Atascadero City Council
Staff Report – Administrative Services Department

2009-2011 Budget Update

RECOMMENDATIONS:

Council:

1. Find it has become necessary to abolish positions of employment and authorize the City Manager to proceed with necessary staff layoffs.

2. Receive and file budget update.

REPORT-IN-BRIEF:

The effects of the severe decline in the worldwide economy are devastating. Local, State, and National agencies are all experiencing unparalleled reductions in revenues. The situation is so bad that some economists are even calling this era the worst economic crisis since the Great Depression. Unfortunately, Atascadero has not been spared. City staff has been working in this challenging climate to develop the 2009-2011 budget. Developing an effective budget that will maintain essential City services during these strained economic times is a difficult task. Through the helpful efforts of Council, Commissions, citizens, and the entire City staff, the management team has been able to compile enough information to form a tight but smart budget plan.

The City has been able to maintain stability through the last decade because of the Council's effective ongoing commitment to a sound fiscal strategy. The concept of this plan is to provide for downswings in revenues by putting money aside in good times and then using some of that money during cyclical periods of economic slowdowns. This policy generally allows for stable operations and continuity in service to the community, and ensures long-term financial sustainability to the organization.
DISCUSSION:

Revenues
The City’s General Fund is feeling a decline in almost every revenue source. Total General Fund revenues had been growing consistently almost every year since 1993. They are now moving in the opposite direction. Fiscal year 2006-2007 was thought to be just one step closer to stable revenues based in Atascadero’s affordable home and commercial properties, economic development, and infrastructure improvements. Unfortunately, fiscal year 2006-2007 instead became the peak revenue year. Revenues began to decrease the following year and still continue their downward spiral. Staff is projecting a double-digit (13%) decrease in 2009-2010 revenues as compared to the peak year of 2006-2007. This, in combination with an average of 3% per year increase in the cost of doing business, leaves the City 22% worse off in just three years.

The news is bad and keeps getting worse. Last May, the Mid-Cycle Budget Report detailed the decline in revenues and changes to expenditures that were apparent at that time. Unfortunately, as the economy continues to struggle, so do the revenues, causing ongoing erosion of revenue base. General Fund Revenues for 2009-2010 are anticipated to be $16.5 million. Although economists are continually revising their estimates, at this point, it appears that the City won’t see any significant improvements until fiscal year 2012-2013.

Critical to the appreciation of this discussion is the understanding that Atascadero is unlike any other city in the County. Of course, that is part of the history and charm of the community. The financial challenges that the City faces are only similar to other agencies in that the outflow is greater than the inflow. A common comparison to other cities doesn’t yield a logical conclusion. Some cities have high Transient Occupancy Tax revenue because they are known as vacation destinations. Other cities have high Sales Tax revenues because they are known as popular shopping destinations. Still others have high franchise fees due to their relationships with utility companies. Atascadero relies heavily on property tax. In fact, 45% percent of the total General Fund revenues are made up of Property Taxes. The next highest piece of the pie is Sales Tax Revenues at 18%. Development revenues, which at one time were the third largest revenues, now come in at only 4%.
Property Tax Revenues

Property Tax Revenue has always been the bread and butter of Atascadero. It has continuously been considered a strong and reliable source of income to the City’s General Fund. Year-over-year growth rates between 2% and 10% were quite common, and in fact, the growth rate hit a record high of 15% in fiscal year 2006-2007. Unfortunately, a whole new world exists now; a time that some said would never happen. The City is no longer seeing this increasing growth rate.

In May of 2008, the information available to staff indicated that Property Tax revenues would see a significant slowdown in the rate of growth due to the economic downturn. Data indicated that although growth slowed, it would indeed remain positive. The county assessor’s office initially reported that it expected to reduce county-wide home values to 2004 rates, which equated to approximately $600 million in value reductions county-wide. Although this is a large reduction county-wide, analysis of this amount indicated that its worst victims would cities other than Atascadero. However, recent reports from the assessor’s office now indicate that that the values will be drastically lowered to 2003 rates, or a county-wide write-down of $1 billion. This is definitely a more severe situation, and caused another round of analysis in terms of what it really means to the City’s most important revenue source.

Property tax revenues are based on property values. In a normal market, property values have a built-in mechanism to increase every year based on how the economy is doing. Increases are equivalent to the lesser of CPI or 2%. Additionally, property is re-appraised to current full market value immediately upon a change in ownership. The property base value, and thus the City’s revenue, therefore typically continues to grow as the years pass, as properties change hands, and as properties are constructed or improved. Atascadero land has been considered one of the best deals in the county over the last several years, so a good deal of construction and home sales has taken place. This is why the City has seen such positive, sometimes even double-digit, growth over the last 10 years.
Conversely, however, as the housing market slumps and property values decrease, the assessed values can be decreased. Typically, the economy goes from good to bad and then back to good. The property base is generally stable enough to handle such cyclical variations and the City continues to see slowed but positive growth during those times. However, there are those rare times when the economy goes from good to bad to terrible, and this is when extreme decreases, even negative growth rates, are present. The initial reports of the devaluation to 2004 rates was of course concerning, but at that time was not considered devastating because there was still a significant portion of the property value base that fell under that threshold. However, the further write down to 2003 rates, had a much more substantial effect. A larger percentage of the City’s property tax base value was now in jeopardy.

As recently as last November, reliable financial experts expected that the housing market would begin recovering in the Fall of 2009. Data now indicates that the first signs of a turn-around in the housing market may not exist until 2012.

Keeping all of this in mind, staff has analyzed the data available at this time and projects, for the first time in history, a two percent decrease in property tax revenues for 2009-2010. Never since incorporation has the City experienced a negative growth rate in this vital revenue. Because property taxes make up almost half of the entire General Fund revenues, even a small decrease in the growth rate has a serious ripple effect to the General Fund and results in severe implications. Property tax revenues are projected at $7.5 for each of the two fiscal years 2009-2011. Staff doesn’t expect this negative trend to reverse until fiscal year 2011-2012.
Sales Tax Revenues
The news doesn’t get any better when it comes to Sales Tax revenues. In fact, the trend for the last several years has been negative. Sales Tax has dropped a stunning 24% since fiscal year 2005-2006. That is an annual revenue loss of over $1 million!

Sales Tax Revenues are the second largest revenue source, representing 18% of General Fund Revenues. Sales tax revenues are down in agencies across the State, but Atascadero was particularly hard hit because it has a narrowly defined Sales Tax Base. In other words, a large portion of Sales Tax Revenue comes from a few retailers in sectors that have been hard hit. Since calendar year 2001, the City’s top two sales tax revenue producing industries have been Building/Construction and Autos/Transportation. Lack of consumer confidence, the soft housing market, and the instability of fuel and energy rates have caused reductions in these both of these two sectors.

The deflation in the real estate industry has influenced the Building and Construction industry. One of the hardest hit sectors of the economy, this influence is reflected in a statewide drop of 12.4% in building materials sales tax receipts over a year ago. Uncertain of future values, consumers are reluctant to invest much toward building and construction projects. Additionally, the sub-prime mortgage crisis has affected the credit market for home equity loans and refinancing loans, further reducing the potential for home renovation projects. Restored growth in this industry is expected to come slowly.

Weak sales in vehicles, SUVs and trucks in particular, have caused the City’s other main sector to suffer. Atascadero Ford, previously a large part of the City’s sales tax revenue base, closed its doors last year. This is a symptom of the depth and length of this recession, as the statewide surplus of auto dealerships continues to be sorted out. From its high point, this is a loss to the City of $320,000 in Sales Tax Revenues annually. This has a significant effect on the City’s already lagging Sales Tax Revenues.

Staff has worked with the Community Development staff, the Office of Economic Development, and HdL, the City’s Sales Tax consultant, to project revenues into the future. Indications are that there is a general malaise in the economy, causing consumers to be more protective of their disposable income. The good news is that there is a projected increase in revenues from Big!Lots and Tractor Supply. This increase will help move sales tax revenues in a positive direction. However, combined with lower fuel prices and the opening of Lowe’s in Paso Robles, the effect of these new retail outlets is softened. Staff projects a continued decrease in 2009-2010, and only a slight increase of less than one percent in the second year of this budget cycle. It is only through the Council’s commitment to economic development and the hopes of a

<table>
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<th>Fiscal Year</th>
<th>Sales Tax</th>
<th>Increase / (Decrease)</th>
<th>% Increase / (Decrease)</th>
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<td>2005-2006</td>
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<tr>
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<td>2010-2011</td>
<td>$2,923,200</td>
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* Underlying Atascadero Sales Tax. This eliminates timing anomalies from State Sales Tax in Lieu Payments.
rebirth in the economy that this downward trend is expected to eventually turn around in 2010-2011.

Development Revenues
Development Revenues closely reflect the current real estate market, and thus have decreased significantly in the last few fiscal years. While staff anticipated a drop in activity, the velocity and severity in which it came was unexpected. In 2005-2006, 276 new residential permits were issued. So far in 2008-2009, only 11 have been issued. This is a 96% decrease in new residential activity in three years' time.

New commercial activity has also decreased. In 2005-2006, there were 21 new construction permits issues, compared to 4 in 2008-2009.

As of the beginning of fiscal year 2008-2009, there were over 500 new residential and new commercial permits that had gone through plan checks but had not been paid for. Council authorized an expiration extension on those permits for developers and homeowners that agreed to pay the fees due. The benefits of this program were many. The City was able to receive payment on costs that had already been expensed to review the permits and the developer or homeowner will have an easier time starting the project back up when the economy rebounds. That is a benefit to the developer or homeowner, and also to the City, as it boosts the local economy. The program was a huge success and over $200,000 was brought in from 226 of the 517 permits that were eligible for this program.

Staff estimates a small increase in development revenues for the next two budget years due to a service fee adjustment, but doesn’t expect a volume increase until fiscal year 2011-2012.

Other Revenues
Generally, revenue discussions are focused on the largest and most critical pieces of the City’s revenue base. However, there are many other sources of revenues that help complete the revenue pie, and it is important to understand what is happening with these sources to get the full picture of the economy’s effect on the City.
Atascadero is seeing drops in almost every revenue source. The above discussion explained why there are decreases in the three revenue sources that make up 67% of the General Fund Revenues. For the most part, the remaining 33% doesn’t look any better. Property Transfer Tax, Intergovernmental Revenues, Motor Vehicle in Lieu, Business License Tax, Gas Tax, Transient Occupancy Tax, Recreation Services, Pavilion Revenues, Administrative Charges and Interest Income are all trending downward. Taken individually, none of these would pose a significant concern to the City’s ongoing fiscal health. However, taken together, and on top of the huge losses that already exist in Property Tax, Sales Tax, and Development Revenues, it is easy to see how the City’s revenue picture is in a devastating situation.

Reserves
All this might leave a person wondering, “What’s the problem? The organization is lean, expenses are tight; just fill in the revenue gap with the reserves. That’s what they were saved for, right?”

These are very good questions, but unfortunately, they are also very complex. Understanding some of the City’s financial history is helpful in finding the answers. The story begins back in the early nineties. As the economy became sluggish, the City began to suffer severe fiscal challenges. Revenues were low, expenses were high, and there were essentially no reserves. Without sufficient reserves to fall back on, the independent auditor reported a going concern. In other words, finances were so bad at the time that there was a serious question of ongoing solvency in the organization. The City Council and remaining staff were able to pull together and rebuild the City, piece by piece. The Council’s Strategic Policy was born from this crisis and eventually the organization was able to create a reserve balance as high as $11 million in the General Fund. That experience certainly was a hard lesson to learn at the time, and one that the City never wants to repeat.

By the end of the current fiscal year, the General fund reserves are expected to drop to $8 million. Council has been supportive of budgeting $1 million in reserves annually to bridge the gap between expected revenues and expenses. This judicial use of reserves should take the City through to fiscal year 2012-2013, when the economy is projected to start turning around. At that time, General Fund reserves are expected to be about $4 million. Because of the lesson learned in the last economic downturn, it’s been Atascadero’s unwritten policy to maintain a prudent level of reserves. Prudent, in this case, is the combined function of the level of General Fund expenditures, the unavailability of some of the reserves, and the potential for contingencies or emergencies. It is critical to retain sufficient resources to maintain services relevant to the City’s core missions.
The available data supports the use of $1 million in reserves annually. In order to maintain the use of reserves at this level, it is necessary to adjust the other pieces of the puzzle. Although the City is doing what it can to boost economic development, not much can be done to change property taxes or revive the national economy. That essentially locks revenues in place. The only remaining piece that can be changed is expenses.

The draft department budgets have been reviewed and the rough pre-cut estimate of General Fund expenses for 2009-2010 is $20.5 million. Revenues are coming in at $16.5 million. This creates a budget gap of about $4.0 million. In order to last until 2012-2013, the reserve fund can only contribute $1 million annually. That means the expenses can only be $17.5 million. After the reserve contribution, expenses need to be reduced $3 million to get from the draft budget requests of $20.5 million to the maximum the City can responsibly spend of $17.5 million.

Of course, this year doesn’t mark the first year budgets have been cut. As indications of the economic crisis began to appear, budget savings measures became the first line of defense.
against what would soon become this unwieldy beast. Staff at all levels came forth with ways to reduce spending, but continue to maintain core mission services. The cuts, along with the planned use of reserves as consistent with Council’s Strategic Policy, seemed, at the time, to keep the City out of reach of the beast.

Unfortunately, the major recession that many economists forecasted seemed to grow closer and its unfavorable influence on the City’s revenues was evident almost daily. The focus on operational cuts became even more intense. Employee meetings were held regularly to keep the staff up to date on the City’s current fiscal status, and to gather ideas for reducing operating costs. Weekly budget meetings were held with representatives from each department and employee association, and weekly budget emails followed up the meetings to keep all employees in the loop. Overtime was used judiciously on only the City’s core missions. Staff positions that had become vacant due to attrition were chilled and later frozen.

Through the efforts of each and every employee, $2.3 million has been squeezed out of the ongoing operating budgets, bringing projected expense down to $18.2 million. As the City’s operations were already lean, the community effect of each of these cuts has been weighed against the benefits they provide. Staff is doing everything possible to maintain the City’s core missions while trimming out those programs or services that will have the least impact of the citizens of Atascadero.

The General Fund is the focus of this discussion because it is the fund with which the City generally has the most discretion for spending. However, other funds, such as the enterprise funds (Wastewater and Transit), the Gas Tax Fund, the Redevelopment Agency Fund, and the Tree Fund have significant impacts on the General Fund. These other funds can have positive or negative effects, depending on how interfund activities are structured. In some cases, it is appropriate to charge enterprise funds for administration overhead or support staff costs. To the degree these transfers are appropriate, the burden of those related costs effectively shift to the enterprise fund. If used properly, this interfund cooperation can provide needed relief to the General Fund.

Following are descriptions of staff recommended cuts to both the General Fund and to other funds that have a financial relationship to the General Fund. If for any reason, one or more of the recommendations are not endorsed by Council; deeper cuts will be required in other areas.

- **Suspend Funding of Annual Building Replacement Reserve (-$406,060 annually)** - Funding replacement of City infrastructure has been a cornerstone of the Council’s Financial Strategy for the last several years. In July of 2000, the City began putting away funds to repair and replace City buildings and in 2003, staff began charging a building occupancy fee to all enterprise funds and using a building occupancy factor in creating an overhead rate. Each department annually contributed its proportionate share to a building replacement reserve. For the last several years, the funds that the City allocated to building reserves have largely been used to pay for repair projects and improvements. Staff recommends suspending the funding of this annual building...
replacement reserve in order to balance the budget. This will drastically reduce available funding for major repairs to City-owned buildings, in effect deferring or putting off these repairs until better economic times.

- **Suspend Funding of Annual Equipment Replacement Reserve (-$50,000 annually)** - The City has historically not been able to fully fund a contribution to the equipment replacement reserve account, however, the Financial Plan called for increasing annual contributions and the City was contributing $50,000 a year toward replacing old and outdated equipment. Staff recommends suspending this annual contribution for 2009-2010 and 2010-2011. This will increase the City’s backlog of equipment that needs to be replaced and will defer replacement until better economic times.

- **Suspend Funding of Annual General Fund Contribution to Road Repairs (-$250,000 annually)** - In 1999, the City developed the Atascadero Road Program to address the City’s backlog of road maintenance issues. As part of that program, the Council agreed to annually fund $250,000 of major road repair projects with General Funds. They also agreed to eliminate this annual funding if the City was in tough economic times. Staff is recommending that the annual contribution for road repairs be suspended. This will in effect lower the overall condition of the City’s roads.

- **Reduce Funding for Local Road Paving Projects (-$50,000 annually)** - As part of the Atascadero Road Program, the City began the Local Road Paving Program where local roads were paved using City crews. Staff is recommending that this program be reduced in order to balance the budget. This in effect lowers the overall condition of the City’s roads.

- **Reduce Strategic Planning, Citywide Training and Committees (-$40,000 annually)** - Staff recommends reducing funding for Council and Department Head Strategic Planning. This will eliminate the use of a facilitator or other contractors to assist with the strategic planning process. Staff also recommends reducing funding for citywide training and committees. Reductions include items such as the Leadership Academy, supervisor training, the Customer Service Committee and AEDAC (Atascadero Employee Development Advisory Committee).

- **Reduce Citywide Services & Supplies by 5% (-$159,770 annually)** - Each department reduced non-labor operating budgets by 5%. This includes reductions such as paper, toner, and other office supplies, cleaning products, landscaping, janitorial costs, contract services, bottled water, utilities, non-essential training, travel expenses, and small equipment replacement. This effectively lowers service levels for services outside of the City’s core missions.

- **Reduce Television Broadcasting and Archiving of Meetings (-$25,650 annually)** - Council voted to begin televising and internet streaming Council and Planning commission meetings in fiscal year 2007-2008. The annual cost of this is approximately $51,000. In this time of economic struggle, staff recommends reducing the cost of this by $25,650. This would eliminate video internet streaming and archiving of meetings and would discontinue all televised coverage of the Planning Commission meetings.
Reduce Chamber and Tourism expenses ($44,290 annually) – The contributions that the City makes to the Chamber of Commerce and toward tourism and marketing are based on revenues received. As the associated revenues decrease with the economy, so do the City’s contributions. This budget reduction reflects the impact of the sluggish economy but does not change the City’s contract commitment toward these important programs.

Reduce Contract Arborist, Contract Biologist, and Tree Brochure ($58,500 annually) – When development was at its peak, the City allocated $30,000 annually toward a contract arborist, $25,000 annually toward a contract biologist, and $3,500 annually toward the printing costs of a Tree Brochure. At that time, these costs were a Council priority. The services that were used on development permits were reimbursed to the City through the permit fee process. Now that development has decreased drastically, the need for these contract services has also decreased. The costs of printing the Tree Brochure have also been reduced. While the brochures are important to the preservation of one of the community’s top natural resources, staff recommends suspending funding during this time of fiscal crisis.

Implement Cost Effective Zoo Animal Food Program ($20,000 annually) – One of the nation’s top animal nutritionists is on staff at Cal Poly and has volunteered to assist in designing ideal and less costly diets for the Zoo animals. Foods that are common to multiple animals can be purchased less expensively in bulk, and then different components can be added to tailor to the dietary needs of each species. This has been an effective program, increasing the benefit to the animals, while decreasing the cost to the City.

Reduce Community Center Expenses ($40,000 annually) – The Colony Park Community Center is a new building with new equipment. As these assets age, more ongoing maintenance and equipment replacement will be necessary. While the Center’s budget can be reduced this budget cycle without much effect on the community, at some point, it will be necessary to increase this budget back to its original level in order to properly care for and maintain these assets. There may be a reduction in some services levels at the Center, but the cuts will not interfere with the City’s core mission.

Institute a Hiring Freeze for Vacant Positions ($704,000 annually) – A hiring chill has been in place since May of 2008. As positions have become vacant, an analysis of each has been performed to determine if the position could be left vacant (frozen). There are currently seven frozen positions. This has affected some service levels and programs, but efforts have been made to reduce the negative impact on the City’s core missions.

Postpone Contribution to Long-Term Vehicle Replacement ($125,880 annually) – The City has a number of vehicles with long-term replacements. These are generally fire department apparatuses and streets vehicles with 20- to 30-year useful lives. The City’s policy is to make contributions from the General Fund to the Vehicle and Equipment Replacement Fund annually so that sufficient funding exists to replace the vehicle at the end of its useful life. At this time of economic downturn, staff recommends postponing the General Fund contributions for these vehicles, and making them up at some point in the future. This doesn’t have any immediate effect on the community, but will increase the future replacement burden.
Suspend Contribution to Historic City Hall Operating Reserve (\(-$174,250\) annually) - In December of 2003, the City staff were forced to move out of the Historic City Hall that had housed City services since incorporation. While the historic icon was a beautiful place to work, it was a very expensive building to maintain. Shortly after the earthquake when staff was evaluating the annual costs of maintaining, repairing and replacing its temporary quarters vs. the cost of maintaining, repairing and replacing Historic City Hall, it became apparent that there was a large discrepancy. Rather than reduce each department’s contribution toward building maintenance and replacement, it was decided to keep funding at the level that existed when the City was housed in Historic City Hall. This would allow the City to put away funds to repair the building and would facilitate the funding transition of moving back into Historic City Hall. Staff recommends reducing building maintenance funding levels to those needed to operate the current City Hall. This action in effect will reduce the amounts put away to assist with normal repairs of Historic City Hall and the funding level will eventually have to be increased once staff moves back into Historic City Hall.

Utilize Balance of Funds Remaining in Gas Tax Fund (\(-$76,510\) each year) – Like the General Fund, the Gas Tax Fund has accumulated a positive fund balance over the years, by consistently coming in under budget. It is estimated that at June 30, 2009 the Gas Tax Fund will have $153,020 in reserves on hand. Staff recommends reducing the General Fund contribution to the Gas Tax Fund by $76,510 in each year, effectively using these Gas Tax Reserves and bringing the Gas Tax Fund Balance to $0 at June 30, 2011.

Restructure Salary Source for Native Tree Planting Activities (\(-$16,690\) annually) – Currently, one of the City’s Parks employees performs Native Tree Planting duties, with that employee’s salary and benefit costs being paid with General Fund money. The portion of this employee’s time that is committed to Native Tree Planting Activities will be paid from the Native Tree Planting Fund. This will reduce the Native Tree Planting Fund amount available for operations and projects.

Reduce Technology Intern (\(-$22,000\) annually) – In July 2007, an intern was hired to assist City Technology staff with the various services that are provided internally. Through the Technology allocation, each City department makes an annual contribution to the operation of the Technology department. This will cut the intern’s current hours in half, which will proportionally reduce internal services to City employees.

Streamline Chipping Program Expenses (\(-$18,000\) annually) – The Chipping Program has historically been over-budgeted. This program, while essential, can be streamlined in such a way as to eliminate excess budgeted expenditures. While there might a slight decrease in service level to the public, staff believes that most goals of the chipping program can be accomplished with the proposed lower funding level.

Elimination of Contract Janitorial Service for City Hall (\(-$21,000\) annually) – Currently the City contracts out janitorial maintenance of City Hall. Staff recommends eliminating this service contract and having City staff do the work. Maintenance service levels at all City Facilities will be lowered to accommodate the extra hours needed to clean City Hall.
Delay Vehicle Purchases for This Budget Cycle (-$35,430 in 09/10 and -$56,960 in 10/11) – The City has historically funded the future purchase of new vehicles with contributions to the Vehicle and Equipment Replacement Fund. Similar to making car payments in advance, when a department’s vehicle reaches the amount required to purchase a new vehicle, the old vehicle is replaced. Staff recommends delaying purchases of replacement vehicles, along with suspending the corresponding contributions to the vehicle replacement fund for 2009-2010 and 2010-2011. This will increase the City’s backlog of vehicles that need to be replaced until better economic times.

Reduce Additional Legal expenditures ($79,120 annually) – In a team effort to assist the organization in reducing costs, City Attorney Brian Pierik has analyzed his City contract and has proposed changes and reductions. Mr. Pierik believes that staff can perform certain tasks in advance of seeking his assistance. In doing this, costs can be significantly reduced but adequate service levels for the City can still be maintained.

Reduce Capital Expenditures (-$86,760 annually) – Although historically only a small portion of the City’s General Fund budget has been directed toward capital expenditures, the City has been able to purchase various pieces of equipment and other items that made staff more efficient, replaced necessary worn out equipment or furthered one of Council primary goals. Staff is proposing that the funding level for capital expenditures be reduced. This in effect defers the replacement of needed furniture, equipment and other capital items.

Other Operating Reductions (-$54,600 annually) – A multitude of other small dollar amount reductions will be implemented throughout the organization. These items include things like installing alternate doggie bag stations that would allow us to use grocery or other plastic bags, turning off the lights in the jail, combining newspaper subscriptions, eliminating coffee and washing vehicles less frequently. All of these small operating reductions will have an effect on the efficiency of staff and the service levels provided, however careful and analysis and planning will minimize the impact to core missions.

Operational Increases (+$275,940 annually) - Although staff was able to reduce budgets in most areas, increased funding levels were required for liability insurance ($109,020), property tax collection ($56,140), animal control services ($30,810), and higher than anticipated employee costs due to low turnover ($25,050). In addition to these increases, reductions in gas tax revenues ($54,920) require an additional contribution of General Funds in order to keep current street maintenance service levels.

Layoffs
The operating services and supplies, capital projects, and special projects have been carved up as leanly as possible. Any additional decreases to the departmental budgets would impair the organization’s ability to continue to deliver its core missions. Although great effort has been made to avoid decreasing employee services, at some point it becomes the only reasonable option left on the table. Because the City is a service organization, historically 73% of the General Fund expenditures have been dedicated to labor and eventually, a reduction to labor costs becomes inevitable.
Many cost decreasing options have been investigated. Information on voluntary furloughs and early separation programs were researched. Unfortunately, the cost savings recognized by these options were not sufficient to close the remaining $700,000 - $800,000 gap. The City Manager therefore requests that Council find it has become necessary to abolish positions of employment and authorize the City Manager to proceed with necessary staff layoffs. This action is taken as a last resort for the long-term fiscal health of the organization. It is a very serious matter as it concerns the positions that are laid off, the community, and the resulting challenges for the remaining employee positions. The City Manager has worked diligently to evaluate all of the positions in the organization, selecting those in which the work, project, or program can be eliminated. The objective is to remove the work associated with services not considered part of the City's core missions, and reduce expenses by the amount associated position. Positions that are already frozen will be included in the layoffs. The impact to the community has been and will be thoroughly considered prior to any final decisions by the City Manager. In addition, the Personnel Rules and Regulations will be carefully followed and any affected personnel will be provided with information explaining the layoff procedure and resources for services. It is critical that all City staff is treated with respect during this challenging time, as this is indeed the most difficult era the City has faced in some time.

**Summary**

The City is experiencing a financial crisis unequaled in proportion to anything it has been through for the last 15 years. Revenues are down across the board. For the first time in Atascadero history, property tax revenue growth is negative. Sales tax revenues are down $1 million annually since the high point in fiscal year 2005-2006. Development, previously the City’s third highest revenue source, is now at 4% of the General Fund Revenues. Compounding the problem, Property Transfer tax, Intergovernmental Revenues, Motor Vehicle in Lieu, Business License Tax, Gas Tax, Transient Occupancy Tax, Recreation Services, Pavilion Revenues, Administrative Charges and Interest Income are all trending downward. Although the City is reaching out through economic development, tourism, infrastructure improvements, development permits streamlining, and a friendlier attitude toward business, it cannot change the economy overnight.

General Fund reserves have been the City’s saving grace during this time of turbulence. Born out of the last fiscal crisis, the Council’s Strategic Policy created reserves that hit a high of $11 million. These reserves have been critical in the organization’s efforts to maintain a constant
flow of services that make up the City’s core missions. Reserves are estimated to be $8 million by the end of fiscal year 2008-2009. The available data supports the judicial use of $1 million in reserves annually to help bridge the $4.0 million gap between revenues and expenses. However, it is critical to retain prudent reserves. Prudent reserves take into account the level of General Fund expenditures, the inaccessibility of some of the reserves, and the potential for contingencies or emergencies. As the City learned during the early 1990’s, the need for reserves on hand is crucial to the fiscal health of the organization.

Several rounds of operating expense cuts have been made. Each and every employee pitched in to try to reduce costs and cut programs that weren’t essential to the City’s core missions. This was a series of productive exercises, yielding $2.3 million in cuts. However, even these drastic cuts to the already lean expenditure base aren’t enough to close the gap left by the devastative revenues. Because the City is a service organization, historically 73% of General Fund expenditures have gone toward labor. This is a huge piece of the pie, and eventually, labor cost reductions must be investigated. Several options were researched, including voluntary furlough and early separation programs. None of these options resulting in savings sufficient to close the remaining $700,000 - $800,000 gap. Therefore, it is with great difficulty that layoffs are considered. Layoffs are necessary as they are only remaining viable solution for the long-term health of the City. This is a serious measure and is done as a last resort. The layoff process will be done respectfully and fairly, addressing those positions in which the program or associated work can be eliminated. No individual personnel will be targeted. All existing frozen positions will be included in the layoff. The effected personnel will be provided with information explaining the layoff procedure and resources for services.

Staff will continue to keep the Council informed with regular budget updates. The draft budget will go before the Finance Committee in May, with the revised draft budget to Council in June.

**FISCAL IMPACT:**

The budget that is adopted by Council in June will be the fiscal model to carry the City through the next two-year cycle.

**ALTERNATIVES:**

Council has the authority to accept, modify, or decline any of the recommended budget reductions.