



**TO:** City Council  
**FROM:** City Manager  
**DATE:** April 15, 2010  
**SUBJECT:** Fiscal Year 2010/11 Operating Budget

### FISCAL STATUS OF THE CITY

Last year I identified the fiscal status of the City as problematic. Sales tax revenues were on a material decline over the prior two years and no sales tax growth was projected for the next two years. For fiscal year 2007/08, the last audited fiscal year at that time, total revenues were \$13,483,100. For the fiscal year ending June 30, 2009 total audited general fund revenues were \$11,943,374, and projected revenues for fiscal year 2009/10 are \$12,354,000. While for fiscal year 2009/10 the revenue estimate appears to be better than the prior fiscal year adjusting out a one-time State Board of Equalization accounting error of about \$380,000 reduces the 2009/10 revenues to about \$11,974,000. This is about a 12.5% reduction in total annual revenues for the City from fiscal year 2007/08 through fiscal year 2009/10. This trending declined due mostly to reduced retail sales and a reduction in property development is disturbing. The good news is that the rate of economic decline has declined, and the City Council has been able to remain in compliance with its financial policies on reserves during this period.

During the past fiscal year, several significant factors have occurred that have or will affect significantly the fiscal status of the City. As mentioned, the national economy has been in significant decline during the two years, impacting retail sales, property development, and housing prices and sales, three of the City's major revenue sources. The state of California has a \$20+ billion shortfall in its budget, and seems perpetually inclined to making up a material portion of that deficit through reducing or diverting local government revenues. Last year, Mervyn's, Ocean Honda and Gottschalks left the City. Only Mervyns and been replaced by Kohls. These losses not only significantly impact sales tax revenues, but also jobs. For the last two years the unemployment rate for the Santa Cruz County has been in the double digits. In January 2010 the U.S. bureau of Labor Statistics put the Santa Cruz County unemployment rate at 15%, a rate greater than the Nation or the State.

The City Council, however, has taken affirmative action to manage this decline in revenues, and to anticipate as best as is practical further declines and possible future state action. During the mid year review of the 2008/09 budget, beginning of January 2009, staff was directed to begin concession negotiations with the employee bargaining units. These negotiations resulted in a one

day per month furlough for all employees, and freezing, beginning July 1, 2010, for vacant positions. These vacancies were achieved through an early retirement program offered to certain employees. These changes have resulted in an estimated change of the projected June 30, 2010 fund balance for the General Fund of about \$700,000, a large portion of which was due to a one time positive adjustment by the State Board of Equalization to sales taxes. It is important to note that the principal contribution to this remarkable net result was the furlough and early retirement programs, which could only have been accomplished through the cooperation and thoughtful partnership of the employees of the City.

In looking forward, the specter of the federal narrow banding mandate is diminishing significantly. The countywide narrow banding team as managed through Netcom has modified significantly its plan to implement inter-operability; and, much of the costs of the ongoing planning and initial implementation steps have been paid through grants. Particularly, Capitola Police Department has managed to acquire radios and other ancillary communication equipment through the City's SLESF grants, which augmented the countywide homeland security grants a portion of which the City used for radios. The City manages its storm water management plan through the public works department, and last year the mandatory compliance efforts were well within budget. The main concerns for next year are revenue related, particularly: retail sales, construction/development and any unforeseen impacts that may come from the State of California. The most significant concern for next year is estimating sales taxes. Using various predictive calculations sales tax estimates, including in lieu taxes and the City's ¼ cent district tax, the sales tax revenue estimates for fiscal year 2010/11 ranges from about \$4.3 million to \$4.9 million. Development applications are down markedly from last year, as is the revenue associated with such development. It is noteworthy that the new Marriott is under construction and should be ready for occupancy by February next year. The budget includes \$75,000 of increased Transient Occupancy Tax in recognition of the new hotel. The state is making some noises with regard to diverting local revenue, mostly it is Redevelopment money. However, the League of California Cities is sponsoring an initiative for this November's ballot securing the local revenues. Expectations are that the initiative will make the ballot and be passed by the voters.

This budget corrects a budgeting error from two to three years ago, and by so doing reduces staffing costs by \$330,000. When the City negotiated with the employees a cap on retirement costs, and the Pension Obligation Bonds were sold to prepay a CalPERS unfunded liability, an internal service fund was established to expense from each department into the retirement internal service fund an amount equal to total retirement costs, including POB debt service. Moneys from this fund were then used to pay CalPERS their formulated retirement assessments to the City, and to pay a portion of the debt service of the POB. In this way the City could track all costs of retirement including the POB payments. This is important during labor negotiations or at times when the City wants to compare labor costs with other cities. If this were not done, in particular capturing the costs of the POB debt service, Capitola's retirement costs would be understated. To make a complex matter more complicated, the Council approved a 10 year term for the POB, about ½ of the term CalPERS used to amortize this debt. This resulted in a significant savings of interest costs for the City, but also increased the annual debt service. This increase in debt service, due to a decreased term, if not in some manner adjusted, would overstate the City's retirement costs. To solve this problem, the difference in debt service due to

the decreased term was treated as a fund transfer, rather than an expense to the departments. Through miscalculation this fund transfer in combination with the retirement expenses to the departments was overstated and double counted that portion of the debt service due to a decreased term. In the initial budget projections for the 2010/11 fiscal year that overstated amount equaled \$330,000. It was this adjustment and revised sales tax estimates, made after the October through December numbers were received, that finally brought this budget into balance without reductions in staffing hours. With the exception of the Finance Director which is funded in this budget at about 60% to recognize that it will take time to recruit and hire the position, all other prior frozen positions remain frozen.

With regard to expenditures no new major programs are being proposed, although \$2,000 has been budgeted for the 211 program sponsored by United Way. Although the dramatic downturn in the economy over the last two years still requires the City to limit services to a certain extent, its lessening severity has allowed this budget, on a slow incremental basis, to return some municipal services. The furlough programs in place in March 2009 will expire June 30, 2010, at which time all work schedules and office hours will return to normal. The budget reflects \$250,000 being transferred into the CIP fund, a \$100,000 increase from the prior year.

### **PRIOR YEAR ACCOMPLISHMENTS**

The most significant accomplishment during the 2009/10 fiscal year was delivering quality city services during a year of reduced resources from a very constrained fiscal environment. All departments were affected by the furloughs, but City services were for the most part maintained.

The Community Development Department had some significant successes this past year. The housing element was certified by the state. CDBG grants of \$70,000 were approved. The Bay Avenue Senior Apartments project has been successfully proceeding toward completion. In a combined effort with the City Managers Department, Community Development obtained the permits necessary for the fireworks program celebrating the City's 60<sup>th</sup> Birthday.

The various divisions of the City Manager department worked hard to hire a new Police Chief, successfully obtain a \$40,000 EDA grant, and to complete labor negotiations. The Shop Capitola program was initiated. The Ad Hoc Library Committee debuted and a library site recommendation will have been presented to the City Council. The Finance Department, currently under the direction of the City Manager until a Finance Director can be hired, did an excellent job continuing the implementation of the New World financial system and performing their regular duties without a Finance Director. Recreation, always successful in its programming, was particularly innovative with the establishment of its new dodge ball league. The program is experiencing surprising success.

Public Works and Capital Improvements Projects were also significant this last year. The reconstruction of 41<sup>st</sup> Avenue was completed. The Capitola Road pedestrian project was designed and built; and the Hill Street project was completed. Also, the Parking Commission was inaugurated and recommendations on village parking will soon be forth coming.

In a reprise of their success with the beach tile wall this year, the Arts and Cultural Commission published its tile book. The Commission's major project for the year, the aquarium paintings on the City's traffic signal utility boxes, was a great success.

Police has transitioned very well with Mike Card as the new chief. He has been encouraging to the Department employees, and is dealing well with problems as they arise. The Community Out Reach Center is now being staffed with volunteers from the VIP program, which has matured into a very successful resource for the Department under the direction of Mike Banks, the volunteer coordinator.

Transition is the best word to describe this past fiscal year. Reduction in revenues requiring significant reduction on services, and the retiring of several prominent employees including the Police Chief, the Building Official, and the City Manager has required the City to accommodate significant change, and it has successfully done so.

## **BUDGET FORMAT**

This budget presentation has changed materially from prior years. Staff reductions and the uncertain economy have made it impossible to project a meaningful two year budget. This problem is not unique to the City of Capitola. The firm of Muni Services provides the City sales tax projections and they have said that their projections out to 2011/12 have very little meaning in this tumultuous economy. Also, some charts and detail contained in the prior year budget have been removed in favor of a modestly more simple presentation.

## **GENERAL FUND**

The General Fund provides for the general operations of the City departments. This proposed budget for fiscal year 2010/11 represents about a \$265,000 increase in expenditures from the 2009/10 year end estimated expenditures. The increase is primarily due to: Adding the Finance Director position; the elimination of the furlough program; and, complying with the POA renegotiated contracted salary increase of 2%.

Transition is again the theme for the 2010/11 fiscal year. Prominently, a new City Manager, Jamie Goldstein, will take the reins of the City. The newly appointed Police Chief, Mike Card, although he has spent almost thirty years of his police career in Capitola, will certainly have a transitional impact on the department. The Community Development Department now includes the Building Department as a division, and the recruitment for a new Community Development Director will be completed by the beginning of the fiscal year. If the City's fiscal circumstances remain relatively positive and the Finance Director recruitment is completed, the 2010/11 fiscal year will be one of the City's hallmark years for change.

There are several significant projects scheduled for this prospective fiscal year. The initiation of the General Plan revision will, it is hoped, begin under the leadership of the new Community Development Director. The survey that provides the street condition information for the capital improvement projects will be conducted again this year. Cherry Street resurfacing, the Esplanade Park retaining wall and Clares Street are the scheduled CIP projects. The Library Ad Hoc Committee has begun the process to build a new library by recommending a site to the Council/RDA Board; and, it is expected that a funding plan will soon follow. Similarly, the

Parking Commission has made its recommendation to the City Council to construct a multistory parking structure; and, Council has given direction to staff to follow up on that recommendation.

The General Fund has been pretty well beat up during the last two years. In addition to the unfunded Finance Director, the Police Department and the Public Works Department have lost a total of about six positions. While services levels have decreased during this period, every effort has been to isolate those service decreases to areas of the City where the impacts would be less noticeable. In public works the grass may mowed less frequently or replacement and repairs may take a little longer. Although the beach is a priority, there are times for the Esplanade Park of the beach when repairs or clean-ups are delayed. In Police, non-dedicated patrols may occur less frequently or non-mandatory training has been lessened. These same strategies will be employed for the prospective 2010/11 fiscal year.

### Revenue Summary

The following table presents a summary of the General Fund revenue by broad category, comparing the prospective 2010/11 revenue to the June 30, 2010 estimate and prior years. Revenue estimates for significant revenue sources are addressed in detail in the General Fund Revenues section of the operating budget.

	FY07-08 Actual	FY08-09 Actual	FY09-10 Adopted	FY09-10 Mid-Yr Est	FY10-11 Adopted
Revenue					
Taxes	\$9,489,300	\$7,852,553	\$8,408,900	\$8,095,000	\$8,091,500
Licenses and permits	\$247,884	\$354,335	\$190,000	\$266,400	\$229,000
Intergovernmental revenues	\$218,435	\$178,923	\$283,700	\$437,000	\$386,900
Charges for services	\$1,986,745	\$2,092,783	\$2,172,900	\$2,300,200	\$2,360,000
Fines and forfeitures	\$671,668	\$673,892	\$755,000	\$819,000	\$859,000
Use of money & property	\$533,382	\$409,801	\$439,800	\$378,200	\$339,800
Other revenues	\$74,292	\$85,447	\$71,000	\$58,200	\$63,500
Other financing sources	\$188,000	\$611,957	\$0	\$0	\$0
Revenue Totals	\$13,409,705	\$12,259,690	\$12,321,300	\$12,354,000	\$12,329,700

Revenues represent one-time and ongoing income to the City. One time revenue sources include but are not limited: fund balance contributions, grants, and one-time adjustments from ongoing revenue sources. The projections for the 2010/11 fiscal year are usually based upon certain assumptions, which remain fairly consistent from year to year. However, because of the economic downturn, it has become difficult to use past revenue experience to predict next year's revenue receipts. The most difficult has been estimating the sales tax revenue for next year. The volatile economy has made prior year revenue receipts less than useful as a predictor for the 2010/11 fiscal year. Several major retail firms have either left the City or have discontinued business, and retail sales for almost all firms have markedly declined over the last two years. This makes it difficult to estimate sales tax revenues, the single largest revenue source for the City. This budget uses the first two quarters of the 2009/10 fiscal year as an estimate of 52% of the sales tax for the entire fiscal year. Also, revenues from the loss of retail firms and the addition of new firms are used to adjust the total. Then the budget assumes, after the adjustments, that the 2010/11 fiscal year sales tax revenues will be the same as the 2009/10 sales tax revenues. This may be a bit optimistic, but given the projected increase in fund balance at

the end of the 2009/10 fiscal year of more than \$500,000, and the expectation that the Finance Director position is currently vacant provides enough cushion to make such an estimate more than acceptable.

### Expenditure Summary

The tables below present a summary of the General Fund expenditures, comparing the past actual and adopted expenditures to the adopted 2010/11 expenditures.

GENERAL FUND EXPENDITURES	2007-2008 Actual	2008-2009 Actual	2009-2010 Adopted	2009-2010 Mid-Yr Est	2010-2011 Adopted
<b>DEPARTMENT TOTALS</b>					
City Council	\$118,967	\$72,446	\$70,700	\$80,900	\$87,100
Community Grants	\$269,999	\$274,637	\$275,000	\$275,000	\$275,000
Finance	\$732,382	\$736,454	\$753,400	\$580,700	\$690,800
Attorney	\$291,206	\$200,245	\$203,560	\$365,900	\$273,600
City Manager - Admin	\$760,914	\$753,972	\$764,200	\$780,700	\$766,200
City Manager - Personnel	\$173,997	\$165,312	\$196,800	\$160,000	\$197,600
Museum	\$63,218	\$65,246	\$63,400	\$63,000	\$67,200
Art & Cultural Commission	\$47,148	\$43,305	\$42,200	\$41,944	\$48,300
Police - Law Enforcement	\$4,929,686	\$5,203,451	\$5,096,342	\$4,891,700	\$5,116,500
Police- Parking	\$506,752	\$469,746	\$432,700	\$459,200	\$448,800
Police - Lifeguards	\$69,612	\$84,036	\$86,100	\$87,100	\$91,200
Police - Animal Services	\$12,722	\$7,317	\$16,400	\$9,700	\$14,200
Community Development	\$891,574	\$922,336	\$829,200	\$845,100	\$694,000
PW - Streets	\$1,113,835	\$1,222,585	\$1,004,700	\$955,200	\$1,044,700
PW- Facilities	\$223,530	\$245,373	\$218,200	\$226,200	\$208,800
PW- Pac Cove Park	\$46,724	\$24,978	\$18,200	\$18,200	\$20,000
PW - Parks	\$591,029	\$550,148	\$447,600	\$421,500	\$453,300
PW - Fleet	\$299,404	\$279,278	\$282,200	\$282,200	\$285,400
Recreation	\$767,755	\$800,725	\$843,000	\$810,000	\$836,800
<b>Subtotal - Before Fund Transfers</b>	<b>\$11,910,455</b>	<b>\$12,121,591</b>	<b>\$11,643,902</b>	<b>\$11,354,244</b>	<b>\$11,619,500</b>
Fund Transfers	\$1,537,100	\$444,846	\$568,900	\$568,900	\$710,000
<b>TOTAL</b>	<b>\$13,447,555</b>	<b>\$12,566,437</b>	<b>\$12,212,802</b>	<b>\$11,923,144</b>	<b>\$12,329,500</b>

GENERAL FUND EXPENDITURES BY SERVICE CATEGORY

GENERAL FUND EXPENDITURES	2007-2008 Actual	2008-2009 Actual	2009-2010 Adopted	2009-2010 Mid-Yr Est	2010-2011 Adopted
Personnel	\$7,512,650	\$7,976,795	\$7,577,200	\$7,364,244	\$7,527,500
Contract services	\$2,535,947	\$2,562,214	\$2,450,002	\$2,459,900	\$2,467,500
Supplies	\$639,662	\$519,246	\$568,200	\$481,600	\$490,000
Community Grants	\$269,999	\$274,637	\$275,000	\$275,000	\$275,000
Capital outlay	\$93,296	\$0	\$0	\$0	\$0
Internal service fund charges	\$856,300	\$788,700	\$773,500	\$773,500	\$859,500
<b>Subtotal - Before Fund Transfers</b>	<b>\$11,907,855</b>	<b>\$12,121,592</b>	<b>\$11,643,902</b>	<b>\$11,354,244</b>	<b>\$11,619,500</b>
Fund Transfers	\$1,539,700	\$444,846	\$568,900	\$568,900	\$710,000
<b>Expenditure Grand Totals:</b>	<b>\$13,447,555</b>	<b>\$12,566,438</b>	<b>\$12,212,802</b>	<b>\$11,923,144</b>	<b>\$12,329,500</b>

This year’s budget eliminates the furlough program initiated last fiscal year and reflects the reinstatement of the Finance Director at about 60% to allow for recruitment delays. However, other the positions frozen last year remain frozen in this proposed budget. In addition, one CSO position and a ½ time Records Clerk position remain frozen. Also, the Associate Planner position has been eliminated from the budget because of reduced development activity. During the initial preparation of this budget consideration was given to freezing a vacant Police Officer Position. That consideration was abandoned in favor of a negotiated postponement until the following fiscal year of half of the 4% POA salary increase.

**Ongoing Revenues and Expenditures**

As with last year, the City will have to suspend its policy relating to ongoing revenues and expenditures which states: “The City will maintain a balanced operating budget for all governmental funds with ongoing revenues equal to or greater than ongoing expenditures and debt service. This policy requires that in any given fiscal year we do not budget proposed expenditures in excess of the revenue we expect to receive in the same time frame.”

On the next page is a summary chart of the ongoing revenue and expenditure analysis. Although this chart shows that ongoing expenditures exceed ongoing revenues, this calculation is made without recognizing Measure D revenue. Measure D revenues represent about \$850,000 in annual receipts. If the Measure D revenues were included in the analysis, as are the POB, CIP and Compensated Absences expenditures and transfers, revenues would then exceed expenditures and the City would then be in compliance with its policy.

<b>On-going Revenues &amp; Expenditures Detail</b>	<b>2009-10 Mid-Yr</b>	<b>2010-11 Adopted</b>
<b><u>General Fund - Source of Funds</u></b>		
<b>Total Revenues</b>	<b><u>12,354,000</u></b>	<b><u>12,329,700</u></b>
One-Time State Board of Equal Adjustment	380,000	
One-Time Capitola Transaction & Use Tax (Measure d)	850,000	847,500
One-Time PD - Grants	284,400	\$266,900
One-Time EDA Grants	40,000	
<b>Total One Time Revenues</b>	<b><u>1,554,400</u></b>	<b><u>1,114,400</u></b>
<b>On-going revenues</b>	<b><u>10,799,600</u></b>	<b><u>11,215,300</u></b>
<b><u>General Fund - Use of Funds</u></b>		
<b>Total Expenditures</b>	<b><u>\$11,932,100</u></b>	<b><u>\$12,329,500</u></b>
One-Time Expenditures (PD Grants, EDA Grants & Election)	\$324,400	\$288,900
<b>On-Going Expenditures</b>	<b><u>\$ 11,607,700</u></b>	<b><u>\$ 12,040,600</u></b>
On-Going Revenues (Excludes Measure D)	10,799,600	11,215,300
On-going Expenditures	\$ (11,607,700)	\$ (12,040,600)
<b>TOTAL</b>	<b><u>-808,100</u></b>	<b><u>-825,300</u></b>

### Reserves

The City's fiscal management policy states the Emergency and Contingency Reserves shall be 5% and 10% of the General Fund Expenditures, respectively. The General Fund Expenditures are determined based upon the General Fund budget expenditures less fund transfers. The General Fund Expenditures, less fund transfer, for proposed fiscal year 2010/11 are \$11,619,500. The target Emergency and Contingency Reserve balances are \$581,000 and \$1,162,000. Both the Emergency and Contingency Reserves exceed their funding target.

### CONCLUSION

It is anticipated that the economy has bottomed and revenues will be nearly the same for the 2010/11 fiscal as the in the previous fiscal year. This budget represents a modest increase in the proposed level of municipal services for the 2010/11 fiscal year as compared to the previous fiscal year. The main change of the budget is switching from an across the board decrease in services, as represented by the furlough program, to a more service program specific reduction. This has been achieved through maintaining the frozen position in the Police Department and Public Works. In addition, and because of reduced development activity, the elimination of the Associate Planner position is also reflective of specific program service reduction.

The staff of the City of Capitola submits this budget to the City Council in acknowledgement of our mission to provide high quality service for our residents, visitors, the business community and employees, and with the belief that this budget is consistent with that mission. Each department actively participated in the process both as a department representing their specialized interests, and as City officials trying to provide the best services possible for the

entire City while constrained with limited resources. Finally, I would like to extend my compliments to Jamie Goldstein, Community Development Director, Lisa Murphy, Assistant to the City Manager, Lisa Saldana Supervising Accountant, and Lonnie Wagner Accountant II, as well as to all others who significantly contributed to the preparation of this budget.

Respectfully Submitted

A handwritten signature in cursive script, appearing to read "Richard Hill".

Richard Hill  
City Manager

THIS PAGE INTENTIONALLY LEFT BLANK