT 1

FINANCE DEPARTMENT

FY 2017-18 Financial Report

For the Six Months Ending 12/31/17

February 6, 2018

OVERVIEW

The FY 17/18 adopted budget had a surplus of $0.2 million. This is the first year that the City has had a surplus budget since the recession began. The City closely managed expenditure levels in an effort to sustain the general fund's reserves until such time as the pension obligation bonds were paid off in FY 16/17. The City's long-range financial model was used as a tool to carefully balance the City's priority service needs with the fiscal reality of limited revenues all with the end goal of a balanced budget in FY 17/18. The City has achieved this fiscal goal only to now be confronted with exorbitant future CalPERS retirement cost increases which will cause significant financial stress on the City's budget priorities.

As of July 1, 2017, the general fund had an unassigned fund balance of $6,076,786 as stated in the City's annual independent audit, the Comprehensive Annual Financial Report (also known as CAFR). This amount meets the City's Fiscal Policy requirement of a 15% general fund reserve. The 15% Fiscal Policy minimum reserve level is a recommended best practice and is supported by the Government Finance Officer's Association of the United States and Canada.

Although the City has recovered from the recession, we continue to carefully prioritize our finite resources. The current expansion phase of the business cycle began more than seven years ago, after the recession bottomed out in June, 2009. As of January, 2018, we have had 103 months of expansion, and counting. The average expansion cycle from 1945 to 2009 (11 cycles) has been 58.4 months. We are well beyond that. It is difficult to determine when the next downturn in the economy will occur, the only certainty is that it will. It is important for the City to maintain it's 15% general fund reserve; ensure that both the water and wastewater enterprise fund revenues are sufficient to cover operating, debt service and infrastructure replacement costs; plan for infrastructure renewal and replacement; and to continue monitoring fiscal performance regularly.

The CalPERS Board voted in December, 2017, to maintain the lowered discount rate from 7.5% to 7.0% with the three year phase-ins over a period of several years beginning in FY 18/19 for public agencies. The CalPERS Board had been evaluating the possibility of lowering it even further. This would have had abysmal fiscal impacts on the City. As it is, the fiscal impact of a 7.0% discount rate will be <u>significant</u>. The most recent projections based upon the June 30, 2016 CalPERS actuarial reports project that retirement costs will grow from $6.8 million in FY 16/17 to $12.3 million by FY 24/25, nearly doubling. It will be a challenge for revenues to grow sufficiently to keep pace with just this mandatory expenditure. This doesn't take into consideration growth in other expenditure categories or needs of the community such as infrastructure renewal and replacement, employee cost of living increases, or any other budget priorities. The City Council will be carefully prioritizing allocation of resources to cover increases in employee compensation and benefit costs, allocate funding towards unfunded pension liabilities, fund unmet facility and infrastructure needs related to parks and roads, cover the cost of providing police services to all City residents, and address deferred maintenance and improvements throughout the City. The good news, in FY 15/16 City Council approved the set-aside of $2 million in a Pension Stabilization Trust Fund which can be utilized to buy down a small portion of the large pension cost increases looming on the horizon.

The City's financial model projected a balanced budget beginning in FY 17/18 prior to the action taken by the CalPERS Board to increase retirement contributions by lowering the discount rate. Given that action, the City will continue to have financial challenges beginning in FY 19/20. The projected increases in CalPERS, healthcare and workers' compensation costs will be partially offset by increased revenues in both sales tax and property taxes. However, without further prioritizing service delivery, revenues will not be able to keep pace with expenditures in future years.

The City continues to see a large number of vacant positions. Finance evaluates vacancies on a quarterly basis to monitor the anticipated savings to the budget based on those vacancies. During the past year the vacancy ratio has ranged from a low of 10.5% in December, 2016, to a high of 15.2% in June, 2017. Human Resources places a priority on recruitments in order to expedite the hiring process. However, the City's goal remains to hire the right people to join the City's team rather than merely filling slots. Finance anticipates that even though the FY 17/18 adopted budget has a small surplus, the City will end the fiscal year with a larger surplus due to the number of vacant positions throughout the year and the savings that is generated. The savings will be partially offset by the cost of one-time payments to employees which have been agreed to as part of the bargaining unit negotiating process. There will be additional vacancy savings offset due to increased overtime for shift coverage in both the Police and Fire departments.

With the City facing projected budget deficits again beginning in FY 19/20 based upon the large increase in CalPERS costs, the City has worked to balance out employee desires for salary increases with available resources. What this has resulted in with bargaining units that the City has achieved agreement with is a combination of one-time money with on-going money. More specifically, where closure has been achieved the City has agreed to pay 2% or $1,500, whichever is higher, to employees in FY 17/18 along with a 2% on-going increase as of July 1, 2018.

This report is prepared on a cash basis; therefore it describes the timing of cash flows as it relates to the City's revenues and expenditures.

Beginning Balances. The City's annual independent audit was complete in December. We have received and included the auditor's adjustments to the City's ledgers. The beginning fund and working capital balances presented in this report are final year end amounts from the previous year audit report and will not change.

Adjusted Budgets. The revenue projections and expenditure budgets include adjustments for encumbrances, carryovers, and any supplemental appropriations made by the Council as of December 31, 2017.

GENERAL FUND

General Fund Financial Condition. With 50% of the year complete, General Fund revenues are at 25.9% of projections and expenditures are at 48.4%.

General Fund

	Budget	YTD Actual	Percent
Balance, Start of Year	$ 6,076,786	$ 6,076,786	-
Revenues	42,222,740	10,945,911	25.9%
Expenditures	(42,531,375)	(20,566,741)	48.4%
Balance	**$ 5,768,150**	**$ (3,544,044)**	**-**

The budgeted expenditures shown above include encumbrance carryovers from FY 16/17 of $555,000. Encumbrance carryovers are outstanding purchase orders as of June 30th. Encumbrances are liquidated and paid from the beginning fund balance as prior year budget monies are used to pay for them (as opposed to current year revenues). In addition, budgeted expenditures include $533,000 added for public safety grant funded programs.

In the YTD Actual shown above, the ending fund balance is negative as of the end of the second quarter. The negative balance is an indication of the typical cash flow pattern for the general fund. This happens because general fund expenditures for payroll and vendor payments are incurred evenly throughout the fiscal year whereas our largest revenue sources of sales tax and property tax lag in receipt compared to the timing of when they are earned. Property tax is received in two large payments in February and May when property taxes are received from Sutter County. This is the City's second largest revenue source for the general fund and when they are received only two times per year, it causes the cash flows (and therefore fund balance) to go deficit until the first installment is received. The City receives two advance payments and a true-up payment for each quarter of sales tax revenue. However, there is a lag in time as to the end of the quarter of revenues and when the cash is received. For example, the advance payments for the Christmas quarter (October through December revenues) are received by the City in January and February with the true-up payment in mid-March. When additional sales tax is received from the State and property taxes are received from Sutter County, this will turn around and fund balance will end the fiscal year with a positive balance. The negative fund balance as of December 31, 2017, was compared to that of December 31, 2016, and the City is approximately $725,400 worse off (a larger negative) in 2017. Upon analyzing this change, it is entirely attributable to the City prepaying its unfunded actuarial liability payment to CalPERS in July, 2017, in order to receive a discount. After factoring in this pre-payment, the City anticipates having budgetary savings of approximately $1 million at the end of the fiscal year.

Revenues.

The City's top ten revenues account for approximately 94% of total General Fund revenues. As such, they provide a very good summary of our revenue position. Key revenues are performing as projected based on payment schedules and past trends for the half way through the fiscal year. More detailed information is noted below.

Top Ten Revenues	Budget	YTD Actual	% Received
Property Taxes	$ 12,456,700	$ 104,340	0.8%
Sales Tax	13,350,000	4,475,734	33.5%
Business Licenses	947,200	73,434	7.8%
Franchise Fees	1,769,600	309,149	17.5%
Hotel/Motel Surcharge	961,500	279,385	29.1%
Building Permits	900,000	492,489	54.7%
Police Special Services	220,000	51,071	23.2%
CSA "G" Fire Contract	735,400	0	0.0%
Recreation Fees	1,012,900	323,782	32.0%
Operating Transfers	7,293,931	3,646,479	50.0%
Total	**$ 39,647,231**	**$ 9,755,862**	**24.6%**

- **Property Tax.** The first apportionment of FY 17/18 taxes will not occur until February, 2018. The FY 17/18 adopted budget projected a 4.0% increase in property taxes. Based upon the final assessed valuation reports from the Sutter County Auditor-Controller's Office, general fund secured and unsecured assessed values increased by 4.79%. Property tax revenues are expected to exceed budget projections by approximately $50,000 at the end of the fiscal year.

Five of the largest components of the change in assessed values are as follows:

- Properties were adjusted by a CPI factor of 2.0% between FY 16/17 and FY 17/18 (an increase of $63.9 million in assessed valuations), this accounted for 30% of all growth experienced in the City.
- Residential increased by 5.7% ($193.7 million).
- Unsecured decreased by 7.75% ($25.8 million) in assessed valuations. The decrease in values is attributable to revaluation of certain power plants.
- Industrial increased by 5.5% ($11.3 million).
- Commercial values increased 6.0% ($52.0 million) largely due to sales which added $27 million.

The City received the benefit of $72.9 million in assessed value increases during FY 17/18 attributable to an increase in market value compared to prior years when there had been decreases in assessed values pursuant to Proposition 8. The increase in Proposition 8 values included $54.1 million in residential (affecting a total of 2,796 residential parcels) and $18.8 million in non-residential. An additional 2,714 parcels remain under Proposition 8 status, with a total potential recapture of $176 million. The City will see these increases in assessed value translate to increases in property tax revenues if real estate sales prices continue to escalate. The potential recapture is eliminated when and if a home under Proposition 8 status is sold for less than the recapture value.

- **Sales Tax.** When the FY 17/18 revenue projections were developed, sales tax was projected to increase 3.0%. The most recent quarterly sales tax results increased 9.4% on a cash basis and increased 6.9% on an adjusted basis (July - September, 2017 sales) and increased 3.3% on a cash basis and 3.1% on an adjusted basis (April - June, 2017). Sales tax continues to be unpredictable and volatile, but has shown overall increases. The average quarterly increase was 3.925% for FY 15/16 and 1.65% for FY 16/17. The first quarter FY 17/18 increase of 9.4% is abnormally high, over one-third of this increase is attributable to new automobile sales. Finance doesn't expect sales tax revenues from new automobile sales to continue at this inflated level indefinitely and anticipate that at some point in the future these revenues will first level off and subsequently decline.

There is a lengthy lag time between the time that sales occur and when the City receives the information regarding the sales tax revenues in order to compare the data to the same quarter of the previous year. As of the date of this report, Finance staff is still waiting for the Christmas quarter results which will be available in mid-March, 2018. Finance continues to be cautiously optimistic because overall sales tax revenues have increased in 13 of the past 14 quarters (all 14 quarters have been positive on an adjusted basis).

As stated, the revenue data for the October through December quarter sales has not yet been released by the Board of Equalization. The revenue shown here represents the first quarter payments received from the State and advance payments received towards the second quarter revenues.

- **Business Licenses**. Business licenses are renewed in January of each year; therefore most of the revenues from business licenses are received during the third quarter of the fiscal year.

- **Franchise Fees**. The City receives franchise fees from PG&E, Recology, AT&T and Comcast; the fees are based upon a percentage of their revenues. The receipts for the second quarter of the fiscal year are not received until the end of January and PG&E pays theirs annually in April. Therefore, we would not expect franchise fees to be near the 50% mark during the first two quarters of the fiscal year.

- **Hotel/Motel Surcharge.** Surcharge revenues for the first quarter are included in the amount shown, but second quarter receipts are not due or paid until the end of January and are therefore not included here.

- **Construction Permit Fees.** Building Permits are higher than anticipated at 54.7% received only half way through the fiscal year. This is an indication of the continued increase in construction and development.

- **CSA "G" Fire Contract.** The City receives these funds for fire services to the unincorporated area that was formerly served by the Walton Fire Protection District. Since revenues are property tax based, the first apportionment will be received in February, 2018.

- **Recreation Fees.** At 32.0% of budgeted revenues, service fees from recreation programs appear to be lower than anticipated halfway through the year. This is typical due to the seasonal nature of the programs offered.

- **Operating Transfers.** The General Fund receives reimbursement for operating costs associated with support services provided to the water and wastewater utilities as well as other fund transfers. Transfers are on track with budgetary expectations.

Expenditures. Operating costs are all within budgetary expectations with the exception of the Fire Department as summarized below. It appears that the Fire Department exceeds the 50% expected half way through the year but this overage is attributable to: 1) The pre-payment of the unfunded actuarial liability for CalPERS that was made in July for the entire fiscal year; and 2) Increased overtime costs related to strike teams due to all of the fires in California last fall. The Fire Department's budget will be increased to account for the increase in overtime costs when the strike team revenue reimbursements are received from the State of California.

Expenditures	Budget	YTD Actual	% Expended
City Council	$ 155,262	$ 69,708	44.9%
City Attorney	250,000	121,871	48.7%
City Manager	596,708	283,964	47.6%
Finance/IT	2,707,546	1,238,565	45.7%
City Treasurer/City Clerk	38,787	15,683	40.4%
Human Resources	930,978	425,545	45.7%
Development Services	1,458,993	675,970	46.3%
Public Works	4,819,659	2,057,190	42.7%
Police	14,652,304	6,933,864	47.3%
Fire	11,441,952	6,385,276	55.8%
Animal Control Services	835,464	348,955	41.8%
Economic Development	339,701	118,291	34.8%
Contingency	154,600	1,122	0.7%
Non-Departmental Misc.	406,783	176,285	43.3%
Community Services	3,742,639	1,714,453	45.8%
Total General Fund	**$ 42,531,375**	**$ 20,566,741**	**48.4%**

ENTERPRISE FUNDS

The following summarizes year-to-date revenues, expenditures, and changes in current assets net of current liabilities for the enterprise funds. Depreciation is included as a footnote in the budget and is therefore not included below.

Water Fund

	Budget	YTD Actual	Percent
Balance, Start of Year	$ 17,177,660	$ 17,177,660	-
Revenues			
Operating	13,522,000	7,929,676	58.6%
Capital	465,700	326,265	70.1%
SRF Surcharge	661,700	273,661	41.4%
Sub-Total Revenues	14,649,400	8,529,601	58.2%
Expenditures			
Operating Programs	(9,920,342)	(4,631,707)	46.7%
Capital Equipment	(80,000)	(31,361)	39.2%
CIP Contributions	(207,500)	(207,500)	100.0%
Debt Service	(3,243,817)	(1,111,377)	34.3%
Sub-Total Expenditures	(13,451,659)	(5,981,944)	44.5%
Balance	**$ 18,375,401**	**$ 19,725,317**	**-**
CIP Projects	**$ 13,224,000**	**$ 775,980**	**5.9%**

Water service revenue increases were approved by City Council in June, 2017, in order to cover the operating cost of the Water utility, debt service costs and necessary infrastructure renewal and replacement projects. For FY 17/18, the increased rates went into effect on July 1, 2017. In reviewing revenues billed for July through December, 2017, it is clear that the revenue increases are being generated as planned. Below is a summary of the total service revenues billed from July to September and then from October to December, comparing the total revenues billed, the consumption and the percentage of revenues billed changes from 2017 to 2016:

July 2016	July 2017	August 2016	August 2017	September 2016	September 2017
$ 995,369	$1,407,189	$1,091,859	$1,544,439	$1,233,639	$1,499,123
590,406	645,006	668,897	739,255	663,774	710,190
% change	41.4%	% change	41.5%	% change	21.5%

October 2016	October 2017	November 2016	November 2017	December 2016	December 2017
$1,134,371	$1,373,217	$ 989,068	$1,311,919	$ 872,413	$1,042,508
584,645	628,240	446,739	556,244	308,851	340,050
% change	21.1%	% change	32.6%	% change	19.5%

The percentage of revenues increased significantly more in July and August of 2017 because the rate increases for FY 16/17 were not implemented until September, 2016. Therefore, the billings for July and August 2016 did not include the first year of rate increases.

Operating revenues in the water fund are at 58.6% of the amount budgeted and are on track to meet budget projections at the end of the fiscal year. At first glance halfway through the year, it would appear that we should have only approximately 50.0% of budgeted revenues as of December, 2017. However, this is somewhat misleading because the highest billing months occur in July, August and September. Last fiscal year, as of December 31st, the total billings were at exactly 50% of the amount budgeted, but at year end, only 90.2% of the total amount budgeted was received. Therefore, since operating revenues are at 58.6% mid-way through the year, Finance is confident the City will meet it's targeted budget revenues by the end of the fiscal year.

Achieving targeted revenues is a high fiscal priority as the City's bond covenants require the City to raise rates in order to continue meeting a 1.2% debt coverage ratio. Capital connection fee revenues are at 39.2% of the amount budgeted.

Operating expenditures are at 46.7% at the mid-point of the fiscal year. There is savings in salaries and benefits due to 4.25 full-time equivalent vacant positions in the water utility, in addition to budgetary savings to date in operation and maintenance accounts.

Debt service expenditures are less than half for the first two quarters for both Water and Wastewater as they include only an interest payment because the payment that includes both principal and interest is not due until June 1st of each year.

Wastewater Fund

	Budget	YTD Actual	Percent
Balance, Start of Year	$ 19,925,378	$ 19,925,378	-
Revenues			
Operating	14,745,700	7,385,753	50.1%
Capital	598,100	213,006	35.6%
Sub-Total Revenues	15,343,800	7,598,759	49.5%
Expenditures			
Operating Programs	(10,331,765)	(4,726,223)	45.7%
Capital Equipment	(340,369)	(36,578)	10.7%
Debt Service	(2,387,479)	(1,135,773)	47.6%
Sub-Total Expenditures	(13,059,613)	(5,898,574)	45.2%
Balance	**$ 22,209,565**	**$ 21,625,562**	**-**
CIP Projects	**$ 14,853,000**	**$ 3,573,025**	**24.1%**

Wastewater operating revenues are at 50.1% of the amount budgeted and capital revenues are at 35.6%. Revenues through December 31st are closely on track with expectations.

Wastewater operating expenses are slightly lower than anticipated halfway through the year at only 45.7% of budget. There is savings in salaries and benefits due to 4.75 full-time equivalent vacant positions in the wastewater utility, in addition to budgetary savings to date in operation and maintenance accounts.

Finance staff accounts for the operating funds and capital connection fee funds for both the Water and Wastewater operations separately. Debt service payments are allocated to the capital connection fee funds based upon how the debt proceeds were used to finance projects at the time the debt was issued. Repayments for bond principal and interest are charged accordingly. Public Works/Utilities advises Finance when a Water or Wastewater project is approved how much should be paid from operating funds vs. capital connection fee funds. In recent years with the decline in development activities, City Council has been advised that at some point Finance staff may draw the connection fee fund reserves into a negative position in order to make debt service payments. Council concurred that this was an acceptable practice as long as Finance kept track of the funds separately, and replenished the cash flows as development activities increased. As of December 31, 2017, Finance reviewed the available cash balance in both the Water and Wastewater connection fee/capital funds and provides the following update:

		Water		Wastewater
Cash available @ 12/31/17	$	(769,847)	$	977,415
Annual D/S from connection fees	$	1,498,786	$	816,294
# of years of coverage available		-0.51		1.20

This table indicates that indeed, the Water connection fee fund cash balance is deficit as of December 31, 2017. This table compares the amount of cash reserves available in each of the capital connection fee accounts to the total annual debt service currently being allocated to and paid from capital connection fees. Those two amounts are then compared to calculate a ratio of how long, in terms of years, the City will be able to pay debt service without drawing capital connection fee funds into a deficit position. In this case, it shows that the Water capital connection fee fund is approximately 6 months in a deficit (negative) position. Measured in terms of shortage in dollars, the operating funds would need to provide the following amounts of cash to meet the 1.2 requirement for debt coverage:

		Water		Wastewater
Required Ratio		1.2		1.2
Cash Reqd. to be at 1.2 Coverage	$	1,798,543	$	979,553
Cash Short @ 12/31/17	$	2,568,389	$	2,138

This calculation does not consider amounts used from capital connection fees for future capital projects or future revenues received; it is a snapshot in time of where the funds stand as of December 31, 2017. The Wastewater fund is in a better position to cover debt service than the Water fund, but without additional development to increase revenues, both will be need to cover debt service from the operating funds as has been anticipated.