FY 2014-15 Financial Report

For the Six Months Ending 12/31/14

March 3, 2015

OVERVIEW

The FY 2014-15 adopted budget had a $1.41 million structural deficit that was funded using the City's Economic Stabilization Reserve (ESR). The balance in the ESR as of July 1, 2014 was $4,541,557 as shown in the City's audited Comprehensive Annual Financial Report (CAFR). The $1.41 million deficit includes savings from the 10% employee furlough because at the time the budget was adopted, none of the bargaining unit contracts had been completed. The City Council set three goals for inclusion in the City's negotiations for new contracts beginning July 1, 2014. They were:

- Eliminate the city's 10% furlough program; and
- Have employees contribute to their retirement cost; and
- Balance the general fund budget by FY 2017-18.

The cost of eliminating the 10% furlough was estimated at $2.3 million for the general fund. If this were done all at once with no other expenditure adjustments considered, the general fund deficit would grow to $3.7 million overnight. Considering the ESR balance of $4.5 million, the ESR could not sustain the City until the pension obligation bonds are paid off in FY 2016-17. Paying off the pension obligation bonds will reduce general fund expenditures in future years by $1.2 million.

During negotiation discussions, the City indicated a willingness to balance the budget through a combination of using reserves from the ESR to cover deficits but negotiated for a permanent change in having employees pay a share of their retirement costs along with an increased contribution towards healthcare. The City reached agreement with several bargaining units including Mid Managers, Confidentials, First Level Managers, Executive Team, Police Officers Association and Sergeants to eliminate the furlough over a two year period; have employees contribute to their retirement cost (also phased in over a two year period); and have employees pay 20% of the monthly premium cost of healthcare. Some bargaining units previously had a healthcare split of 20% of the increase in cost, rather than 20% of the overall total monthly premium cost.

None of the new bargaining unit agreements contained raises for employees with the exception of the Police Officer's Association and Sergeants. Due to the City's inability to recruit and retain a sufficient number of qualified Police Officer positions, a 3.5% raise along with a one-time distribution of $1,000 was approved.

The contract amendments discussed above caused supplemental budget appropriations totaling $518,000, adding further to the adopted budget deficit for FY 14-15.

Finance projections indicate that the City will continue to have financial challenges through FY 2016-17. We are projecting increases in CalPERS, healthcare and workers' compensation costs. These will be partially offset by increased revenues in both sales tax and property taxes. However, without reducing expenses in some other manner, the City will continue to have a need to draw on the ESR for several more years.

The City has a budget deficit in FY 2014-15 which follows a surplus for FY 2013-14 on an actual basis. In FY 2013-14 the City also had a budget deficit, but when all of the revenues and expenditures were finalized for the fiscal year end, the actual results from operations caused a surplus of $636,000. This was attributable to the City having many vacant positions during FY 2013-14. At one point during this period, the City had a vacancy rate of 12.5%. Human Resources has placed a priority on recruiting and filling vacant positions. When vacancies are filled, the City will once again incur a deficit on an actual basis and will use the ESR to pay for it. In FY 2013-14 the $636,000 surplus was added to the ESR thereby supporting funding future year deficits.

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

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

Adjusted Budgets. The revenue projections and expenditure budgets include adjustments for

encumbrances, carryovers, and any supplemental appropriations made by the Council as of December 31, 2014.

GENERAL FUND

General Fund Financial Condition. With 50% of the year complete, General Fund revenues are at 24.3% of projections and expenditures are at 45.1%.

General Fund

	Budget	YTD Actual	Percent
Balance, Start of Year	$ 4,325,998	$ 4,325,998	-
Revenues	35,893,412	8,721,000	24.3%
Expenditures	(38,005,497)	(17,134,302)	45.1%
Balance	**$ 2,213,913**	**$ (4,087,305)**	**-**

The budgeted expenditures shown above include encumbrance carryovers from FY 2013-14 of just under $250,000. Encumbrance carryovers are outstanding purchase orders as of June 30th. Encumbrances are liquidated and paid from the beginning fund balance as prior year budget monies are used to pay for them (as opposed to current year revenues). In addition, budgeted expenditures include $893,000 added for public safety grant funded programs, $518,000 for negotiated employee contract changes, and just under $35,000 for other personnel cost budget amendments. Included in the other items was $24,000 added for a limited term Human Resources Technician to perform recruitments for the City, $7,000 for health insurance for limited term employees as required by the Affordable Care Act and restructuring the Parks & Recreation Department to Community Services and in the City Manager's Office.

In the YTD Actual shown above, the ending fund balance is negative as of the end of the second quarter. This balance includes only the unreserved/undesignated operating fund balance of the general fund, not the ESR. The negative balance is an indication of the typical cash flow pattern for the general fund. This happens because general fund expenditures for payroll and vendor payments are incurred evenly throughout the fiscal year whereas our largest revenue source is received in two large payments in February and May when property taxes are received from Sutter County. The property tax receipt from Sutter County includes not only property tax revenue but a portion of the City's sales tax revenues. These are by far the two largest revenue sources for the City and when they are received only two times per year, it causes the cash flows (and therefore fund balance) to go deficit until the first installment is received. When additional sales tax is received from the State and property taxes are received from Sutter County, this will turn around and fund balance will end the fiscal year with a positive balance. The negative fund balance as of December 31, 2014 was compared to that of December 31, 2013, and the City is approximately $175,500 better off (less negative) in 2014.

Revenues.

The City's top ten revenues account for approximately 95% of total General Fund revenues. As such, they provide a very good summary of our revenue position. Key revenues are performing as projected based on payment schedules and past trends for the half way through the fiscal year. More detailed information is noted below.

Top Ten Revenues	Budget	YTD Actual	% Received
Property Taxes	$ 10,909,500	$ -	0.0%
Sales Tax	11,413,000	3,146,231	27.6%
Business Licenses	833,400	41,304	5.0%
Franchise Fees	1,475,000	223,844	15.2%
Hotel/Motel Surcharge	647,700	239,546	37.0%
Building Permits	550,000	373,112	67.8%
Police Special Services	220,000	41,396	18.8%
CSA "G" Fire Contract	632,000	0	0.0%
Recreation Fees	1,078,913	391,851	36.3%
Operating Transfers	6,297,400	3,139,080	49.8%
Total	**$ 34,056,913**	**$ 7,596,364**	**22.3%**

- **Property Tax.** The first apportionment of FY 2014-15 taxes did not occur until February, 2015. The FY 2014-15 adopted budget projected a 4.0% increase in property taxes. Based upon the final assessed valuation reports from the Sutter County Auditor-Controller's Office, general fund secured and unsecured assessed values increased by 6.28%. Property tax revenues are anticipated to exceed budget estimates by approximately $225,000 at the end of the fiscal year.

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

- Properties were adjusted by a CPI factor of 0.45% between FY 2013-14 and FY 2014-15 (an increase of $9.5 million in assessed valuations).
- Residential increased by 7.5% ($212 million).
- Unsecured increased by 1.1% ($3.8 million) in assessed valuations (the largest increase was due to Comcast and Holt of California).
- Industrial decreased by 0.65% ($1.3 million).
- Commercial values were flat for FY 2014-15 in part due to a full exemption for Rideout Memorial Hospital.

The City received the benefit of $175.5 million in assessed value increases during FY 2014-15 attributable to an increase in market value compared to prior years when there had been decreases in assessed values pursuant to Proposition 8. An additional 4,976 parcels remain under Proposition 8 status, with a total potential recapture of $351 million. The City will see these increases in assessed value translate to increases in property tax revenues if real estate sales prices continue to escalate. The potential recapture is eliminated when and if a home under Proposition 8 status is sold for less than the recapture value.

- **Sales Tax.** When the FY 2014-15 revenue projections were developed, sales tax was projected to increase 3.5%. The most recent quarterly sales tax results increased 10.7% on a cash basis and 7.7% on an adjusted basis (July - September, 2014 sales) and 1.8% on cash basis and 1.4% on an adjusted basis (April - June, 2014). Sales tax continues to be unpredictable and volatile, but has shown overall increases. There is a lengthy lag time between the time that sales occur and when the City receives the information regarding the sales tax revenues in order to compare the data to the same quarter of the previous year. As of the date of this report, Finance staff is still waiting for the Christmas quarter results. Finance continues to be cautiously optimistic because overall sales tax revenues have been increasing for the past 12 quarters (10 out of 12 have been positive on a cash basis).

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

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

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

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

- **Construction Permit Fees.** Building Permits are higher than anticipated at 67.8% received only half way through the fiscal year. This is an indication of the increase in construction and development activities.

- **CSA "G" Fire Contract.** The City receives these funds for fire services to the unincorporated area that was formerly served by the Walton Fire Protection District. Since revenues are property tax based, the first apportionment was received in February, 2015.

- **Recreation Fees.** At 36.3% of budgeted revenues, service fees from recreation programs appear to be lower than anticipated halfway through the year. This is typical due to the seasonal nature of the programs offered.

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

Expenditures. Operating costs are all within budgetary expectations as summarized below.

Expenditures	Budget	YTD Actual	% Expended
City Council	$ 132,718	$ 63,360	47.7%
City Attorney	150,000	100,627	67.1%
City Manager	560,838	211,970	37.8%
Finance/IT	2,328,641	1,038,465	44.6%
City Treasurer/City Clerk	51,455	7,727	15.0%
Human Resources	536,754	249,750	46.5%
Community Development	959,894	428,487	44.6%
Public Works	5,379,782	2,263,372	42.1%
Police	14,538,381	6,605,982	45.4%
Fire	9,709,629	4,915,199	50.6%
Animal Control Services	677,112	104,506	15.4%
Economic Development	228,137	94,049	41.2%
Contingency	197,281	7,696	3.9%
Non-Departmental Misc.	272,419	96,087	35.3%
Parks & Recreation	2,282,456	947,025	41.5%
Total General Fund	**$ 38,005,497**	**$ 17,134,302**	**45.1%**

ENTERPRISE FUNDS

The following summarizes year-to-date revenues, expenditures, and changes in current assets net of current liabilities for the enterprise funds. In general, revenues and expenditures are consistent with past trends. Depreciation is included as a footnote in the budget and is therefore not included below. Revenues in the water fund exceed the 50% expected for the percentage of the year complete as they reflect the seasonal pattern of usage during the summertime months. Capital connection fee revenues are far less than the expected 50% received because the amount budgeted includes $1.6 million in anticipated connection fees for the Proposition 84 waterline project which have not yet been received but are expected to be received during the 2nd half of FY 2014-15. Debt service expenditures are less than half for the first two quarters for both Water and Wastewater as they include only an interest payment because the payment that includes both principal and interest is not due until June 1st of each year.

Water Fund

	Budget	YTD Actual	Percent
Balance, Start of Year	$ 14,150,267	$ 14,150,267	-
Revenues			
Operating	10,463,000	5,652,704	54.0%
Capital	2,278,100	184,892	8.1%
Expenditures			
Operating Programs	(7,737,899)	(4,085,034)	52.8%
Capital Equipment	(59,250)	(12,829)	21.7%
CIP Contributions	(442,962)	(442,962)	100.0%
Debt Service	(2,339,539)	(791,225)	33.8%
Balance	**$ 16,311,717**	**$ 14,655,813**	**-**

CIP Projects	**$ 15,543,000**	**$ 4,952,899**	**31.9%**

Wastewater Fund

	Budget	YTD Actual	Percent
Balance, Start of Year	$ 8,730,928	$ 8,730,928	-
Revenues			
Operating	12,047,180	5,990,108	49.7%
Capital	464,400	187,573	40.4%
Expenditures			
Operating Programs	(8,921,662)	(3,487,418)	39.1%
Capital Equipment	(404,250)	(34,478)	8.5%
CIP Contributions	(836,586)	(836,586)	100.0%
Debt Service	(1,536,941)	(179,358)	11.7%
Balance	**$ 9,543,069**	**$10,370,769**	**-**

CIP Projects	**$17,194,000**	**$ 1,712,697**	**10.0%**

Finance staff accounts for the operating funds and capital connection fee funds for both the Water and Wastewater operations separately. Debt service payments are allocated to the capital connection fee funds based upon how the debt proceeds were used to finance projects at the time the debt was issued. Repayments for bond principal and interest are charged accordingly. Public Works/Utilities advises Finance when a Water or Wastewater project is approved how much should be paid from operating funds vs. capital connection fee funds. In recent years with the decline in development activities, City Council has been advised that at some point Finance staff may draw the connection fee fund reserves into a negative position in order to make debt service payments. Council concurred that this was an acceptable practice as long as Finance kept track of the funds separately, and replenished the cash flows as development activities increased. As of December 31, 2014, Finance reviewed the available cash balance in both the Water and Wastewater connection fee/capital funds and provides the following update:

	Water	Wastewater
Cash available @ 12/31/14	$1,044,323	$1,828,429
Plus receivable-Prop 84 Project	$1,630,908	
Total net resources available	$2,675,231	$1,828,429
Annual D/S from connection fees	$1,523,234	$770,099
# of years of coverage available	1.76	2.37

What this table shows is the amount of cash reserves (plus the Proposition 84 receivable for Water connection fees) available in each of the capital connection fee accounts compared to the total annual debt service currently being allocated to and paid from capital connection fees. Those two amounts are then compared to calculate a ratio of how long, in terms of years, the City will be able to pay debt service without drawing capital connection fee funds into a deficit position. This calculation does not consider amounts used from capital connection fees for future capital projects or future revenues received; it is a snapshot in time of where the funds stand as of December 31, 2014. The Wastewater fund is in a better position to cover debt service than the Water fund, but without additional development to increase revenues, both will be in a difficult position to cover debt service without borrowing funds from the operating funds activities to do so.

For comparison purposes, the table below shows the same information for both Water and Wastewater as of December 31, 2013:

	Water	Wastewater
Cash available @ 12/31/13	$2,383,384	$2,419,386
Annual D/S from connection fees	$1,504,275	$879,098
# of years of coverage available	1.58	2.75

By comparing the two tables, it is clear that the Water fund is depleting capital connection fee funds available for debt service much more rapidly than the Wastewater fund due to the larger debt service payment amounts. As stated previously, the capital connection fee fund is anticipating receipt of $1.6 million later this fiscal year for the Proposition 84 waterline project's connection fees (220 connections) so this was added as an available resource in the table shown as of December 31, 2014 as it is expected to be received prior to the end of the fiscal year. This improves the Water fund capital connection fee cash reserves, at least in the short-term. Longer term, this will be addressed as part of the Rate Study currently in progress by the Public Works Department.