TAB 14

COMMUNITY BLUE RIBBON TASK FORCE ON FISCAL HEALTH

2011 – Final Report

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City of Walnut Creek Community Blue Ribbon Task Force on Fiscal Health 2011 *Final Report*

November 15, 2011

WALNUT CREEK COMMUNITY BLUE RIBBON TASK FORCE on FISCAL HEALTH REPORT – FINAL REPORT

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EXECUTIVE SUMMARY

Introduction

The Walnut Creek City Council created the Community Blue Ribbon Task Force on Fiscal Health ("Task Force") on December 7, 2010 to provide an analysis of the City's current financial condition and evaluate prospective courses of action that could be adopted by the City to ease challenges in the future. The design of the Task Force was to create an independent body of residents with a broad range of experiences that would conduct a thorough, in depth analysis of the City's current financial situation and develop appropriate strategies for a time frame extending ten to fifteen years into the future.

The charter of the Task Force included the following:

- Obtain sufficient understanding of the City's operating and capital budgets;
- Review documents, reports and studies to assist in learning City finances;
- Produce a written report to the community and the City Council; and
- Recommend next steps as appropriate.

The City Council selected fifteen community members from 110 applicants to serve on the Task Force. Each member brought to the group a different background, perspective and experience as well as their passion and commitment to the quality of life and bounty of services that make Walnut Creek a unique and desirable community in which to live.

The Task Force identified four primary areas to investigate as background for its recommendations. These are: 1) delivery of services, 2) capital investment program, 3) revenue enhancement, and 4) demographic trends and growth.

Background, Context and History

The current economic challenges facing local governments today are rooted in a continuing series of State ballot measures, starting with Proposition 13 in 1978, which have severely limited the ability of local governments to raise revenue. With the economic downturn that began in 2008, revenues generated by cities were significantly impacted. Although Walnut Creek has historically experienced revenues (primarily from property taxes and sales taxes) to levels higher than most cities in the region, it has still felt the financial squeeze caused by recently declining revenues. In addition to dealing with the current challenges, Walnut Creek's leaders have recognized the importance of looking beyond short-term measures and beginning to develop long-term strategies to address an uncertain financial future.

The Task Force took into account the values and concerns of Walnut Creek residents in evaluating potential financial strategies. Previous surveys and community outreach efforts have provided the elected officials and City staff with an understanding of the community's priorities. This information was considered during Task Force deliberations.

Walnut Creek has long been in a financially enviable position relative to other communities in the Bay Area. Walnut Creek is a major professional, financial and real estate employment center. It has also grown into a retail destination, which draws people from many miles around for its diverse and quality shopping opportunities. These factors have enhanced Walnut Creek's ability to sustain the quality of life that its residents appreciate and have come to expect. Because of this success, it is understandable that nearby cities hope to lure development that will compete with Walnut Creek. In recognition of this concern, the City Council created an Economic Development Program in 2011. Their first step was to hire an Economic Development Manager. Through this program, the City expects to further bolster its economic competitive advantage within the region. For this reason, the Task Force considered economic development to be a key focus.

In order to fully consider viable long-term financial approaches to the City's future, the Task Force also looked into the changing demographics of the City. Many resources, such as the most recent Census, Association of Bay Area Governments data and the City's General Plan, were used in evaluating probable demographic changes during the next 10 to 15 years.

Revenue and Expenditure Picture

The City of Walnut Creek provides a large variety of services to its residents. Such services include: 1) planning and building permits, 2) engineering and capital projects, 3) street, park and facility maintenance, 4) police and public safety, and 5) arts, recreation and community services and programs. The City also bears the responsibility for general governmental services such as the City Council, City Manager, City Attorney, City Clerk, and public information and community relations. As part of general services, the City maintains its financial and administrative functions, including: accounting, budgeting, business licenses, treasury management, purchasing, information technology, telecommunications, human resources, and risk management.

The municipal services listed above are provided through various City departments. These are: 1) Community Development, 2) Public Services, 3) Police, 4) Arts, Recreation and Community Services, 5) General Government, and 6) Administrative Services. The body of this report elaborates in more detail the functions of each of these departments and their respective budgets.

Walnut Creek supports the costs of its operations through various sources of revenue. The two primary sources of revenue are property taxes and sales taxes. A third major source is revenue received by specific Departments for services they provide. The City's current financial struggle stems, in part, from the fact that these revenues have declined along with most other components of the general economy.

The residents of Walnut Creek are accustomed to a broad spectrum of services and the high quality with which they have historically been provided. The Task Force considered this fact during its assessment of the City's current financial circumstances and its recommendations for assisting the City in maintaining a strong fiscal position into the long-term future.

The City manages its expenditures using a two-year budget, a Capital Investment Program and a Long Term Financial Plan. With these tools, the City can plan effectively for operating costs as well as the preservation and maintenance of its facilities and properties. The City also plans for new capital projects and/or restoration of existing facilities.

During the past several years the City Council has implemented a variety of measures to reduce operating costs. These include new approaches to City employee compensation (reductions in salaries and benefits), reduction in staffing levels (layoffs and unfilled vacant positions), reductions and out-sourcing of some services (such as janitorial), and increased fees for services (user fees).

Despite its efforts, the City still has financial challenges ahead. One of these is its aging infrastructure. Many of the City's facilities, such as Clarke Swim Center at Heather Farm Park and Ygnacio Valley Road, are approaching the need for major expenditures to reconstruct and/or replace them. Historically, the City has not dedicated specific funds for replacement of its major assets. Although the City's conservative financial practices and ample revenue streams in the past have maintained healthy reserves to support some of the City's capital needs, these reserves were generally not dedicated to any specifically identified replacements. As the economy slowed, some of these reserves were used to maintain a high level of service and programs desired by the community and to complete capital projects. The net result is that existing reserves are inadequate to meet the replacement and preservation requirements of the near and long term future.

Another significant financial challenge facing the City is its employee retirement benefit obligations. The City participates in the statewide retirement system for public employees, the California Public Employees Retirement System (CalPERS). The structure of this system provides retired employees a guaranteed retirement income based on the duration of their employment and the salary level of their position. CalPERS' actuarial model includes funds paid by cities and investment returns achieved over time. With the faltering economy, the returns that CalPERS has achieved in recent years have been particularly low, relative to stated rate of return goals. The result is that Walnut Creek's annual pension contributions have increased and are expected to increase significantly over at least the next few years. In addition, the City's actuarial liability has increased.

Reasonably accurate estimates of this liability are difficult to obtain because of the way CalPERS is structured, but estimates of future burdens could be in the tens of millions of dollars – or more. The City's liability may decrease if CalPERS dramatically improves its investment performance, but would further increase if even current levels of return are not improved. The bottom line is that the retirement system to which Walnut Creek is contractually obligated poses a major challenge to the City's future fiscal health.

Another component of uncertainty in the City's financial future is the cost of providing City employees with health insurance benefits. The cost of health insurance premiums has increased at rates that are as much as four times greater than inflation in recent years. There does not seem to be a clear remedy on the horizon. The City therefore has an exposure to an expense that seems likely to continue to escalate. It should be noted that Walnut Creek, unlike many other cities, does not provide its employees with health insurance after retirement and, therefore, the City does not bear future liability for these costs.

The challenges faced by the City of Walnut Creek noted above are common among California cities. While Walnut Creek has addressed these challenges in various ways to date, it still must continue to develop additional strategies to meet future financial requirements.

Key Findings and Recommendations

In the development of this report, certain findings rose to the top as critical for the City to address. Recommendations based upon these findings consequently rose to a higher priority level as well. These key findings fell into four main categories: 1) the City's Long Term Financial Plan, 2) Expenditures, including Capital costs and Operating costs, 3) Revenue, and 4) Delivery of Services. The following section outlines the key findings and recommendations in these areas.

The City's Long Term Financial Plan

The Task Force, during its information gathering phase, recognized that the current financial challenges facing Walnut Creek make a consolidated long-term financial planning strategy more critical than in the past. Therefore, recommendations regarding this finding are crucial to the future management of the City. In order to create the most effective tools, it is important that the City develop a fully integrated financial management process, which includes the City's Long Term Financial Plan and its Capital Investment Program. This will ensure that all needs are considered concurrently including, but not limited to, pension obligations. While undertaking this effort, the City needs to maintain a dialog with its residents in order to establish priorities of services when resources are limited. (Recommendations 1.a, 1.b, 1.c, 1.d, and 1.e)

Expenditures - Capital Costs

The Task Force believes that it is extremely important to give priority to preserving existing assets before adding new facilities. One element in achieving this goal is to set aside sufficient funds in dedicated reserve accounts for the maintenance and replacement of the City's aging capital assets. Additionally, it is recommended that public participation in the financing plan be a key element in undertaking major capital projects. Finally, when considering new capital projects, include evaluations of the future, long-term operating and maintenance costs. (Recommendations 2.a, 2.b, 3.a, 3.b, 4.a, and 5.c)

Other key recommendations focus on managing existing assets. It is likely that concentrating on more efficient use of the numerous facilities owned by the City will allow the sale and/or leasing of some facilities, thus increasing revenues and decreasing operating costs. Along these same lines, the City should consider longer term needs assessments before significant expenditures are committed to replacing or renovating existing facilities. (Recommendations 5.a and 5.b)

Finally, it is important that the City put aside monies on a regular basis (i.e., establish a sinking fund) to be used to replace vital public facilities over the near term as well as over the longer term horizon. (Recommendations 8.a.i and 8.a.iii)

Expenditures - Operating Costs

The largest expenditure in the City's operating budget is employee compensation (73%). In addition to salaries, retirement contributions and health insurance benefit costs need to be considered. Specifically, the structure of the retirement system, CalPERS, exposes the City to a significant but at this time unknown future liability. Future labor contracts should be formulated to provide for greater contributions from all employees to their retirement funds. The City should actively participate with other cities and organizations to work toward statewide retirement reform to minimize the risk of financial uncertainties of municipalities. Also, the City should quantify the exposure of and evaluate and develop tools and measures to mitigate future potential liabilities associated with CalPERS. (Recommendations 6.a, 6.c, 6.e, 6.f, and 8.a.ii)

In a similar fashion, the City should work towards the goal of obtaining greater contributions to health care insurance costs from employees. (Recommendation 6.d)

Concurrently with efforts to control salary and benefit costs, the City needs to remain competitive with the labor marketplace to keep a quality staff. (Recommendation 6.b)

Finally, there are a number of other measures that the City can undertake that will contribute to cost savings. Collectively, these can serve to benefit the City's long-term fiscal health. These are: 1) greater use of volunteers, 2) outsourcing more City functions and services, 3) partnering with community non-profit organizations, 4) cooperating with other agencies to share and/or consolidate services, and 5) invest in Information Technology to provide more efficient delivery of services. (Recommendations 7.a, 7.b, 7.c, 7.d, 7.e, 7.f, and 8.a.iv)

Revenue

Walnut Creek's continued economic strength in the region is essential to the City's financial future. To achieve this, the City has recently created an Economic Development Program. This is an important step, and the City should vigorously support efforts to ensure its success. Our report provides extensive detail on how this might be accomplished. (Recommendation 9.a)

The City provides many services to its residents as well as to users from outside the City. The City needs to closely monitor costs associated with these services and programs so that it can maximize financial recovery from the direct beneficiaries of the services, therefore reducing the burden to its residents in general. (Recommendations 10.a and 10.b)

Even after the efforts to reduce costs as outlined throughout the Report, it is almost certain there will not be sufficient funds to cover near and longer term obligations of the City. The Task Force investigated numerous options to address this expected shortfall. In addition to all of the cost saving recommendations that are included in the report, the Task Force determined that a ½-cent sales tax increase would generate a significant revenue stream to address the City's goals. The advantages of a sales tax increase include the fact that it places some of the burden on consumers and businesses from outside the City, but who benefit from City services. Estimates show that about two-thirds of the sales tax revenue that comes to Walnut Creek is generated by non-residents. Before initiating the proposal for such a tax, the City will need to survey Walnut Creek residents to determine that there is a sufficient level of support and encourage participation by civic and community groups to support such a measure. Prior to instituting a sales tax increase, the City must first take steps to implement additional effective cost reductions. (Recommendations 11.a and 11.b)

Delivery of Services

The residents of Walnut Creek are accustomed to a high level of services, programs, education, amenities and facilities provided within the City. In order to maintain these high levels, there are additional measures that the City should undertake. While each of these steps may seem less significant compared to other recommendations included in this Report, they will help support the aspects of the City that make Walnut Creek unique. The steps are: 1) develop a plan to provide a smooth transition through future staff changes resulting from an aging, long-term staff, 2) continue to work with the School Districts to support the quality education they have historically provided, 3) monitor the demand on police services created by the many downtown, late-night establishments so that Walnut Creek retains its reputation of a safe community, 4) take steps to enhance communication with the City residents, and 5) continue to adjust the delivery of services in response to the changing demographics of the City. (Recommendations 12.a, 13.a, 13.b, 14.a, and 14.b)

Conclusion

The Task Force acknowledges that, since the economic downturn began several years ago, the City of Walnut Creek has already undertaken efforts to address operating budget shortfalls. However, further measures are required.

The conclusions presented in this report are of major importance to the long-term financial well-being of the City. The Task Force has provided 38 recommendations. From these, it has identified several recommendations that will result in the greatest benefits to the City with respect to ensuring long-term fiscal health for both City operations and care of the infrastructure.

These are summarized as follows:

1. Develop an integrated financial management process, which includes a) operations, b) current capital projects, c) maintenance, preservation and replacement reserves for capital assets, d) long term capital investments, and e) long term employee benefits costs. (Recommendation 1.a)

2. Set aside funds for replacement costs of the aging capital assets. This includes catching up on current deficiencies in such funds. (Recommendations 2.a, 8.a.i, and 8.a.iii)

3. Establish greater cost efficiencies in the use of the City's capital assets by consolidating uses in fewer facilities and selling or leasing underutilized properties. (Recommendation 5.a)

4. Reduce the City's operating expenses by implementing reductions in total payroll costs through changes to employee contributions to retirement and health insurance costs and programs. Also, determine how to best manage the unpredictable financial exposure associated with participation in CalPERS. (Recommendations 6.a, 6.c, 6.d, 6.e, and 6.f)

5. Support the efforts of the Economic Development Program in developing effective strategies that will enhance the strength of the City's commercial and retail base. (Recommendation 9.a)

6. After beginning implementation of further cost reduction measures and other methods for increasing revenue (such as economic development and cost recovery), consider a local ½-cent sales tax increase. Conduct a survey of the community to determine the level of community support for the sales tax increase. (Recommendations 11.a and 11.b)

It is most important that the City Council adopt an action plan that will ensure a timely implementation of the recommendations developed by the Task Force. The Task Force also recommends that an accountability process be created. By doing so, the City Council will help assure that the benefits of the work provided by the Task Force will be periodically reviewed and evaluated for effectiveness well into the future. At each of those review periods, adjustments may be deemed appropriate in order to accommodate changing circumstances.

I. INTRODUCTION

A. Background

The Walnut Creek City Council created the Community Blue Ribbon Task Force on Fiscal Health (further known as "Task Force") on December 7, 2010 to address future fiscal challenges after making extremely difficult decisions to close a $20 million gap between revenues and expenditures in the 2010-2012 Budget. The 2010-2012 Budget included staffing and expenditure cuts, renegotiation of employee contracts, and a new fee schedule for City services that decreased net costs. The issues faced in the 2010-2012 Budget were not a one-time situation; revenue and cost forecasts will require the City to continue to look for more operational efficiencies and reductions as well as new sources of revenue. Through the creation of the Task Force, the City Council asked community members with a broad range of professional expertise to help identify short- and long-term solutions so that the City can continue to provide the quality and breadth of services that make Walnut Creek one of the premier communities in California.

The adopted purpose of the Task Force was to recommend viable financial strategies that could be implemented to meet future operational and capital needs. The Charter of the Task Force included the following:

- Obtain sufficient understanding of the City's operating and capital budgets;
- Review documents, reports and studies to assist in learning City finances;
- Produce a written report to the community and City Council; and
- Recommend next steps as appropriate.

The Charter of the Task Force did not include the following:

- Establishing the budget priorities (handled in Balancing for the Future and other means);
- Serving as a Budgetary or Financial Oversight Body;
- Determining service delivery or resource allocation decisions; or
- Setting City policies (reserves, investment, etc.).

The City Council selected 15 members to serve on the Task Force out of 110 applicants. The City Council appointed the following members of the Walnut Creek community at its public meeting on February 15, 2011: Jason Cooke, Leslie Dawson, Ethan Friedman, Mike Garmon, Loella Haskew, Bill Hunt, Jerrold Kaplan, John Kopchik, Jr., Karen Majors, Jim Pezzaglia, Bob Pickett, Lloyd Silver, Laura Simpson, Tom Terrill, and Dan Walden. (Note: Mike Garmon resigned on July 24, 2011.)

The first meeting of the Task Force was held on February 28, 2011. The Task Force elected Bob Pickett as Chairperson and Lloyd Silver as Vice Chairperson. The Task Force meetings were normally held in the evening at City Hall on the 2nd and 4th Tuesdays of each month. The meeting agendas were noticed on the City's web site. Public input was solicited at each meeting; one or two members of the public spoke at a few of the meetings. The first several meetings were devoted to City staff presentations on the City's operating and capital budgets, departmental functions, the financial relationship between cities and the State, and other related topics. The Task Force also hosted a special presentation at the downtown library on June 14, 2011 by a panel of experts in the field of public finance and local tax initiatives.

Four primary areas of interest emerged from these early meetings and subcommittees were formed to pursue studies in each area. The subcommittees and areas of interest are: 1) delivery of services, 2) capital investment program, 3) revenue enhancement, and 4) demographics, trends and growth.

Subcommittee chairs were as follows:

- Jerry Kaplan – Delivery of Services
- Laura Simpson – Capital Investment Program
- Karen Majors – Revenue Enhancement
- Tom Terrill – Demographics, Trends and Growth

Each task force member volunteered for two subcommittees. Each subcommittee gathered information from a variety of sources, including interviews with City staff, interviews with colleagues and business people, and review of operating and capital budgets as well as revenue raising practices in other cities. The subcommittees presented their findings, along with specific recommendations to the full Task Force for discussion. The chairs of each subcommittee served as the writing committee to draft the final report, based upon the four different subcommittees' initial set of findings and recommendations.

The reader should note that the findings and recommendations included in Section III of this report represent the conclusions that the subcommittees developed as part of their review. In some instances, the wording and emphasis placed on certain recommendations in this final report may differ somewhat from the way they were originally promulgated by the four subcommittees. They represent the consensus reached by the full Task Force after further group discussion and deliberation of the four subcommittee reports.

B. Context/History

1. The State-Local Relationship

Today, cities and towns throughout California are struggling to continue to provide quality public services to their residents. Local sales and property tax revenues are declining as a result of a deep and long recession that has impacted the State of California in a way more profound than any other has since the Depression of the 1930s. Concurrently, costs to provide those services are increasing. The severity of the impact of this recession on cities was caused, in part, by the cumulative impact of 33 years of "push-pull" between the voters in California, the State of California and its nearly 500 cities and towns on how, and through what mechanisms, government should be funded.

The seeds of the current fiscal crisis began with the passage of Proposition 13 in 1978 and continued with the myriad of subsequent State initiatives and actions including Propositions 62, 1A, 218 and 26.

Prior to the adoption of Proposition 13 in 1978, a local government in California set its property tax rate based upon an adopted budget. Annual property tax payments provided the majority of funding for the municipal operations approved in an annual budget. Local tax rates varied from community to community and were based upon the services provided and desired by each community. This assessment method was standard at the time and continues to be used in many areas of the country outside California. Prior to 1978, people often made decisions on where to live, based not only on the price of a home but on the property tax rate as well. By the mid 1970s, as residents aged and retired, they found that they could no longer afford the property taxes in the community many they had raised their families. This situation fueled the desire by Californians to find a way to control what some perceived to be runaway property taxes.

Proposition 13, approved by California voters in November 1978, drastically changed the way cities in California are financed and transferred much of a community's ability to make its financial decisions to the State. Proposition 13 made sweeping changes to the Constitution of the State of California. The major changes included:

- Eliminated each community’s ability to establish its own property tax rate.
- Set the maximum general-purpose property tax rate at 1% of the assessed value of a given property.
- Set the 1978 assessed value of a property as the new base. The assessed value could only increase by a maximum of 2% each year thereafter.
- Allowed the assessed property value to be reset to a higher value only when it changes ownership. (There are a few exceptions to this.) Owners may appeal for a lower assessment if current market conditions support it such a change. However, values cannot be less than the original value set at the time of approval of Proposition 13.
- Transferred control over the allocation of property taxes to the State.
- Restricted the purposes for which general obligation bonds may be issued.
- Set a two-thirds voter approval requirement for special taxes including the issuance of general obligation bonds.

- Required two-thirds Legislative approval for any new State taxes.

Proposition 13 had a huge impact on State and local government finance. Proposition 13 cut the amount of local property tax generated by more than half and forced cities, counties and the State into a new, and often dysfunctional, interdependent relationship.

A series of subsequent legislative actions and ballot initiatives added to this precarious fiscal relationship between the State of California and the 52 counties and 482 cities and towns in the State. Each of these actions made it increasingly difficult for local government to operate, provide services, maintain infrastructure, and engage in forward financial planning:

- 1986 – Proposition 62 – Mandated simple majority voter approval for all general taxes and eliminated all local transaction and/or transfer taxes without voter approval.

- 1992 – Education Revenue Augmentation Fund – Diverted specified amounts of local property tax in order to meet the State's obligation to fund public education. Approximately $39 million was diverted from the City of Walnut Creek between 1992 and 2010.

- 1996 – Proposition 218 – Required a two-thirds voter approval for all special taxes and a simple majority voter approval for all general taxes. It also required that all parcel taxes, including all assessment districts, be enacted or modified as a special tax.

- 2004 – Proposition 1A – Sponsored by a coalition of local governmental agencies to protect future reduction or diversion of the local share of property tax, sales tax and vehicle license fee revenues. Any future "takes" by State would be "loans."

- 2010 – Proposition 22 – Sponsored by the same coalition of local governmental agencies to close loopholes in Proposition 1A discovered by the State. Even so, the State of California has taken steps to fundamentally undermine Redevelopment Agencies protected by Proposition 22 by redirecting local revenues to State coffers; a lawsuit is pending.

- 2010 – Proposition 26 – Specified that any levy, charge, or exaction of any kind imposed by a local government which results in the generation of revenue is considered a local tax that must be approved by the voters as a general or specific tax. Proposition 26 specified a number of exceptions.

This long line of ballot initiatives and legislative actions, beginning with Proposition 13, placed ever increasing constraints on a local municipality's ability to raise revenue in order to provide desired services and maintain infrastructure.

The impacts of this series of ballot initiatives and State actions on all communities in California include:

- Property tax is no longer the primary funding source of local government.

- The ability of any city to raise revenue is severely limited.

- Any local increase in property, sales, business license, transient occupancy, and assessment district tax or tax rate must be voter approved.

- The economy of any city in California is directly linked to the economy and legislative decision making of the State of California, and

- The cumulative effect of these numerous actions has been to codify the levy, collection and distribution of various State taxes in an antiquated manner that does not reflect the current economy, consumer trends, or technological impacts, which influence businesses and their customers. By way of example, the State sales tax structure remains rooted in manufacturing, while the California economy increasingly has shifted to a services-based series of industries.

2. Recent National, State and Regional Economic Trends that have Affected Walnut Creek

In addition to the cumulative impact of ballot initiatives and State-Local fiscal battles, the current recession in California has created a perfect financial storm. The *2011-12 Budget: California Fiscal Outlook Report* prepared by the Legislative Analyst's Office notes that the National Bureau of Economic Research determined that the national recession began in December 2007 and officially ended in June 2009. It was the longest recession since World War II and the most severe economic downturn since the Great Depression of the 1930s. The 2007-2009 Recession was triggered by the implosion of an overheated housing market in California and throughout the United States, the resulting balance sheet deterioration of both businesses and households, and the severe strain on world credit markets.

In California, this recession started earlier and was deeper than experienced in many other areas of the U.S. California's recovery is expected to be very slow. Factors contributing to this delayed recovery, particularly in the East Bay, are a combination of: 1) excess inventories of residential and commercial real estate, 2) severely depressed economic confidence among individuals and businesses, 3) decreased consumer spending and investment, and 4) an unemployment rate that is over 10%. Many economists are forecasting that employment will not return to pre-recession levels and the housing market will not gain any significant momentum until 2016.

The impact of this recession on communities in California has been significant. The following highlights show the impact of this recession specifically on the City of Walnut Creek:

- Major City General Fund revenues have declined substantially since the adoption of the 2008-10 Operating Budget in June 2008.

- The 2010-12 Budget estimates that sales tax revenue in fiscal year (FY) 2009-10 was $15.7 million, a decrease of 15% compared to the previous budget cycle and 25% below the peak of $21 million in 2005-06. The primary reason for this significant drop was a decline in auto sales (which makes up approximately 20% of local sales tax) and general consumer retail sales.

- Total revenues were approximately $6.8 million below projections made in June 2008 for FY 2009-10, due primarily to a combination of decreases in sales tax and property tax revenues and declines in fees and charges generated by the City.

- While revenues were decreasing, employee costs (for health insurance and retirement) and other costs (for example, fuel and utilities) were increasing.

3. Walnut Creek's Response

In order to address the decline in the City's financial situation and to achieve a balanced budget for fiscal period 2010-12, Walnut Creek undertook the following actions:

- Negotiated new labor agreements with employee groups that reduced salary and benefit costs;

- Reduced staffing levels by leaving selected positions unfilled, laying off staff, contracting services out, and reducing some positions to part-time, effectively reducing the work force by 18% from the peak in FY 2006-07;

- Increased charges for services (user fees) to more nearly reflect actual costs;

- Used fund balances (surpluses) from prior FYs and approximately $900,000 in reserves;

- Eliminated or reduced some programs and services; and

- Deferred maintenance on some of the City's infrastructure and facilities.

The prediction that employment and real estate values will start to recover by 2016 may be too optimistic. Some economists have predicted a second recession that would further delay the recovery by an additional one to three years. This will further necessitate the need for long-term structural changes to the way Walnut Creek operates and will create significant challenges to the delivery of quality services and the maintenance of assets and infrastructure.

4. Walnut Creek's Quality of Life

The Task Force reviewed a variety of sources to understand the changing demographic picture of the City of Walnut Creek and what to expect for the future. While the City has many long-term residents, it continues to evolve, mirroring changes in the broader Bay Area region and Contra Costa County in particular. Walnut Creek is recognized for its family-friendly environment and its broad range of services fostering a high-quality lifestyle.

a. Key Values and Concerns

In previous surveys and community outreach efforts, the citizens have clearly identified the following key values and issues of concern. The Task Force recognizes that Walnut Creek offers a wide range of valued and desirable programs. While future service cuts will be required, it is important to note that these programs contribute to making Walnut Creek the place where its residents want to live. Based on the Task Force's work through its eight-month study effort, the group made the following general observations:

- Public safety is essential to all residents;
- With a highly educated community, the importance of quality schools and educational opportunities is essential;
- Citizens in Walnut Creek understand and value the quality of life programs the City currently provides including arts, culture, open space and recreation;
- Walnut Creek's position as a sales tax generator is necessary. It provides the financial support for valued quality-of-life programs and public safety; and
- Economic development is critical to creating ongoing revenue to the community and the City of Walnut Creek.

b. Walnut Creek's Enviable Position

The City of Walnut Creek has long been in an enviable position as the geographic and economic center of Contra Costa County. Walnut Creek is considered to be the automotive shopping, retail, restaurant and cultural hub that serves local residents and non-residents alike. In addition, Walnut Creek is a major professional, financial and real estate employment center. Additional people in the workforce boost the daytime population from 65,000 to approximately 85,000. This enhanced population further increases by the number of visitors that come to Walnut Creek on a given day to shop, eat and enjoy its cultural amenities. These components combine to create a strong local economy generating the highest sales tax revenue per capita in Contra Costa County.

c. The Changing Demographics of Walnut Creek

Walnut Creek continues to provide a family-friendly environment for all ages and its increasingly diverse population. A healthy and attractive downtown, stable neighborhoods, a quality education system, and other amenities continue to keep Walnut Creek a place where people want to live, work, shop and play.

The total population of Walnut Creek has essentially remained constant for the period 2000-2010. A decrease in household size and a general increase in vacancy rates for rental housing offset the influx of new residents due to the increasing affordability of real estate. Population growth of .5% to 1% per year is likely over the next 10-15 years as new housing stock is created and occupied.

The majority of the new housing stock will be in the downtown and surrounding areas, as there is limited land available for development in other areas of the City. This development is due to significant market and regional housing pressure and the quality of life in Walnut Creek. It is also supported by the City's General Plan. New developments will create both financial opportunities and challenges. The impacts may be felt throughout the City.

The average Walnut Creek household size of 2.1 is significantly smaller than the average for the County (2.8) or the State (2.9). The household size in the downtown area is 1.79. The downtown rental concentration is significantly greater than the citywide average. Over 79% of downtown residents are renters, while only 33% of the residents in the rest of the community are renters.

A general aging of the City's population will continue to occur. People over 65 years of age currently make up over 27% of the overall City population. This is nearly double the percentage of persons in that same age category when compared to Contra Costa County and the State of California. This group will include more and more baby boomers, who may desire a set of services different from prior generations. This trend will occur both within the Rossmoor community and the senior community at large.

The demand for services will continue to evolve as the generational progression continues in all segments of the community. This includes the aforementioned seniors, and the proportionate increase in both the Gen-X (30-44 years old) and Millennial (18-29 years old) generations as they become City residents. Communication with these age groups will also need to evolve to encourage participation in planning the City's future direction and to create a better sense of community for these individuals and their families.

There are over 40,000 registered voters in Walnut Creek and 35.2% of these voters are 65 years old and over. This group of older voters is more likely to vote in each election. Only 37% of total voters are currently registered at their same address as before 2000. This suggests a changing voter demographic throughout the community.

5. Economic Development is Key to Recovery

The City of Walnut Creek has long been the high-priority location for a wide variety of businesses. Other Contra Costa County cities began aggressive economic development efforts over the last two decades. Walnut Creek relied on strong community planning and downtown revitalization efforts over the last several decades to support and retain its preeminent location, thus enabling the City to devote its resources to activities other than economic development. Now, increased competition from other cities for businesses historically located in Walnut Creek, along with changes in consumer buying patterns, has begun to affect the City's business base. These challenges have caused City leaders to directly engage the business community and adopt a formal economic development program to preserve and enhance Walnut Creek's revenue base and the City's position in the local and regional economy.

The City Council and staff began discussing the importance of increasing and formalizing economic development efforts in early 2010. The Council adopted an economic development program and work plan on March 11, 2011. The three broad goals of the adopted program are: 1) retaining the existing business base, 2) creating strategies to assist existing businesses to grow, and 3) attracting new business to expand the existing base. The City allocated $250,000 in FY 2011-2012 to implement this program. This included funds for a new management position that would implement the program and coordinate with existing staff, the Chamber of Commerce, the Downtown Business Association and other local and regional stakeholders. This base funding will continue in future budget cycles. An Economic Development Manager was hired in August 2011 to lead the program and work plan efforts.

The City's recent creation of an Economic Development Program is an acknowledgement of the need to retain the City's status as the retail and office center in the local and regional economy and to partner in a more formal way with the business community. It is also important to acknowledge that economic development is a long-term investment not a short-term fix. Utilizing economic development tools and strategies can protect core business in place, while diversifying various business categories in the future. Changes in employment, industries and consumer demand will all play a role in contributing to successful economic development in Walnut Creek.

II. THE REVENUE AND EXPENDITURE PICTURE

A. Current City Services and Programs

In order to assess the long-term financial health of Walnut Creek, it was important to:

- Evaluate how the City currently provides programs and services in the community;
- Understand what recent efforts have been made to improve the cost efficiency of the delivery of these services and programs; and
- Comprehend the ability of each City department to recover the cost of delivering services through fees to the consumers of that service.

In a later section, the Task Force presents findings on how the City currently provides services and programs and recommendations on providing these services in a more cost effective and efficient way.

To understand the City's services, Task Force members reviewed current operations and budget documents for each of the City's departments. For the purposes of this report, "operating budget" is defined as the City's General Fund Budget. This is the primary fund for the provision of City services. The General Fund is also the place where discretionary revenues (taxes) are collected and allocated to finance a wide variety of services provided to our community. The Task Force did review and examine restricted funds, such as the City's Boundary Oak Golf Course Enterprise Fund and the Clean Water Program. Given the restrictive nature of these programs, and the limitations placed upon the revenues for these functions, the Task Force chose to only focus on the "operating budget" (General Fund) in this next section of the report.

Staff from each department was interviewed to understand the unit's basic function and responsibilities including, where applicable, the cost recovery for services they provide. The remainder of this section provides a brief summary of each of the City's four major external service providing departments and the two smaller internal departments. It also includes a synopsis of the changes in staffing levels and programs made in the last two to three years as the City worked to contain expenditures and balance its budget. Next to each department heading is the FY 2011-12 estimated operating budget and its percentage of the City's total estimated operating budget of $60.7 million. These figures were obtained from the *City of Walnut Creek Biennial Operating Budget Fiscal Year 2010-2012*, adopted in June 2010. Tables summarizing key information of each department's budget follow the descriptions.

1. Community Development ($4.2 million, 6.9%)

This Department's responsibilities include: 1) plan check and inspection services for construction activities, 2) current and long-term planning services, 3) code enforcement, and 4) implementation of the City's land use goals and General Plan vision. The department also works to create, preserve, and improve housing opportunities within the City and provides leadership on regional transportation issues. Staffing levels in this department have decreased from 32 full-time equivalent positions (FTE) during the two-year budget cycle of FY 2006-08 to 27.5 FTEs during the current budget cycle of FY 2010-12. The department budget was approximately $4.9 million during FY 2006-07 and projected to be about $4.2 million in FY 2011-12.

While there have been no formal or anecdotal complaints reported, staff noted that the public has likely experienced some increase in response time for the services provided by this department. For example, required building inspections which were previously completed in one day, now may take as long as four or five days to schedule and complete. Staff continues to make every effort to provide a rapid response.

The majority of the revenues for this department are generated from fees paid by developers and others who request planning, project review services, and building inspections (i.e., plan reviews, etc.). The amount varies each year depending on the amount of building activity going on in the City, but approximately $3.0 million in fees comes into this department. The estimate for FY 2011-12 is $3.4 million. The cost recovery ratio for this department is currently about 81%. In other words, the department recovers about four out of every five dollars spent to provide services.

2. Public Services ($13.7 million, 22.6%)

This department's mission is to protect and support the City's infrastructure and natural resources. It manages the development, design, construction, maintenance and renovation of capital facilities, infrastructure, parks and open space. The department includes the following divisions: Engineering, Transportation Operations and Planning, Capital Investment Program, Parks, Open Space, Urban Forestry, Maintenance of Streets, Equipment, Building and Traffic, Museums, Graffiti Removal, Street Sweeping, Clean Water Program, Administration, and city-owned garages. Staffing for the department has decreased from 133 FTEs during FY 2006-08 to 109 FTEs during the current budget cycle period of FY 2010-12. The department budget was approximately $13.5 million during FY 2006-07 and projected to be about $13.7 million during FY 2011-12. The budgeted expenditures for the Department have remained relatively flat for several years despite the increased duties and responsibilities outlined below.[1]

In the last few years, this department has taken on greater responsibilities and duties resulting from new facilities such as the new dog park, skate park and library. Staff has responded to this combination of increased workload and decreased resources by taking several actions, including:

- Outsourcing certain low-risk functions (custodial services);
- Partnering with other cities and the county to share the cost/burden of common streets and intersections;
- Increasing user fees; and
- Deferring some major maintenance.

The reduced staffing has led to longer response times for graffiti removal, cleaning, repairing and painting. Maintenance has become more reactive and less proactive. The apparent effects of the reduced maintenance have been minimal. The accumulation of this deferred upkeep will escalate the depreciation of the City's structures over time. Walnut Creek will begin (or has already begun) to "lose its shine."

It is difficult to achieve full cost recovery for Public Services as most services support the community in general. User fees are not charged for maintenance to City Hall, for street repairs, or for mowing the grass in public parks. The bulk of departmental revenues are tied to parking and garage operations, including meter collections and leases from city-owned facilities. In addition, garbage companies pay surcharges to recover some street wear and tear caused by the heavy trucks. Fees are currently projected to increase by 19% over FY 2008-09 levels.[2] This, combined with the relatively flat expenditures discussed above, has led to a 10% reduction in required net support from the City's General Fund. These staff-driven initiatives have increased the projected cost recovery for the current budget cycle from an anticipated 39% to an estimated 44%[3], or $5.4 million.

3. Police ($22.6 million, 37.2%)

This department's responsibility is to assure the security of people and property and thereby maintain the City's quality of life. Department staff works with the public to provide immediate assistance in times of emergency. The department is both proactive and reactive in providing law enforcement, investigation, crime prevention and other public services. Staffing levels have decreased from 119 FTEs in the two-year budget cycle of FY 2006-08 to 111 FTEs in FY 2010-12. However, it should be noted that the staffing level in FY 2004-06 was 116. The department uses a large number of civilian employees. In addition, over 50 citizens volunteer by assisting in

[1] Public Services presentation to Task Force 4/28/11
[2] Public Services presentation to Task Force 4/28/11 – Actual figures not yet available.
[3] 2010-2012 Budget summary dated 6/15/10; Public Services presentation to Task Force 4/28/11

many routine functions. These volunteers include 35 reserve police officers and 15 Volunteers in Police Services (VIPS). Annually, these individuals contribute an equivalent of about nine FTE positions. The departmental budget was approximately $19.2 million in FY 2006-07 and is projected to be $22.6 million in FY 2011-12. Even though there was a decrease in department staffing, as noted above, the budget increased due primarily to salary and benefit increases specified in the current five-year employee contract that covers this time period. Other factors contributing to this budget increase were the allocation of $1.3 million toward repaying prior City reserve balances used to pay off CalPERS retirement obligations and funds for a new regional radio system.

The department has modified its policies to adjust to the decrease in staffing. For example, officers no longer respond to non-injury vehicle accidents on private property or to non-injury vehicle accidents on public streets where there are no public safety issues such as cars or car parts in traffic lanes or intersections.

Approximately $3 million is collected annually by the department with the Parking Division generating the majority of revenues. The cost recovery ratio for this department's expense is currently about 13%.

4. Arts, Recreation, and Community Services ($12.5 million, 20.6%)

The programs and services delivered by this department provide more than one million opportunities for people to enjoy the City's enhanced recreational and cultural resources each year through many different avenues, including the following:

- An arts education program through its Arts Education division and Civic Arts Education facilities. This program represents the largest community arts education curricula in Northern California;
- A performing and visual arts venue at the Lesher Center for the Arts (LCA), which houses three (of the division's four) theaters next to a five-story garage. During a typical year, the LCA offers over 700 performances, speaker programs, and special events that have attracted over 210,000 annually in total attendance;
- The Center REPertory Company, which serves as the anchor program for the LCA;
- The Bedford Gallery, housed in the LCA, that presents a balance of local, regional and national artists in an annual series of four art exhibitions;
- A Recreation Division that provides classes for all ages, summer camps for children, youth and teens; aquatics facilities which offer pool space for swim teams, as well as recreational and fitness swimming programs; and the scheduling for 14 sports fields used by organized sports groups serving children, teens and adults;

- Recreational programming for three gymnasiums and 28 tennis courts, in a partnership with a tennis contract operator;

- The Boundary Oak Golf Course and Golf Clubhouse which offers golf for all ages, a driving range, and food, beverage and banquet facilities for special events in a 30,000 square foot facility;

- A Social Services division that provides programs and services to 3,000 seniors and disabled individuals annually; and

- Management of the rentals and contracts for its facilities with non-profit community organizations, tenants, and professional programs.

Since the economic downturn began in September of 2008, the staffing of the Arts, Recreation and Community Services (ARCS) Department has been cut from approximately 59 FTEs to 47 FTEs. Some of the work carried out before by department staff has been taken up by a large cadre of volunteers. The department uses over 100,000 hours in volunteer support during each year at many of its different venues and facilities. Several programs have also been either reduced in scope and/or eliminated. The department's annual budget has remained at the $12.8 to $14.0 million level over the last six years; estimates for FY 2011-12 are about $12.5 million. Six years ago, in FY 2006-07, the budget was $12.9 million.

Revenue primarily comes from program fees and ticket sales, which have increased from about $8.8 million during FY 2006-07 to amounts reaching between $9.5 and $10 million in recent years. Estimates for departmental revenue for FY 2011-12 are $9.4 million. Of all the City departments, ARCS has one of the highest levels of cost recovery since almost all of the programs provided are offered to the public on a fee basis. The department has increased user fees charged for the rental of various facilities (reserved group activity in parks, Shadelands Civic Arts facility, the Heather Farm Community Center, etc.). Some services, such as the senior center facility and related programs, are subsidized more heavily pursuant to Council policy. The estimated cost recovery for FY 2011-12 is expected to be about 75%. This percentage has increased since FY 2006-07, when it was approximately 68%.

5. General Government ($2.3 million, 3.8%)

This department handles the management of City government including the City Council, City Manager, City Attorney, City Clerk, City Treasurer, community outreach, and corresponding support staff. The department's responsibilities focus on providing the overall legislative and administrative framework from which the various functions of City government receive direction in providing services to the community.

Included in this department's budget are items that cannot be accurately assigned to any other specific department at the time of adoption of the budget. This structure makes year-to-year comparisons difficult. The budget of this department is so small, these contingency amounts, though not significant to the entire City budget, can distort the analysis of this particular department.

Staffing levels decreased from 18.6 FTEs during budget cycle 2006-08 to 17.7 FTEs during the current budget cycle. Several staffing changes occurred during this period – 2.5 FTEs were cut from the budget (mail, public information and administrative support) – while two positions associated with the community outreach program, with funding from special grant funds, were added. The departmental budget (minus the division noted above) was approximately $3.6 million during FY 2006-07 and is projected to be about $2.3 million during FY 2011-12.[4]

With the adjustments noted above, the department is projected to have revenues estimated to be about $100,000 for FY 2011-12 – a cost recovery of about 4%. However, given the nature of the activities reflected by this budget, significant cost recovery is not feasible.

6. Administrative Services ($5.4 million, 8.9%)

This department oversees the City's financial and administrative functions, including accounting, budgeting, business licenses, treasury management, purchasing, information technology, telecommunications, human resources management, and risk management. (Prior to 2010-12, warehouse and reprographic services were part of this department's operations. Those functions have been outsourced or decentralized.)

Staffing levels decreased from 29.9 FTEs during budget cycle 2006-08 to 23.8 FTEs during the current budget cycle. The departmental budget was approximately $4.2 million during FY 2006-07 and projected to be about $5.4 million during FY 2011-12. The cost increase in FY 2011-12 compared to the earlier period was due to a change in the way the City accounted for Risk Management costs (largely insurance). In FY 2008-09, these costs began to be shown as a division within this department. These costs account for the increase in total budget over this period. In addition, as noted above, two divisions were discontinued with the 2010-12 Budget, which reduced staffing by 5.5 FTEs over this timeframe.

The majority of the revenues for this department are generated from business license payments. Approximately $2 million per year is paid by businesses in the City. The amount has varied little over the last several years with an estimated $1.97 million for FY 2011-12. The cost recovery ratio for this department's expenses is currently about 37%.

7. Summary Tables

Tables One and Two that follow provide a summary of the changes in the department operating (General Fund) budgets over the last six years and the level of cost recovery that each department achieves from revenues that are accrued by that department.

Table One shows the relative increases and decreases in the departmental operating budget expenditures. The Police Department experienced the greatest increase in operating costs over the six-year period noted in the table. Police Department costs increased by $3.4 million, or about 18%, from the FY 2006-07 Budget. Most departments experienced a decrease in their operating costs between FY 2006-07 and FY 2011-12.

[4] Discussions with Assistant City Manager, September 2011.

Table One – Department Budgets - Changes Over Time

Department	FY 2006-07 Actuals ($ mil)	FY 2011-12 Budgeted Expenditures ($ mil)	Difference ($ mil)	Percent Difference
Arts, Rec & Comm Serv	$12.9	$12.5	-$0.4	-3%
Community Develop.	$4.9	$4.2	-$0.7	-14%
Police	$19.2	$22.6	+$3.4	+18%
Public Services	$13.5	$13.7	+$0.2	+1%
General Gov't*	$3.6	$2.3	-$1.3	-36%
Admin Services**	$4.2	$5.4	+$1.2	+29%
TOTAL	**$58.3**	**$60.7**	**+$2.4**	**+4%**

Source: Walnut Creek Biennial Operating Budget document, FY 2010-2012, adopted June 2010.

* *General Government totals have been adjusted as noted above.*
** *As noted previously, Administrative Services' budget increased in FY 2008-09 due to the creation of a Risk Management division in the department and include the associated costs (mostly insurance) here. Previously insurance costs were funded elsewhere.*

Table Two shows: 1) each department's projected expenditures for FY 2011-12 and its percentage of the City's total operating budget, and 2) the net cost to the City for each of the departments after considering the amount of estimated user fee revenues that each is expected to recover from the services it provides. The Police Department, while accounting for about 37% of the total budget, is responsible for over 50% of the net operating costs because of the limited amount of revenues generated by that department. A comparison with several other similar Bay Area communities shows that the 50% level is typical.

Table Two – Level of General Fund Support, Net Cost to City
(Estimated for FY 2011-12)

Department	FY 2011-12 Budgeted Expenditures ($ mil)	Percentage of Total Operating Budget	FY 2011-12 Estimated Revenue ($ mil)	Cost Recovery Percentage	Net Operating Cost to City (Difference $ mil)	Percentage of Net Operating Cost
Arts, Rec & Comm Serv	$12.5	20.6%	$9.4	75%	$3.1	8.3%
Community Develop.	$4.2	6.9%	$3.4	81%	$0.8	2.1%
Police	$22.6	37.2%	$3.0	13%	$19.6	52.4%
Public Services	$13.7	22.6%	$5.4	39%	$8.3	22.2%
General Gov't	$2.3	3.8%	$0.1	4%	$2.3	5.9%
Admin Services	$5.4	8.9%	$2.0	37%	$3.4	9.1%
TOTAL	**$60.7**	**100.0%**	**$23.3**	**38%**	**$37.5**	**~100.0%**

By contrast to the Police Department, ARCS also accounts for a significant share of the estimated FY 2011-12 budget, at $12.5 million, or about 21%, but only represents about 8% of net operating costs because of the charges that ARCS assesses to the users of its programs and facilities. Public Services, accounting for about 23% of the City’s budget, has a projected percentage of about 22% of the net operating budget.

Programs and services offered by ARCS are primarily optional in nature when compared to the other departments in the City. However, these are valued services and programs that make Walnut Creek unique and that most residents agree make Walnut Creek a desirable place to live. Some of the services that are the responsibility of the other City departments must be provided due to Federal, State, or regional mandates. In addition, the City’s primary responsibility is to address public safety issues and to maintain the basic infrastructure of the City’s facilities (i.e., roadways, parks, buildings, community centers, etc.). These issues must continue to be the priority of the City. Based on cost projections for operations and capital needs, other programs which are more elective in nature may suffer. This is discussed in more detail later in the report. As the City continues to struggle to maintain a balanced budget to cover its basic operating costs, it becomes increasingly difficult to find funds to meet its capital needs, especially for replacing or refurbishing city-owned buildings and facilities. This difficulty results in delays for some projects that are considered discretionary.

B. Operating Revenues and Expenditures

In addition to the two-year budget process, the City of Walnut Creek uses two very important tools to project the City’s capital and operating needs. A discussion of the City's Capital Investment Program (CIP) is presented in Section C. In this section, long-term operating budgeting and planning efforts for the General Fund are discussed.

Walnut Creek recently began to utilize a Long Term Financial Plan (LTFP) to assist the City in anticipating operating revenue and expenditure changes and understanding the impact of current economic challenges on future budgets. After the adoption of the 2010-2012 Budget, the Walnut Creek City Council directed staff to create a LTFP that would cover the 2010-2012 budget cycle and look ahead to the next three budget cycles (2012-2018).

The first LTFP focused on the four major revenue types: property tax, sales tax, departmental revenue and other revenues. On the expenditure side, the original LTFP forecasted expenses by department. Because personnel costs make up the majority of the City’s operating expenses, the model included an attempt to track and project retirement (CalPERS) rate increases and other benefit cost increases. City staff revised and updated the first LTFP and it will now look forward ten years so that it addresses the same time period as the CIP.

The updated LTFP includes three revenue scenarios – optimistic, pessimistic, and most likely. The November 2011 "most likely" scenario has been renamed the Budget Scenario as City staff believes that, given the assumptions used to develop this scenario, it represents a conservative and realistic financial model from which to begin the 2012-14 budget process.

As directed by Council, future budgets (beginning in budget cycle 2012-2014) will not use reserves to achieve a balance between revenues and expenditures.

The Budget Scenario, approved by the City Council on November 1, 2011 includes the following revenue and expenditure assumptions:

Revenue Assumptions:

- Property Tax – assumes 2% assessed value decrease and an RDA tax increment cap allocation increase for 2011-2012, and a 2% annual growth each year thereafter.

- Sales Tax – annual growth factor of 3% plus additional sales tax that will be generated from the new Neiman Marcus.

- Departmental Revenues – assumes same levels of service, cost recovery and programs; 3% increase in revenue each year.

- Other Sources – assumes a 1% increase per year in other taxes and revenues.

- Transfers In – same each year as in FY 2011-12.

Expenditure Assumptions:

- Overall Expenditures – used the July 2011 twelve-month budget update as the base for all future expenditures.

- Salaries – reflects new labor contracts where employee portion of pension costs are paid by all non-safety employee groups by FY 2013-14. Also assumes no salary increases following the end of current Memoranda of Understanding.

- Non-Personnel – assumes an annual expenditure increase of 2%.

- CalPERS Change – assumes CalPERS changes the actuarial rate of return from 7.75% to 7.5% beginning in FY 2013-14 and estimates this change will increase non-safety rates by 1.5% and safety rates by 4%.

The November 2011 LTFP now includes consideration of a lower actuarial rate of return for CalPERS. The rate assumption has been reduced from 7.75% to 7.5%. With the assumption stated in the last bullet above, the LTFP includes cost allocations that would be incurred by the City if in fact lower rates were realized. In the event that CalPERS rates are not less, these funds could be used to begin offsetting the City's unfunded liability of its retirement program.

The LTFP also reflects reduced property tax revenues resulting from lower assessed property values as reported by the County Assessor.

Table Three – November 2011 Long Term Financial Plan General Fund Revenue and Expenditure Projections Budget Scenario

Fiscal Year	Revenues ($ mil)	Expenditures ($ mil)	Surplus/(Shortfall) ($ mil)
2010/2011	$65.3	$64.4	$0.9
2011/2012	$64.6	$64.6	$0.0
2012/2013	$64.1	$64.8	($0.7)
2013/2014	$65.7	$67.3	($1.6)
2014/2015	$67.4	$68.5	($1.2)
2015/2016	$69.1	$69.9	($0.8)
2016/2017	$70.8	$71.3	($0.4)
2017/2018	$72.6	$72.9	($0.2)
2018/2019	$74.5	$74.5	$0.0
2019/2020	$76.3	$74.2	$2.1

The above numbers indicate that the City will have significant fiscal challenges for essentially the next seven fiscal years and will need to make additional and noticeable cuts and/or need financial resources to preserve valued community services and programs. In addition, the November 2011 LTFP does not include any additional General Fund support to make up for the loss of Measure Q in 2014 (annual resources through 2014 are approximately $900,000/year which support additional library hours and programs in the both Walnut Creek Libraries). The tax lapsed in 2010, and this specific resource will be exhausted by 2014. Although it begins to address the CalPERS unfunded liability issue, the LTFP does not reflect the need for additional resources for short and long term capital projects. Finally, there is concern by the Task Force that the assumption of an annual 3% increase in sales tax revenue over the next ten years may not be achieved.

C. Capital Needs

The second tool is the Capital Investment Program (CIP). The City's Public Services Department prepares the CIP, a ten-year plan listing the upcoming needs for maintaining the City's existing assets. These assets include 59 buildings of varying sizes and complexity (listed in Appendix 1), two major aquatics facilities, 22 parks, 2,704 acres of open space, 213 centerline miles of streets with 96 traffic signals, 1,290 city-owned streetlights, and 90 miles of storm drain systems of varying sizes.

CIP projects are funded by separate City Council action approving a two-year Capital Budget. The goals of the City's CIP are to:

- Prioritize preservation of the City's existing assets;
- Resolve identified health and safety problems;
- Address legal mandates;

- Respect the City's limited resources for capital expenditures;
- Leverage outside funding sources; and
- Minimize impacts to annual operating costs.

The Public Services Department breaks down capital needs into three categories: regular facility maintenance (the Maintenance Master Plan), enhancement of existing assets (Asset Management Projects), and construction of new capital projects, including complete replacement of some existing assets (Discretionary Capital Projects). For ease of understanding and analysis, this report categorizes both the maintenance and enhancement of existing assets, as needed or as required by Federal or State mandates (such as the Clean Water Act, the Americans with Disabilities Act, etc.) as Asset Management Projects (AMPs), and new capital or replacement construction projects as Discretionary Capital Projects (DCPs).

AMPs are divided into seven main categories of existing infrastructure within the CIP. They are:

- Roads
- Storm Drain Repairs
- Building/Facility Maintenance
- Parking Lots
- Parks and Open Space
- Curb, Gutter and Sidewalks
- Signals and Streetlights

The total ten-year cost of these items is estimated to be $73 million, of which approximately $29 million does not have identified funding sources.

DCPs are projects to be built as new City assets or to replace existing assets. They have a 20-year minimum lifespan. Certain discretionary projects are highlighted in the CIP as high priorities. They are:

- The Civic Park Master Plan (includes exploration of a permanent ice rink, plaza, creek walk and other amenities);
- Clarke and Larkey Swim Centers (as defined by a City Council approved needs assessment study and conceptual designs). These projects could be as substantial as $20-$25 million;
- Energy Strategy Projects; and

- Ygnacio Valley Road Circulation Improvements (left turn lane lengthening at Tampico, San Carlos, Walnut Blvd, and Homestead Avenue and the intersection at Oak Grove Road second left turn lane).

The total cost estimate for DCPs in the 2010-2020 CIP in current dollars is approximately $33 million (using a $20 million Clarke and Larkey Swim Centers cost estimate) of which $21 million, or 64% of the total, is unfunded.

In addition to the AMPs and DCPs, other potential capital projects have been identified that are within the City's physical jurisdiction, including certain drainage and flood control improvements and slide repairs. However, the City has no responsibility for these projects, in part because they reflect land conditions and facilities that existed when certain areas were annexed to the City in the 1960s and 1970s.The drainage and flood control projects, in particular, were built to handle the drainage needs of the era in which they were built and not the needs today. In addition, there is no evidence that the conditions where these projects occur are changing. In any event, the proposed drainage and flood control projects would require multi-jurisdictional solutions, cooperation and funding (including participation from Contra Costa County, the County Flood Control District, and the Army Corps of Engineers and private property owners in affected neighborhoods).

Table Four summarizes the costs of the 2010-20 CIP. As shown in the table, $50 million of the $106 million, or about 47%, does not have an identified funding source.

Table Four – Summary of Ten-Year (2010-2020) CIP Costs

	Total Cost ($ mil)	Funded ($ mil)	Unfunded ($ mil)
Asset Management Projects	$73.0	$44.0	$29.0
Discretionary Capital Projects	$33.0	$12.0	$21.0
TOTAL	$106.0	$56.0	$50.0

*Estimated amount includes updated cost estimate of $20 million for Clarke and Larkey Swim Centers.

There are also longer-term projects for consideration that are not programmed or included in the CIP, such as a downtown parking garage, public plaza, and other desired projects.

Depreciable Assets – According to the City of Walnut Creek's 2010 *Comprehensive Annual Financial Report* (CAFR), the historic cost of the City's depreciable assets is $313 million. On average, these assets are halfway through their useful life. The actual cost to replace, renovate and modernize these assets will be significantly higher than their original cost basis. At this point in time, the City of Walnut Creek does not have sufficient funds available to replace and/or maintain all of its existing assets and infrastructure.

D. Employee Compensation, Benefits and Pension Obligations

Walnut Creek offers a package of benefits to its employees including but not limited to retirement, health insurance (including dental and vision), disability and life insurance. Walnut Creek does not compare the compensation it provides to its employees to the private sector, but only with other government entities.

Walnut Creek provides a defined benefit pension plan for full time employees through the California Public Employees Retirement System (CalPERS). According to State law, annual employer contributions to the State's CalPERS defined benefit plans require accumulating enough assets over a member's (employee) active service life to sufficiently fund the total retirement benefits due a member at the time of retirement. Pension rates for Walnut Creek, like all other municipalities, have two components. First, the employers' annual *normal cost* represents the present value of benefits that have accrued on behalf of the members during the pension valuation year.

In addition to an annual normal cost, an employer may also be required to make payments toward the CalPERS unfunded actuarial liability. An employer accrued liability contribution consists of the employer's share of the pension system's total unfunded actuarial liability amortized over a 5 to 30 year period. The unfunded actuarial liability of a retirement system at any time is the excess of the system's actuarial liability over the value of its assets. An unfunded actuarial liability can either be generated or increased in a number of ways, including enhancement benefits or the occurrence of actuarial losses. Actuarial gains or losses occur when actual experience of the system differs from the actuarial assumptions used to project the pension system funding requirements. An example of an actuarial loss would be if the assumed CalPERS 7.75% investment rate of return on assets does not achieve this goal during each valuation period.

Payments to the CalPERS State fund have increased to $8.3 million in FY 2011-12. This represents greater than 11% average annual compound growth rate since FY 2000-01. As of June 30, 2009, the underfunded accrued liability for the City's miscellaneous employees was $22.6 million. There is no comparable figure available for the public safety employees as they are part of a larger pool of safety employees in CalPERS. However, the underfunded accrued liability for the larger statewide public safety pool was nearly $1.7 billion as of June 30, 2009. In addition, these amounts are likely understated because CalPERS has not fully recognized the recent declines in the invested assets. In 2009, the actual market value of assets was 27% less than the actuarial value of assets used in the underfunded accrued liability figure. Given this information, the amount of unfunded pension liabilities is significantly greater than those calculated and reported using June 2009 CalPERS valuations.

This pension liability can only be reduced by payments from the City or greatly improved investment performance by CalPERS. There is significant risk that CalPERS cannot achieve their stated objective of a 7.75% average return in the foreseeable future.

If the actual rate of return achieved by CalPERS is only 3.8%, which is suggested by academics as realistic, the “buy out” figure for the City of Walnut Creek to withdraw from CalPERS is as much as $158 million. This is compared to $50 million that was informally estimated by CalPERS in 2007 using a higher rate of return. These figures relate to miscellaneous employees only (i.e., non-safety and management). When the safety employees are included, the figure is considerably higher.

Clearly, Walnut Creek is facing an unknown and growing multi-million dollar unfunded liability. It is unclear whether there will be sufficient funds that can be set aside in the future to pay for these expenses without compromising many of the services and programs now provided by the City. Walnut Creek is not alone, as this potential problem threatens many municipalities and other public agencies throughout California.

The City provides the following defined benefit plan (see Glossary for definition):

- Current Walnut Creek employee retirement plans include a “3% @ 50” plan (this means that an employee can retire at any age after 50 and receive 3% of their salary for each year of service) for public safety employees. The City also provides a “2% @ 55” plan (this means that an employee can retire at any age after 55 and receive 2% of their salary for each year of service) for current miscellaneous employees.

- Under the safety retirement plan an employee's retirement compensation is capped at 90% of their final salary. There is currently no cap for miscellaneous employees.

- The pension plans have a 2% annual inflation escalation for retirees.

- Currently, miscellaneous employees pay between 3.5 and 7% of their salary towards their pension costs; police management pay 7% and non-management safety employees pay 0%.

In FY 2009-10, payments to CalPERS by the City were 21.6% of salary for miscellaneous employees and 47.8% of salary for safety.

The City recently negotiated new labor contracts that require miscellaneous (non-safety and management) employees to pay 7% of their salary towards their pension costs. This is about one-third of the total that must be paid to CalPERS.

<u>Health Insurance Benefits</u>: The cost of providing health insurance benefits to City employees continue to increase at an alarming rate. Since FY 2000-01, the health insurance benefit costs have grown annually at a rate higher than 10% per year. For FY 2011-12, health insurance costs are expected to be $4.4 million. General City employees pay about 5% of the cost of their health insurance. However, since their payment amount is based upon a percentage of their salary, they have been insulated from the continuing rapid escalation in the cost of health insurance premiums in recent years. If the employee has no increase in salary for that year, their contribution to the health insurance benefit remains the same as the prior year; the City pays the entire increase. Management employees pay approximately 10% of their insurance cost and executive employees pay approximately 20%.

Many surrounding cities have negotiated a higher contribution from their employees towards the cost of health insurance premiums. As an example, existing employees for the City of Pleasant Hill will see their share of health insurance premiums increase from 10% to 20% over the next two years.[5] Pleasant Hill management employees have, in the past, paid $55 per month for family medical coverage, but will now pay over $500 per month if they elect that coverage.

Walnut Creek does not offer retiree health insurance benefits that are a common practice in some city retirement programs. An individual who retires from the City prior to the age of 65 (when Medicare coverage becomes available) has to pay the full cost of their health insurance.

[5] Contra Costa Times, October 17, 2011, *Pleasant Hill reaches deal on three year contract with management employees.*

III. FINDINGS AND RECOMMENDATIONS

In the development of this report, certain findings rose to the top as critical for the City to address. Recommendations based upon these findings consequently rose to a higher priority level. These key findings fell into four main categories: 1) the City's Long Term Financial Plan, 2) Expenditures, including capital costs and operating costs, 3) Revenue, and 4) Delivery of Services. The following section outlines the key findings and recommendations in these areas.

A. The City's Long Term Financial Plan

FINDING 1:

Walnut Creek has stood out among its peers in its past ability to fund ongoing programs and services as well as major capital projects and facility investments as part of its annual budgeting process. For example, projects such as the Lesher Center, the gyms at Foothill Middle School and Tice Valley, the skate park, and the new library have been paid for without needing to issue bonds or other forms of debt instruments. In addition, more recently the City has initiated numerous measures to keep revenues and expenses in balance as the economy has soured. Actions taken were discussed in an earlier section and included some staff reduction through layoffs, outsourcing, cost sharing of benefits with employee groups, employee wage freezes and furlough days, and fee increases for services and programs provided by the City.

The current economic conditions have existed for several years and are expected to continue for the near-term future. The City will continue to struggle to balance its operating budget for the next several years. Because the City has, in the past, been able to fund the programs and services desired by its residents, as well as support a significant portion of its capital needs, long term planning and budgeting for major capital projects (including both facility replacement and/or rehabilitation) has not been as vigorous and thorough as the current situation demands. The needs of the future operating budget and capital improvements are significant.

RECOMMENDATIONS:

1.a. Continue to develop and refine fully integrated financial planning practices that include the City's Capital Improvement Program (CIP) and the City's Long Term Financial Plan (LTFP). This integrated approach should reflect current economic trends, strong fiscal governance, cost control, management of rising employee wage and benefit costs, containment of unfunded liabilities, and "best practices."

1.b. Communicate to both the community and the staff the results of the updated LTFP as the new financial reality for the City of Walnut Creek.

1.c. Continue to address operating deficits for the foreseeable future.

1.d. Prepare the community for possible changes in service and programs that reflect the current and near term fiscal realities as well as the changing demographics of the City.

1.e. Re-evaluate existing programs and services and establish clear, and possibly new, priorities for City services that will ensure future financial stability for the programs and services offered.

1.f. Work with other Contra Costa County cities and the League of California Cities to prevent fiscal drain from State and Federal mandates.

B. Expenditures

FINDING 2:

The CIP includes Asset Management Projects (AMPs) and new Discretionary Capital Projects DCPs). The projects in the adopted 2010-2020 CIP total $106 million; $50 million of which is unfunded (47%). Refer to Table Four.

As defined earlier in this report, AMPs are projects that maintain or improve existing assets of the City, such as road repaving or facility renovation. AMPs make up $73 million (69%) of the City's current CIP (ten-year list of capital needs). Of the $73 million, funding sources of $44 million are anticipated to be available from various sources; $29 million is unfunded over the ten-year period (about $3 million each year).

DCPs include new construction or major replacements, such as the Larkey and Clarke Swim Centers. The DCPs, which total $33 million, include a $20 million cost estimate for updating the Larkey and Clarke Swim Centers during the 2010-2020 period. Of the $33 million, funding sources of $12 million are anticipated to be available from various sources; $21 million of the DCPs is unfunded.

Overall, there is insufficient funding to maintain many of the City’s assets at current levels. This creates a large, unknown cost over time and raises concerns that critical existing facilities may not be maintained at the City’s customarily high level. There are currently no policies in place that require a minimum level of funding for the AMPs.

Findings and Recommendations under the Revenue Enhancements and Delivery of Service sections of this report will provide solutions for funding Walnut Creek's capital needs.

RECOMMENDATIONS:

2.a. In setting priorities for the use of its General Funds for capital needs, the City should focus on preserving or replacing its existing assets (those on the AMP list), before embarking on new facilities (those on the DCP list).

2.b. To preserve existing community assets, increase the amount of funds set aside in each budget cycle for asset management projects in the existing Capital Equipment/Facilities Replacement Fund. This will necessitate reducing operating costs or increasing operating revenue or both.

2.c. Evaluate grant opportunities for CIP goals. Recognize the cost of applying for grants and the success ratio from such efforts.

FINDING 3:

The CIP includes several new discretionary projects including the replacement of the Larkey and Clarke Swim Centers. The City has, in the past, funded other large DCPs with accumulated budget surpluses and significant contributions from project advocates, as was the case with the Lesher Center and the new downtown library. For the foreseeable future, any accumulation of budget surpluses will likely need to be used for maintenance of current assets. Funding for future large discretionary projects will require community financial support in the form of tax increases or bonds along with contributions from project advocates and users.

RECOMMENDATIONS:

3.a. Require that funding for future large discretionary projects include a portion of the total project funding to be raised by the community and/or users as well as a commitment to seek and support citywide based (voter approval) funding.

3.b. Establish a minimum threshold for community-based financial participation in funding DCPs as a requirement for committing City resources to those projects. This has been an integral part of past projects such as open space acquisition, building of the LCA and the new library. In the current, more difficult financial environment, community-based financial participation in funding DCPs is essential.

FINDING 4:

Ongoing maintenance costs and long-term implications to the City's operating expenses have not always been evaluated as a factor in considering a DCP project. The replacement of these new assets becomes a significant liability over time if no funding source for replacement is designated.

RECOMMENDATION:

4.a. As part of the capital budgeting process every two years, continue to include an analysis of the projected operating and maintenance costs of each proposed DCP to ensure that costs are incorporated both into the operating budget and into the set aside requirement for the Capital Equipment/Facilities Replacement Reserve Fund. This analysis should be performed even if adequate funding is available to construct the project. A dedicated revenue stream should also be identified for ongoing operations and maintenance expenses.

FINDING 5:

The City of Walnut Creek owns, uses and/or manages 59 public facilities (Appendix 1) to deliver services. In addition, the City owns numerous other infrastructure assets (e.g. roads, drainage systems, etc.). Many of the facilities built in the 1960s and 1970s, such as the Corporation Yard and current swim facilities, have reached, or are about to reach, the end of their useful life. Many of these facilities may require renovation or replacement in the next 10 to 15 years. In some instances, the same services are being provided at multiple facilities therefore creating redundancy.

The City currently prepares ten-year forecasts on asset replacements and major repairs, but not 20 to 30-year forecasts. It does not project long-term costs beyond ten years or allocate funds toward replacing or renovating these assets. The historic cost of the City's depreciable assets is $313 million. On average, these assets are halfway through their useful life. The actual cost to replace, renovate and modernize these assets will be significantly higher than their original cost basis. Therefore, a gap exists between the identified future costs and available funds on hand.

RECOMMENDATIONS:

5.a. Within the next two years analyze the current use of each city-owned facility. Where appropriate consolidate activities and programs into fewer facilities. Identify the underutilized facilities and consider changing the use, leasing or selling them.

5.b. As part of the CIP process undertaken every two years, and before the City considers significantly renovating or replacing an aging facility, the City should complete or update a needs assessment to determine if the facility will continue to be needed in the future.

5.c. Establish funding mechanisms for the replacement of critical public facilities.

FINDING 6:

The continued increase in total labor costs due to both retirement and health insurance benefits pose a significant risk to the City's long-term financial security unless adjustments are made. Labor costs (salaries and benefits) represent about 73% of the General Fund operating expenditures, with salaries comprising some 50% of the budget and benefits comprising the remaining 23%.

Walnut Creek's labor costs have increased substantially over the past ten years while staffing levels were relatively flat or declining. The City's 2010 Biennial Operating Budget includes data that shows total salary and benefits increasing from about $27.3 million in FY 2000-01 to a high point of $49.9 million by FY 2007-08. During the period when costs increased by about 83%, staffing levels grew by only 12.5 FTEs, from 373 to 385.5 (3.3% increase). By FY 2011-12, staffing was projected to decrease to 330 FTEs, (a 14% decrease), but total salaries and benefits are expected to remain flat.

There is significant risk that CalPERS cannot achieve their stated objective of a 7.75% average return over the foreseeable future. If they only achieve a 3.8% return, which academics suggest is likely and which CalPERS uses to estimate returns for any entity wishing to withdraw from CalPERS, Walnut Creek is facing a potential unknown, underfunded pension liability estimated in the tens of millions of dollars – or more. CalPERS funding issues are significant. CalPERS provides information that informs the City of its current fund balance, its future obligations and the unfunded balance for present and past employees to the date of a report. This calculation does not reflect some important effects:

- CalPERS smoothes its calculation of funded balances to minimize abrupt changes in the market value of its investments. These balances do not represent the current market value of CalPERS investments, but rather an average value that does not reflect the substantial under performance of the market in recent years. Additional contributions from the City will be required unless CalPERS investments appreciate significantly in the next few years.

- CalPERS expects that its funds will earn an average of 7.75%.

- Each year, the City is required to contribute an amount that will be the basis for paying an employee's retirement benefit. The required contribution is based on the 7.75% expected rate of return.

- Until the employee retires, the City's balance of contributions is expected to grow at an annual average rate of 7.75% per year.

- When an employee retires, the accumulated principal and the investment return it provides will be used to pay the employee's retirement checks.

- The average rate of return that CalPERS achieved in the last ten years was only 5.3%. When the actual rate of return is lower than CalPERS' expectations of 7.75%, the City's balance of contributions will not grow sufficiently and there will be less principal and earnings available to pay retirement benefits. The City will eventually be required to contribute additional money to make up the shortfall.

Walnut Creek's retirement benefit costs have been rising at an average rate of more than 10% per year. When the effects described above are fully reflected, Walnut Creek's pension benefit costs will rise sharply at an even greater rate. But Walnut Creek cannot predict how quickly CalPERS will recognize the actual underperformance of its investments and increase the City's required contributions. It is problematic whether there are (or will be) sufficient funds that can be set aside to pay for these expenses without compromising many of the services and programs now provided by the City. The City is not alone as this same problem faces many municipalities and other public agencies in California. Specifically, the structure of the CalPERS retirement system exposes the City to a significant, but at this time unknown, future liability. As such, the City will need to structure future labor contracts to achieve more transparency and to provide for greater contributions from the employees to their retirement funds. Also, Walnut Creek, along with other Cities, should extend efforts to modify the fundamental structure of CalPERS in order to reduce the volatility of the City's liability.

Labor costs continue to rise for a number of reasons, all of which create a substantial risk to the City's long-term financial security:

- Salary Levels and Methodology: Until 2009, employee contracts reflected a policy of paying employees at the 75th percentile in comparison to the local public-sector market as a means of remaining competitive. Conversely, the City offered less-lucrative benefits than other municipalities. An example is that Walnut Creek does not offer medical benefits for retirees. To achieve the 75th percentile market level, salaries had been adjusted annually based on a survey of the market – represented by a review of 13 agreed-upon cities in the East Bay. In addition, employees had been guaranteed a cost-of-living adjustment (COLA) each year in the contracts. Merit ("step") increases were also provided for employees. Starting in 2009, new employee contracts have not included either market adjustments or COLAs due primarily to the changing economic conditions, but step increases have continued. Over 250 of the City's current 330 employees are currently at top step salary.

- Rising Cost of Retirement Program: As outlined in Section II, Walnut Creek participates in the California Public Employee Retirement System (CalPERS) and, through this system, offers employees a defined benefit retirement program. The City's contribution to CalPERS to cover employee retirement costs has continued to increase each year in order to:

  - Account for the increasing life expectancy of employees (i.e., people are living longer in retirement); and

  - Offset the decline in the investment market and CalPERS's lower-than-projected investment returns.

  With the recent miscellaneous employee contract approvals entered into by the City, new miscellaneous employees will be provided a starting annual-defined pension benefit equal to a his or her three-year average annual salary times the employee's years of service times a multiplier of 2% payable upon retirement at age 60 (sometimes referred to as a "2% at 60" retirement benefit). This will lower the long-term retirement costs of the City for future employees. The City has not yet determined the expected cost savings these new agreements would provide over the next 10 to 15 years.

- Employee Share of Retirement Costs: As with Social Security, the CalPERS program encompasses both an employer and an employee contribution. The employee contribution has been fixed by CalPERS at 7% for miscellaneous employees and 9% for public safety employees. Like many cities, Walnut Creek had traditionally paid almost the entire employee portion of the retirement contribution, which further increased the City's retirement benefit costs. Starting in 2009, most employee groups began paying more toward their retirement contributions. With the recent approvals of five new labor contracts, all miscellaneous employees will be paying the full 7% employee share of their retirement costs by the ends of their respective contract periods. In addition, police managers currently pay 7% of the 9% of the employee share. Other sworn police employees pay 0%.

- Health Insurance Costs: Slowdown in annual health insurance increases are not expected in the near future. Since FY 2000-01, the health benefit costs have grown annually at a rate higher than 10% per year. For FY 2011-12, healthcare costs are expected to cost the City about $4.4 million of the $60.7 million annual General Fund budget.

RECOMMENDATIONS:

6.a. Prior to the end of the current employee contracts, evaluate the methodology used to develop the total City employee compensation package (wages and benefits), including the “percentile” value used for market adjustments, the step increase procedure, the cost of living (COLA) adjustments and how raises are granted.

6.b. To ensure Walnut Creek continues to remain competitive in the employer marketplace, perform a comprehensive compensation survey (salaries and benefits) prior to the end of the current employee contracts. Where applicable, ensure that the survey includes both the public and private sector. The City should consider including such a comprehensive survey periodically to ensure that City salaries stay competitive in the future but not out of line with both private and public sector compensation.

6.c. In all employee negotiations, work towards a rapid increase in the amount of the employees’ share of contribution to their retirement fund. The goal should be to increase all employee pension contributions to the maximum limit set by the CalPERS retirement program. This will allow the City to share the burden of future cost increases with employees. In upcoming employee negotiations, establish a second-tier retirement program for future employees.

6.d. In all employee negotiations, work towards a rapid increase in the amount of employee contribution to their health insurance premiums. As an approach to lowering total premium costs, also consider using an alternate health care plan provider as well as evaluating the cost savings that could accrue if changes in the current plan parameters, including the amount of co-pays and deductibles, are instituted.

6.e. Because the City cannot control the unpredictable financial exposure of participation in CalPERS, the City should actively participate with other cities through the League of California Cities and other organizations to work toward statewide retirement reform to minimize the risk of financial uncertainties of municipalities.

6.f. Quantify the exposure of, and evaluate and develop tools and measures to mitigate, future potential liabilities associated with CalPERS.

FINDING 7:

Even with reductions in the City’s employee compensation package (salaries and benefits) as discussed in the prior Finding, it is almost certain that additional actions will be needed in order to be able to provide the City’s preferred level of programs and services. The City has already effectively used a variety of alternative service delivery models in recent years in order to reduce costs and/or to streamline services. Examples of these actions are:

- Volunteers: The City has used volunteers in many areas to enhance the delivery of service and reduce operating costs. For example, the Police Department uses reserve police officers and volunteers in police services (VIPs) program; the Lesher Center uses volunteer ushers for performances and events; the Open Space Division also uses volunteers in several of their programs.

- Enterprise Funds: The City operates the Boundary Oak Golf Course as an enterprise fund and contracts with a private firm to operate the golf and food/beverage operations. The revenues from operations are used to cover costs. With this arrangement, the City benefits from a company with golf course expertise at private sector prices. If a City staff person were to have this responsibility, the experience brought to the position might not be as great, and the City employee package of retirement and health benefits would likely be significantly more costly.

- Private Service Providers: The City contracts with a private firm to operate and maintain the City's tennis facilities. Similar to the golf course example above, the facility users receive the expertise of the operator at non-public-employee costs.

- Contracting and Outsourcing: In 2010, the City eliminated its custodial positions and began contracting with a private firm to provide these services. The change netted an annual savings of $300,000. As another example, the Planning Division contracts for the services of professional planners and other consultants when workload exceeds staffing capacity or when specific expertise is required.

- Consolidations/Joint Powers Authority (JPA): The City has consolidated service delivery with other local agencies to streamline service and reduce costs. For example, in the mid-1990s, the City created the Central Contra Costa Solid Waste Authority, a JPA with four other cities and the County, to contract with and provide for garbage services. The result was a significant decrease in costs to the customer and a reduction in the work each city and the County had to do annually to manage individual garbage franchises.

- Non-Profit Partnerships: The City partners with a number of community organizations to provide services to the community. The contractual arrangements of the numerous partnerships vary. By way of example, the City owns the properties, such as the Lindsay Wildlife Museum and the Walnut Creek Historical Society, and provides funds for some capital improvements; the non-profits provide the services and the ongoing maintenance.

RECOMMENDATIONS:

7.a. Identify opportunities to outsource elements of City functions that will produce significant cost savings while preserving those City employee positions that are performing essential functions. Any potential outsourcing should be accomplished without any significant loss of service or program quality.

7.b. Look for additional cost-effective opportunities to partner with community non-profit organizations to deliver services and meet City goals.

7.c. Identify possible City-run programs that can be transferred to a sustainable non-profit entity. Evaluate future funding to encourage the ongoing delivery of the service to the community.

7.d. Increase the use of volunteers where feasible. If necessary and financially prudent, establish a volunteer position within the City structure that could manage the general recruitment and selection of volunteers. Walnut Creek residents are well educated and have demonstrated a willingness to volunteer for community service.

7.e. Increase cooperation with other agencies to share and/or consolidate services.

7.f. Increase use of and investment in Information Technology to provide more efficient and effective services directly to the public and to support departments in their delivery of services.

FINDING 8:

Until recently, the City of Walnut Creek has been able to fund most capital projects from the operating budget surpluses. This has alleviated the need to issue debt instruments (i.e., bonds) to pay for capital development projects and/or necessary major improvements. However, the economic downturn of the past several years has eliminated the City's ability to generate annual surpluses. While projections of future surpluses are uncertain, the City at some point in time may be able to experience a positive budget balance that would again allow Walnut Creek to allocate these excess resources.

RECOMMENDATIONS:

8.a. The City should develop or amend specific policies to guide the allocation and use of any surplus operating budget funds in some proportion to the following:

8.a.i. The existing Capital Equipment/Facilities Reserve Fund;

8.a.ii. PERS Reserve Fund;

8.a.iii. Unfunded or underfunded Projects in the CIP; and

8.a.iv. The existing Technology Replacement Reserve Fund.

C. Revenue

FINDING 9:

The City's newly created Economic Development Program is acknowledgement of the City's need to work to retain its status as a significant regional retail and office center. Walnut Creek is viewed as one of only a few locations in the Bay Area for boutique retail. Local residents and businesses do continue to go outside the City for many of their big box retail purchases.

Redevelopment funds support the City's affordable housing programs and have helped fund downtown infrastructure. Even if the State budget bills survive legal challenges, these funds will disappear altogether in approximately five years. The City will need to rely on In-Lieu Housing funds generated by new development and other resources, including General Fund resources, to support affordable housing programs.

RECOMMENDATION:

9.a. Support the efforts of the Economic Development Program in developing effective economic strategies that enhance the financial health of the City, including those that impact downtown merchants, auto dealerships, office tenants, medical facilities, the arts community, neighborhood shopping centers, and small businesses. Support the following strategies:

- 9.a.i. Enhance the image of Walnut Creek as a boutique/high end regional retail destination.
- 9.a.ii. Continue efforts to bring a boutique hotel to the City and expansion of local Transient Occupancy Tax revenue.
- 9.a.iii. Provide locations for retail companies that are being attracted to nearby cities due to availability of land and price.
- 9.a.iv. Enhance the City's auto sales position in the central county, encouraging the sale of vehicles to the Lamorinda, Diablo Valley and broader area.
- 9.a.v. Continue to develop and support restaurant success in the downtown.
- 9.a.vi. Retain local services for Walnut Creek residents and workers to continue to encourage everyone to "Shop Walnut Creek," both downtown and in neighborhood shopping centers.
- 9.a.vii. Enhance the City's arts programs to encourage local and regional patronage and related revenue generation.
- 9.a.viii. Be responsive and flexible to new retail trends and uses that are developing in the marketplace and that will provide services to Walnut Creek residents and provide tax and fee revenues.

9.a.ix. Strengthen Walnut Creek’s position as a leading central county professional and corporate office location.

9.a.x. Recognize the importance of the small businesses located in Walnut Creek and investigate methods of promoting their success, training and marketing.

9.a.xi. Enhance Walnut Creek’s position of providing critical and state-of-the-art medical care and services to the broader region.

9.a.xii. Encourage medical, biotechnology, and other science based technology research facilities to locate in Walnut Creek. This should include green and clean technologies.

9.a.xiii. Coordinate business retention and recruitment activities with the Downtown Business Association, Chamber of Commerce and other county/regional efforts.

9.a.xiv. Coordinate City development services to ensure that permitting is efficient, cooperative, time sensitive and consistent with the City's economic development and General Plan goals.

9.a.xv. Evolve a housing vision within the General Plan for the Downtown and in the vicinity of the two BART stations that provides a mix of housing opportunities for both young professionals and those wishing to downsize and remain living in the community. This could free up quality older housing stock for families to locate in Walnut Creek, while sustaining the property tax revenues and sales tax derived from these residents. This vision may also need to provide more infrastructures, which could include additional parking, enhanced downtown parks, plazas and recreation opportunities, and increases in police services.

9.a.xvi. There is an increasing population of residents over 65 years of age in the community. The Rossmoor community and general senior population should be encouraged to view Walnut Creek as their primary source of their services.

9.a.xvii. Work with office building property owners in the vicinity of the two Walnut Creek BART station areas and other office nodes to develop an attractive shuttle system to encourage employees to visit downtown for food services and shopping. Where there is existing service, encourage companies to partner with the City to support these transportation services.

9.a.xviii. Improve “way-finding” throughout the community to assist traffic flow and directions to parking and amenities. Focus efforts to improve access to the core business district and the performing arts venues.

9.a.xix. Work with office building owners in the Shadelands Business Park to develop an action item list of issues that can be used to improve the ability to attract and maintain office and medical uses in the business park. Business parks evolve over time and need to respond to changing market conditions and workplace situations.

9.a.xx. Evaluate the impacts of internet sales on the City's retail community and City revenues and monitor State and Federal efforts to tax internet sales.

FINDING 10:

The City of Walnut Creek has been proactively increasing the cost recovery of its delivery of services. This is most commonly accomplished through a fee paid by the user that offsets the cost of the service provided. A balance needs to exist between the fees charged users and the market tolerance for such costs. A comparison with other cities helps in understanding the rates that are acceptable to users. ARCS currently achieves about a 75% cost recovery for its services and continues to evaluate additional recovery strategies.

Changing uses in the downtown area can create additional costs for police and other services. Close monitoring of the late-night downtown activity help ensure that it does not negatively impact the image of Walnut Creek as a safe and entertaining venue for the region. This will help control costs incurred by the City associated with the downtown entertainment and dining activities.

RECOMMENDATIONS:

10.a. Move further toward setting fees to produce full recovery of costs for services where fees are charged. In determining those costs, departments should include the full cost of support from other departments such as Administrative Services and Public Services including information technology, other administrative support and maintenance of infrastructure needed for providing services. Market competition may limit fees but the City should endeavor to recover its costs to the extent the market for its services allows.

10.b. Recover the added costs of providing police and other services from those who are using a disproportionate amount of public services.

FINDING 11:

All sources of tax revenue have declined since the FY 2007-08. Current tax revenue generation has fallen to approximately the level generated in FY 1996-97. Tax revenue in the FY 2010-11 is up slightly from FY 2009-10 and only a minor increase in tax revenue is expected in FY 2011-12.

Sales and property tax revenue combined generate almost half of the City's General Fund revenues. These two essential sources of local revenue are subject to state and national economic challenges and trends as the City Budget indicates. Economists indicate that it could be another five years before sales and property tax revenues return to the levels generated in FY 2006-07.

Based upon the current LTFP, the City of Walnut Creek will have an operating shortfall in each of the next seven fiscal years that will need to be addressed by additional expenditure and/or program reductions, staff reductions, use of reserves, generating additional operating revenue, or a combination of all four. The City will also have to address the loss of Measure Q funding for additional Library hours in the next two years by reducing hours or identifying alternate funding.

There are a number of potential community-based mechanisms to generate additional General Fund revenue including increases in a sales (transaction and use) tax, parcel (special) tax, business license tax, transient occupancy tax, and utility user tax. All require voter approval. Based upon preliminary estimates, a sales tax revenue increase would generate the most new General Fund revenue. A sales tax increase offers the broadest (general-purpose) usage opportunities for new funds, including meeting future operating and capital needs. Additionally, the use of a sales tax offers the ability to collect from residents and visitors alike, both of whom benefit from the provision of City services. The following table summarizes the revenue that might be generated in several examples.

Table Five – Community Based Revenue Enhancement Options

Type	Use	Methodology	Who Pays	Estimated Annual Rev. ($ mil)
1/2% Sales Tax Increase	General or Special	Based on City's current 1% sales tax generation of approximately $15.0M	Visitors, Businesses, and Residents	$7.0
Parcel Tax	General or Special	Based on 25,000 parcels at $100/year	All Property Owners	$2.5
Business License Tax Increase	General or Special	Based on doubling the current Business License Tax rates	Businesses and Consumers	$2.0
Utility User Tax	General or Special	This rate is very difficult to estimate and reflects input from the City Manager.	Residents and Businesses	$2.0
Transient Occupancy Tax Increase	General or Special	Based on increasing current rate from 8.5% to 12%	Visitors and Business	$0.6

RECOMMENDATIONS:

11.a. Even after the efforts to reduce operating costs and accumulate funds for needed capital projects, there will not be sufficient revenue to fund repairs to roads and streets, renovations or replacement of aging facilities and continue, arts, recreation and community service programs that are valued and supported by residents. The Task Force investigated numerous options to address anticipated shortfalls and recommends a ½-cent sales tax increase as an additional measure to address the City's goals.

11.b. The City should survey the public to determine the level of community support for a general or special sales tax increase to be used to provide additional support for needed capital projects, unfunded liabilities and to preserve valued community services.

D. Delivery of Services

FINDING 12:

Over two-thirds (68%) of the City's current management and supervisory staff is comprised of individuals in the 45-64 year old age group. This portends significant upcoming management and succession issues. With 53% of the *overall* staff falling within this age range, the City will see major transitions occurring during the coming years.

RECOMMENDATION:

12.a. Develop a plan to provide smooth transitions when older staff members retire.

FINDING 13:

Walnut Creek is recognized as a family-friendly place to live, work and recreate. The community is attractive to families for its safety and quality education opportunities. Civic Arts, open space, the downtown and recreation programs are important to residents of all ages. Walnut Creek and its characteristics continue to evolve and reflect changes in the Bay Area Region and Contra Costa County in particular.

RECOMMENDATIONS:

13.a. Continue to work in partnership with the school districts and private schools to support quality education and the adjunct services provided (e.g., after school and community-based activities) to promote Walnut Creek as a family-friendly community.

13.b. Monitor and manage the demand for late-night establishments in order to balance those activities with the resident mix of the community so that downtown continues to reflect an attractive, safe asset for the residents and visitors alike.

FINDING 14:

Methods of communicating continue to change, including social media. The demographic make up of Walnut Creek is changing to include an aging population, young professionals moving into the community and the increase in the number of languages spoken.

RECOMMENDATIONS:

14.a. Evaluate the communication approaches and methods used between the residents and City staff to reflect the changing resident demographics. This evaluation should include the increased use of social media and be driven by the changing needs and languages of the residents in order to build a better sense of “community.”

14.b. Evolve the delivery of services to the changing demographic of the consumer. Invest in more effective software and social media that provide more useful data from event registration and patron surveys that will allow staff to evaluate programs and quickly adjust to changing demands.

IV. CONCLUSION

The Task Force strongly recommends that the City Council adopt an action plan for implementation of the recommendations contained in this report. The Task Force further recommends that an accountability process be created. By doing so, the City Council will help ensure that the benefits of the work provided by the Task Force will be periodically reviewed and evaluated for effectiveness over the long-term future. At each of those review intervals, adjustments may be deemed appropriate in order to accommodate changing circumstances.

APPENDIX 1

City of Walnut Creek City-owned buildings and other structures:

1. Arbolado Park Restroom/Maintenance Shed
2. Assistance League
3. Borges Ranch Outbuildings (4 buildings)
4. Borges Ranch Ranger Residence
5. Borges Ranch Visitor Center
6. Boundary Oak Golf Course Restroom
7. Broadway Garage
8. City Hall & Police Department
9. Civic Arts Shadelands
10. Civic Arts Shadelands Annex
11. Civic Arts Studio D, E & J
12. Civic Park Assembly Hall`
13. Civic Park Community Center
14. Civic Park Gazebo
15. Clarke Pool
16. Clarke Swim Center Snack Shack
17. Corp Yard Covered Parking
18. Corp Yard Sweeper Shed
19. Corporation Yard Maintenance Building
20. Corporation Yard Warehouse/Reprographics
21. DLRCA Actor's Center
22. Dean Lesher Regional Center for the Arts
23. Glenhaven House
24. Heather Farm Ballfield Restroom #1
25. Heather Farm Ballfield Restroom #2
26. Heather Farm Ballfield Restroom #4
27. Heather Farm Tanks
28. Heather Farm Community Center
29. Heather Farm Garden Center
30. Heather Farm Studio H
31. Howe Homestead Barn
32. Howe Homestead Ranger Residence
33. Howe Homestead Office
34. Howe Homestead Pump House
35. Larkey Maintenance Bldg
36. Larkey Swim Center
37. Lar Rieu Residence
38. Lar Rieu Outbuildings (4 buildings)
39. Lindsay Museum
40. Model Railroad
41. North Locust Street Garage & Retail
42. Park Place
43. Police Range Building
44. Police Repeater Station
45. Rudgear Park Restroom/Maintenance Shed
46. Shadelands Historical Ranch Caretaker's Shed
47. Shadelands Museum
48. Shadelands Tank House
49. Shadelands Museum Pump House
50. South Locust Street Garage & Retail
51. Sugarloaf Ranger Residence
52. Sugarloaf Outbuildings
53. Tennis Pro Shop
54. Tice Valley Gym
55. Tice Valley Park Restroom/Maintenance Shed
56. Traffic Operation Center
57. Traffic Operation Center Outbuildings
58. Walden Park Restroom
59. Walnut Creek Library