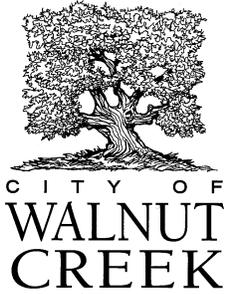


**GENERAL FUND
LONG TERM FINANCIAL FORECAST**

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Agenda Report

DATE: NOVEMBER 19, 2013

TO: CITY COUNCIL.

FROM: ADMINISTRATIVE SERVICES DEPARTMENT - FINANCE

SUBJECT: UPDATE TO THE GENERAL FUND LONG TERM FINANCIAL FORECAST 2012-2022

STATEMENT OF ISSUE:

Dating back to the adoption of the 2010-2012 City budget, staff have been providing the community and City Council a long term outlook of our financial picture, with a specific focus on those services, programs and revenues that are captured in our General Fund. The City Council adopted the 2010-2020 Long Term Financial Plan in November of 2011. A similar process was conducted last year, leading to the adoption of the 2012-2022 Long Term Financial Plan in February of 2013.

At the October 25, 2013 Council retreat, staff presented a preliminary, updated 2012-2022 General Fund Long Term Financial Forecast (LTFF). (Note – we have changed this name from a plan to a forecast, as this is a fiscal modeling instrument, not a formal plan of action). Staff presented three sets of assumptions for revenue and expenditures that represent optimistic, moderate and pessimistic scenarios. Staff received guidance and some confirmation on the assumptions used under the moderate scenario. Staff incorporated the feedback in the moderate scenario model which, pending Council's approval, will serve as the baseline for developing the next two-year (2014-2016) budget.

RECOMMENDED ACTION:

Discuss and approve the Updated General Fund Long Term Financial Forecast for 2012-2022 (Attachment 1).

DISCUSSION:

The LTFF is designed to cover a 10-year period—the current two-year budget plus the next eight years. While it includes the 2012-14 budget, the LTFF should be viewed differently from our budget document because of the increasing uncertainty attached to projections beyond the next two years. Even so, the LTFF is a valuable forecasting tool to help us anticipate challenges and provide adequate time to address them so that when we arrive at a particular budget cycle, we are well prepared to deliver a balanced budget.

The LTFF is focused primarily on the General Fund because it represents the bulk of our operating budget and is highly discretionary. At the 12-month budget review for fiscal year 2013-2014, the General Fund expenditures are projected to be \$69.6 million. The City's Other Funds tend to have restrictions on how we receive the money, how we spend the money or both. Having said that, staff also monitors activity in Other Funds to anticipate future changes. In this LTFF, we have two cases where expenses that have been funded by one of the Other Funds are moved to the General Fund when those funds are exhausted or no longer sufficient to cover the entire annual cost.

As you review this updated model, which is occurring over the same ten year period originally approved in February 2013, you should note the following:

- Fiscal Year 2012-2013 data represents unaudited results of the past twelve months.
- Fiscal Year 2013-2014 data reflects the twelve month budget update figures you approved this past summer, with a few modifications as noted in this report. (Staff intends to include these changes in the 18 month budget update to be reviewed in early 2014).
- Fiscal Years 2014-2015 to 2021-2022 – these are projections, based upon current available data, recent trends, and other information that influences this fiscal outlook.

Staff presented preliminary assumptions for expenditure and revenue projections to the Council at its retreat on October 25, 2013. The Council discussed the assumptions and other information, and provided feedback and direction that have been incorporated into the final LTFF shown as Attachment 1 and a corresponding graph is shown as Attachment 2. More information on expenditure and revenue assumptions follows.

LTFF Model: Expenditures

Staff has prepared a set of projections for the period 2014 through 2022 that assume most service levels will continue at the level experienced by the community today. Some significant financial implications of these assumptions (as summarized in Attachment 3) are embedded in the LTFF and outlined below:

- **The libraries will not continue to be open 56 hours per week.** Starting in fiscal year 2015-2016, when funding from the accumulated proceeds of the expired Measure Q parcel tax for the 21 extra open hours is exhausted, the City will only fund library facility operations, maintenance and equipment upgrades. These become new costs to the General Fund. This change will return libraries to 35 hours of service per week, consistent with a level of service provided to all cities across the County. Total estimated costs starting in fiscal year 2015-2016 for operations & maintenance ranges from approximately \$500,000 to \$915,000 depending on the equipment replacement cycle (like the book sorter).

The following table illustrates the balance of the accumulated funding available (Measure Q and interest) and the use funds for the Library operations.

Table 1: Library Expenditure Projections

	FY2013-14	FY2014-15	FY2015-16
Walnut Creek O & M	\$321,000	\$327,000	\$333,000
Ygnacio O & M	119,000	121,000	124,000
Equipment	50,000	48,000	433,000
O & M and Equipment Subtotal	490,000	496,000	890,000
Walnut Creek Hours	356,000	371,000	0
Ygnacio Valley Hours	170,000	177,000	0
Hours Subtotal	526,000	548,000	0
Total Annual Cost	\$1,016,000	\$1,044,000	\$890,000
Beginning Balance	\$1,745,000	\$737,000	n/a
Use of Measure Q Funding	-1,016,000	-737,000	n/a
Other Revenue (Interest)	7,000	0	n/a
Remaining Balance	\$737,000	-\$307,000	-\$809,000

- The City’s communication network will continue to function and will connect all City facilities in the same way it does today.** For more than a decade the City has been receiving free communication services from Astound via an institutional network (I-Net) that was built according to a franchise agreement negotiated with them in 2000. That agreement expires in 2014 and State law now precludes cities’ ability to negotiate these agreements. As we noted in last year’s report, our choices are to build our own I-Net (at a cost of approximately \$2.5 million plus additional personnel and/or contractual costs for operation and maintenance) or purchase the services from a provider. Extensive time has been spent by IT staff, in cooperation with the City of Concord (who have similar needs) to examine all possibilities, and determine our best course of action.

Updated estimates through complex negotiating reveal the cost to be approximately \$125,000 per year for the next 10 years due to the Request for Proposals process prepared by our Chief Information Officer. This amount is considerably better than the original estimate of \$500,000 per year, with a startup cost of \$250,000, assumed in the previous long term financial forecast. Therefore, for this updated LTFF, we have assumed that we will buy the services from a provider. In the 18-month budget update, an adjustment to include the estimated cost of \$125,000 for the year will be submitted for Council’s consideration. If approved, the \$125,000 will be included in the budget each of the following years.

- The City will continue to comply with the Clean Water permit requirements.** Necessary funds to comply with the Clean Water Permit will exceed the annual assessment and exhaust the reserve by approximately \$430,000 per year starting in 2020-2021 (a partial amount will be needed in 2019-2020). Council directed staff to include these cost estimates as part of the General Fund in the LTFP 2012-2022. This assumption remained in the updated LTFF. The expense will become part of the Public Services Department budget in the future.

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- **The City will maintain current staffing levels.** We have made assumptions related to staffing and compensation as directed during various budgeting and sustainability meetings. Specifically, staffing levels are expected to remain the same as authorized in the 2012-2014 budget. The Fiscal Sustainability Strategic Priority meetings resulted in a series of steps summarized in a separate Council approved action plan, but did not direct any immediate reductions or eliminations of existing General Fund services. Therefore, service levels and staffing required to deliver said services are projected at constant levels. It should be also be noted, no restoration or expansion of services is provided, even though staff acknowledge our community and their service needs will continue to change as we look to the future.

 - **The City will update salary and benefits as needed.** Compensation changes reflect contracts with bargaining units that are in place today and for the outlying years. Labor agreements in place today expire no later than 2016. A review of the Consumer Price Index (CPI) for our area over the past 10 years shows an average increase in the cost of living of 2.2%. Unlike the prior long term forecasts, staff has included salary increases for those years beyond current labor contracts, at this rate of 2.2% per year. The 1% cost of salaries, including retirement related costs, totals \$465,000 across the organization. Including these increases adds approximately \$1,000,000 per year, compounded, to our long term cost projections.

The City is contractually bound to fulfill benefit obligations as defined in our labor agreements. The two largest cost components are retirement and health care premiums. Over the past five years, the City and employee labor units (seven in total) have bargained to have all employees paying toward both of these obligations. Pension and health care cost increases will occur as indicated by CalPERS, information from our health care brokers and based on historical trends.

An adjustment has been made to the LTFF for temporary salaries which when comparing the department costs between fiscal years 2013-2014 and 2014-2015 will correct the discrepancy noted in the LTFF presented to Council on October 25, 2013. The major effect is to the Arts, Recreation and Culture Service Department.

A summary table of these salary and benefit assumptions is included as Attachment 4. Current contracts for two of the three negotiating bargaining groups were approved and ratified on November 5, 2013. Contract adjustments for salary and benefit budgets will be presented to Council as part of the 18-month budget adjustment. It should be noted the Public Employee Pension Reform Act (PEPRA) will produce very gradual results, or favorable impacts, to our pension costs. The updated LTFF reflects estimated rates published by CalPERS last year for fiscal year 2014-2015. Although we expect new employer retirement rates by year end, we are anticipating increases to future employer rates due to policy changes by CalPERS. Some of the changes proposed by CalPERS includes a direct rate smoothing method, a review of the investment returns and discount rates, and a change to the mortality expectations. Our increases are based on the estimated increases shared by CalPERS in a May 2013 webinar on the anticipated policy changes.

Health care premium costs are in a state of flux, with one key component being the impacts coming from the Affordable Care Act (ACA). City staff have been working on the implementation of this complex legislation. We are unable at this time to determine our fiscal impacts with respect to compliance. However, we do expect reflect Walnut Creek's ACA impacts when we present the City Council our 2014-2016 two year budget.

As part of the important work completed over the past year to address the City's fiscal sustainability, Council has provided feedback and guidance as City staff proceeds with implementing the Council's direction. The feedback includes planning for asset management and replacement costs and increasing the cost recovery of City services. We have included in our forecast a start to funding our unfunded asset management and technology needs with an amount of \$500,000 a year for both in the next 8 years. A summary table of additional funded costs is listed on Attachment 5. Asset Management dollars are committed to preserving and maintaining our City facilities. The 5 year Information Technology Strategic Operating Plan identified needs of \$12,000,000. Council funded an additional \$200,000 per year toward technology projects when adopting the current two year budget. The added \$500,000 per year for IT partially funds these needs, and will not fully meet these requirements over the remaining eight years of the updated LTFF.

This financial forecast presents two different scenarios. We are defining our *moderate scenario* as the most likely or middle of the road model – stated differently, what staff believes represents a forecast that is most probable. Staff has considered the estimates of consultants, reviewed past history, and analyzed economic views for the future to help develop the model. Even in this scenario, it should be noted several items remain unfunded or underfunded as shown in Attachment 6. These include:

- The remainder of infrastructure needs (excluding parking and building assets) as identified in the City's current 2012-2022 Capital Investment Program (CIP).
- No funding for any discretionary projects listed in the current CIP
- Insufficient funding for technology investment.
- Extra library hours currently in place, which will sunset when Measure Q special tax revenues are depleted in fiscal year 2014-2015.

LTFF Model: Revenues

Staff have developed two revenue scenarios as shown in Attachment 7 that reflect different sets of expectations related to our sales tax revenue, property tax revenue, and revenue generated by department fees and charges (such as building permits, ticket sales, etc.). We have included changes that could result from major development projects (i.e., the proposed renovation of Broadway Plaza and other construction in process).

We have also assumed that Council's policy on moving toward full cost recovery will continue and have adjusted fees and charges to approximate increases in staffing costs that would be passed on to those receiving the services or programs. During the 2012-2014 budget development process, fees and charges were examined and those that were eligible were adjusted to reflect this move toward 100% cost recovery (although not based on "fully burdened" rates). Staff is in the process of

updating our cost allocation study, and related fee schedule, which the City Council will review early next year.

The Net Result—Projected Expenses Continue to Grow Faster than Projected Revenues under the Moderate Scenario

As the numbers in Attachment 1 and the graph (Attachment 2) demonstrates, our projected revenues continue to lag behind projected expenditures. This is true even with the many, many changes implemented over the past few years such as reductions in the number of staff (391.5 in 2006; now 341.5); cost-sharing with employees for pension and health care expenses; implementation of a second pension tier; contracting for services once provided by employees (e.g., janitorial services, median maintenance, etc.); eliminating some divisions entirely (warehouse and reprographics services).

The graph on Attachment 2 reflects a full picture of addressing the unfunded portion of the CIP asset management needs, fully funding our ITSOP requirements, and continuing Library hours. As noted on Table 1, the remaining funds available for the Library hours will only partially cover the hours in fiscal year 2014-2015. Also, the graph on Attachment 2 does not reflect funding CIP discretionary projects (e.g. pools and synthetic fields). This more complete picture demonstrates that the City's fiscal challenges, beginning next year, of not being able to sustain our current levels of programs and services and addressing our capital needs.

As part of the development of the 2012-2014 Budget, Council adopted a *Use of One-Time Revenue and General Fund Surplus* Policy that articulates the Council's direction of assigning one-time revenues to meet one-time equipment and capital needs. Once the audit is completed for 2012-2013, staff will return to City Council, pursuant to this Policy, to seek your direction on the use of the General Fund surplus for one time capital and infrastructure projects.

As staff has noted in prior meetings, the City Council directed staff to use on-hand reserves from several funds to pay down the PERS public safety side fund obligation. This action was taken to avoid partial interest costs to PERS of \$300,000 per year. Staff has included this schedule as Attachment 8. It should be noted that when all funds are repaid to the General Fund reserves in 2018-2019, Worker's Compensation and PERS reserves will be restored to pre-loan values of approximately \$2,000,000 and \$5,000,000, respectively.

Moderate Alternative Scenario

Staff prepared a moderate alternative scenario. These are not presented for your formal consideration, as the focus of this report, and your deliberations and decisions centers on the *moderate scenario*. For illustration purposes, we have provided, as requested from the October 25 retreat, a view of the revenues using the moderate estimates from February 2013.

Attachment 9 reports the numbers and the corresponding graph on Attachment 10 demonstrates the gap for the very conservative revenue assumptions. Key assumptions for moderate alternative scenario are included in Attachment 3 and Attachment 7 of the report.

FINANCIAL IMPACTS:

Approving the attached updated General Fund Long Term Financial Forecast 2012-2022 does not have direct financial impacts. Determining the elements and assumptions of the 2012-2022 updated LTFF makes a first determination of our 2014-2016 budget scenario. This data will be modified, as new information and decisions impact the projections, as the City moves toward presenting and adopting a balanced 2014-2016 balanced budget in June.

ALTERNATIVE ACTION:

1. Change the assumptions and elements in the modified scenario for the updated LTFF.
2. Do not update the General Fund LTFF.

DOCUMENTS:

ATTACHMENT 1: Moderate Scenario – Long Term Financial Forecast (LTFF)

ATTACHMENT 2: Moderate Scenario Graph (LTFF)

ATTACHMENT 3: Expenditure Assumptions

ATTACHMENT 4: Salary and Benefit Assumptions

ATTACHMENT 5: Table of Additional Funded Costs

ATTACHMENT 6: Table of Unfunded Costs

ATTACHMENT 7: Revenue Assumptions

ATTACHMENT 8: PERS Safety Side Fund Repayment Schedule

ATTACHMENT 9: Moderate Alternative Scenario – LTFF

ATTACHMENT 10: Moderate Alternative Scenario Graph (LTFF)

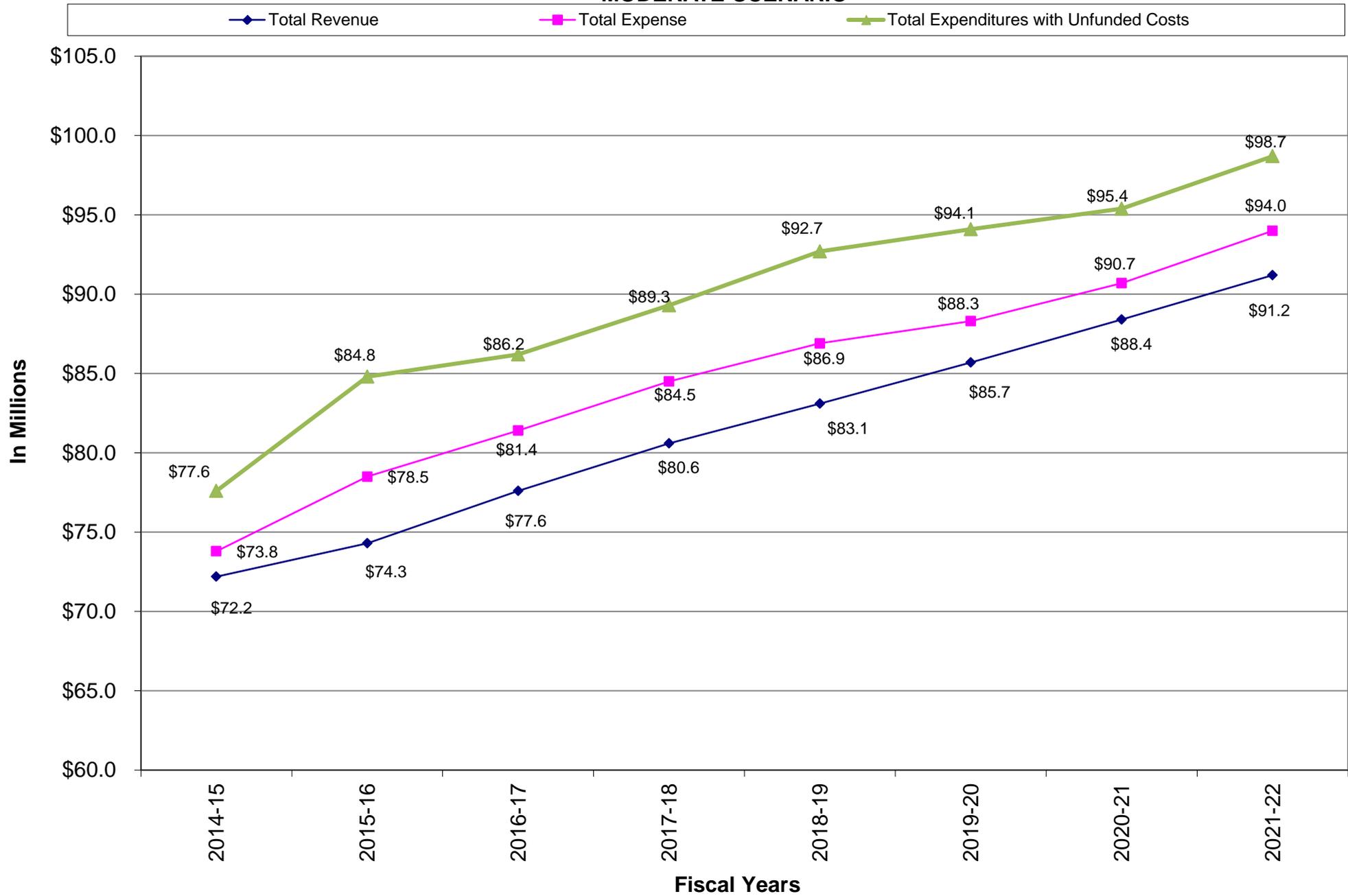
COUNCIL ACTION RECOMMENDED:

Move to approve the updated General Fund Long Term Financial Forecast 2012-2022.

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City of Walnut Creek
 LONG TERM FINANCIAL FORECAST FY2014-2022
 MODERATE SCENARIO



**City of Walnut Creek
Expenditure Assumptions for Moderate and Moderate Alternative**

Expenses	Moderate and Moderate Alternative
Overall Expenditures	Used actual unaudited FY2012-13 and 12-month budget update presented to Council in August 2013 as the base for expenditures. iNet expenditure increase starts in FY2013-14; Library O&M for WC & YV starts in FY2014-15; Clean Storm Water expenditure increases started in FY2018-19.
Salaries	Adjusted salaries costs to follow MOU's approved before November 2013-Employee's portion of pensions are paid-in-full by all non-safety groups by FY2013-14 and by safety groups during FY2014-15. Assumed 2.2% salary increases following the end of the MOUs (based on a 10 year average of CPI annual change) Adjusted for PERS Safety Side Fund payment
Non-Personnel	Increased expenditure by 2.2%
PERS Changes	Used CalPERS employer rate for FY2013-14 and CalPERS estimated rates for FY2014-15. Safety: Assumes a 0.40% addition to base rates each year thereafter and an additional increase in rates from 8.76% to 13.52% for valuation changes for smoothing, discount rate, and mortality rate. Miscellaneous: Assumes a 0.20% addition to rates each year thereafter and an additional increase in rates from 5.10% to 7.90% for valuation changes for smoothing, discount rate, and mortality rate.
Medical and Other Benefits	Assuming medical premiums are increasing at the same rate as it has in the past years and based on broker information. Increase health care rates approximately 10% to 14%. Other benefits like dental, life insurance, unemployment will increase 3.5%.

**City of Walnut Creek
Salary and Benefit Assumptions**

ATTACHMENT 4

	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21	2021-22
Salary Adjustments								
Miscellaneous (Misc)	2.20%	2.20%	2.20%	2.20%	2.20%	2.20%	2.20%	2.20%
Police Management Assn. (PMA)	2.50%	2.20%	2.20%	2.20%	2.20%	2.20%	2.20%	2.20%
Police Officers Assn. (POA)	2.50%	2.20%	2.20%	2.20%	2.20%	2.20%	2.20%	2.20%
Percentage of Salary:								
Pension Rates (PERS)								
Misc - City pays	18.40%	23.50%	25.10%	26.70%	26.90%	27.10%	26.30%	26.60%
Employee pays	7.00%	7.00%	7.00%	7.00%	7.00%	7.00%	7.00%	7.00%
PMA - City pays	32.7% / 29.70%	38.86%	41.64%	44.42%	44.82%	45.22%	44.12%	44.52%
Employee pays	6.00% / 9.00%	9.00%	9.00%	9.00%	9.00%	9.00%	9.00%	9.00%
POA - City pays	32.7% / 29.70%	38.86%	41.64%	44.42%	44.82%	45.22%	44.12%	44.52%
Employee pays	6.00% / 9.00%	9.00%	9.00%	9.00%	9.00%	9.00%	9.00%	9.00%
Safety Side Fund*	13.09%	13.42%	13.74%	14.03%	14.36%	0.00%	0.00%	0.00%

	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20	2019-20	2019-20
Year over year increase:								
Medical Insurance	12.00%	14.00%	14.00%	14.00%	14.00%	14.00%	14.00%	14.00%
Other benefits	3.50%	3.50%	3.50%	3.50%	3.50%	3.50%	3.50%	3.50%

*Additional pension costs associated with public safety employees; payment amount is shown here as percentage of salary for ease of comparison; repayment complete in 2018-19. Repayment schedule is attached to the staff report.

NOTES:

1. Assumes no changes in current staffing (ie staffing budgeted in fiscal years 2012-14).
2. Impact of the pension reform legislation that became effective January 1, 2013 has not had a major impact for our pension cost and will not in the early years. This change is a long-term impact in 15 to 20 years. Employer rates will be impacted by CalPERS's new direct rate smoothing method, investment returns and discount rate changes, and mortality expectations. Actuarial valuations are expected at the end of November 2013 for rates for fiscal year 2014-15. Current estimates for fiscal year 2014-15 were provided by CalPERS's actuarial valuations dated October 2012. Other future rate increases were estimated with information obtained through CalPERS's May 2013 webinar on policy changes.
3. The impact for health care benefits due to the Affordable Care Act is not known at this time and not included. HR is working diligently to determine the impact for our temporary work force. Employee cost-sharing amounts will be adjusted as contracts are approved and ratified, therefore any changes will be brought to Council at the 18-month budget review cycle.

City of Walnut Creek
Revenue Assumptions for Moderate and Moderate Alternative Scenarios

	MODERATE	MODERATE ALTERNATIVE
Revenues		
<i>Property Tax</i>	Assumes a range between 4% - 3% annual growth starting with FY2014-15. Included an estimated increase in construction completion for various projects in FY2015-16.	Assumes 2% annual growth starting with FY2014-15. Included an estimated increase in construction completion for various projects in FY2015-16.
<i>Sales Tax</i>	An annual growth factor ranging from 4.4% to 3% is used based on Sales Tax Consultant's estimates.	An annual growth factor of 2.2%.
<i>Departmental Revenues</i>	Assumes same levels of service, cost recovery, and program users. Assumes an annual growth factor of 4% for each year.	Assumes same levels of service, cost recovery, and program users. Assumes an annual growth factor of 4% for each year.

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