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CITY OF LONG BEACH

DEPARTMENT OF FINANCIAL MANAGEMENT

333 West Ocean Boulevard 6th Floor • Long Beach, CA 90802

January 4, 2005

HONORABLE MAYOR AND CITY COUNCIL
City of Long Beach
California

SUBJECT: Fiscal Year 2004 Year-end Budget Performance Report (Citywide)

DISCUSSION

One of the City's goals is to provide timely reporting of expenditures and revenue to the City Council and community. The information provided is unaudited since audited financial statements for Fiscal Year 04 (FY 04) will not be available until March 2005, due to the City's complex accounting activities.

The following report provides a thorough review of the City's budget performance, as well as the internal and external factors that shaped the fiscal environment in FY 04. The report covers a broad spectrum of financial information for all funds and departments with multi-year comparisons, charts and graphs to provide a clearer picture of the City's financial situation. While the focus of this report is the General Fund, exceptional performance (both positive and negative) in other funds is highlighted where deemed significant. Analysis also provides for other key budgetary concerns, including an outlook for FY 05.

Summary

On September 16, 2003, the City Council adopted an annual expenditure budget for FY 04 that totaled $1.93 billion for the City's 22 departments. Of the total amount, a $360.6 million General Fund budget was adopted to provide core municipal services such as public safety, public works, recreation and library services.

During the year, in response to the City's growing structural deficit, the City Council and City Manager imposed cost saving policies, including a hiring freeze and a purchasing curtailment, to instill fiscal discipline and generate savings to allow for a progressive resolution to the deficit situation. Through these measures, all departments generated savings in FY 04. Despite $8.6 million revenue take-aways from the State of California, these savings as well as better than expected revenue performance in certain related funds, created a year end General Fund balance of $10.9 million, as anticipated in the Three-Year Financial Strategic Plan (Plan).

FY 04 REVENUE PERFORMANCE – ALL FUNDS

The City's estimated revenue for FY 04 for all funds was $1.55 billion. Combined with multi-year carryover funding (multi-year funding for long-term projects and grants) and amendments made during the fiscal year by the City Council, the final adjusted estimate was $1.90 billion. Citywide year-end revenue actually finished at $1.85 billion, approximately 2.5 percent under projected levels. This variance is attributed mostly to the inclusion of the All Years Carryover, which are revenue estimates for multi-year projects that are not completed within the fiscal year, and are accounted for in a separate "All Years" fund. Unused "All Years" resources will carry forward into FY 05 to complete projects.

Please see **Attachment A** for a breakdown of citywide revenue performance by fund, and **Attachment B** for citywide revenue performance by department. Some variances of note at the department-level include:

- City Clerk received reimbursements for a total of $313,000 for election services to the Long Beach Unified School District and Long Beach Community College District;
- Human Resources realized additional interest income and miscellaneous refunds/reimbursements in the amount of $398,000 due to a reimbursement to the Insurance Fund for a RDA loan in FY 2000 to demolish the Chestnut Garage; and
- Long Beach Energy received a $4.6 million settlement from El Paso Corporation (the majority of which was used to provide credits to rate payers), as well as additional parking citation and refuse and recycling fee revenue, for a total net additional revenue amount of $5.9 million.

Please note that **Attachment B** does not include All Years Carryover revenue by department, as the current accounting system does not track All Years Carryover revenue other than at the fund level. Also, following the recommended format, neither **Attachment A** nor **Attachment B** document beginning fund balances, thus they do not reflect total available resources or ending fund balances. This information is available in the forthcoming annual adopted budget book.

Listed below are funds that require further detail than the attachments include. A specific discussion of General Fund revenue performance can be found in the next section of this report. FY 04 non-General Fund revenue performance of note includes the following four funds: Southeast Resource Recovery Facility (SERRF) Fund, Tidelands Oil Fund, Uplands Oil Fund, and the Redevelopment Fund.

<u>SERRF Fund</u> – This fund maintains the Solid Waste Program as an Enterprise Operation, provides disposal services at the Southeast Resource Recovery Facility (SERRF) for residential and commercial refuse delivered by the City and various surrounding communities, and implements waste reduction and recycling activities. The two main sources of revenue for the SERRF Enterprise Fund are electrical sales to Southern California Edison (SCE), which accounts for approximately 60 percent of the total revenue, and customer disposal fees, which represents approximately 40 percent of total revenue.

Revenues from electrical sales to SCE are expected to remain unchanged for the next several years per the contract with SCE. Revenues from disposal fees of private haulers without current contracts are expected to increase annually by an amount equal to increases in the Consumer Price Index (CPI), plus any disposal fee increases above CPI imposed at Puente Hills Landfill (the facility at which the output from SERRF is disposed). Long Beach and Lakewood disposal fees are expected to increase by CPI only, since their price has been contractually established. From these revenue sources, the SERRF facility is able to make an annual profit transfer to the General Fund of $2.5 million. In FY 04, however, the SERRF operation realized an additional $2.2 million profit transfer due to better than expected refuse and electric performance. Since this cannot be relied on from year-to-year, the FY 05 estimated General Fund transfer remains at $2.5 million. Furthermore, due to the scheduled maintenance of several SERRF turbines in FY 05, the base profit transfer of $2.5 million will not be available to the General Fund in the following year (FY 06). This loss of revenue is anticipated to be a one-time occurrence and has been accounted for in the Plan.

Tidelands Oil Revenue Fund – The Tidelands Oil Revenue Fund (TORF) is used to account for the proceeds from oil operations within the Tidelands area and for accumulating reserves held in Trust for the State of California to pay for well abandonment and site clearance liabilities. The major source of revenue for the TORF is generated from oil operations in the Tidelands area, which is dependent upon the price of oil. It is important to note that the price of crude oil fluctuates on a daily basis depending on a variety of factors, including, but not limited to, refinery closures, pipeline repairs and natural disasters. The Department of Oil Properties feels it is prudent to project revenues based on a more conservative price considering the volatility of the oil market. Due to unusually high prices for oil during FY 04 (averaging $31 per barrel), TORF realized an additional $6.0 million in revenue available for the Tidelands Operating Fund over budgeted estimates, which were based on $20 per barrel. This one-time spike in revenue allowed the City to mitigate the tenuous condition In the Tidelands Fund. The one-time resources were used to finish the year with a healthier fund balance, which will give the City some time to make operational adjustments needed to permanently resolve the structural budget deficit in the Tidelands Fund. Please see the Tidelands Fund section on Page 5 for a discussion of the Fund's structural deficit.

Upland Oil Fund – The Upland Oil Fund is used to account for all costs and revenues for the City's proprietary oil interests and for accumulating reserves to pay for the City's portion of well abandonment and site-clearance liabilities. The sources of revenue for the Upland Oil Fund are revenues from the City's participation in proprietary oil operations and overhead fees received by the City as Unit Operator for the Tidelands Oil Operations. The projected revenues for FY 04 were based on a $20 per barrel price for crude oil. During the past year, Oil Properties experienced a higher than usual cost per barrel, which allowed the Department of Oil Properties to increase their Upland Oil Fund transfer to the General Fund by an additional $3.7 million, for a total of $7.6 million. This additional one-time revenue was used to help the General Fund absorb one-time revenue losses created by the State triple flip and Vehicle License Fee (VLF) take-aways. For FY 05, the budgeted rate per barrel was increased to $25 to project revenues. This new rate is still lower than the current average but, as mentioned above, the cost per barrel is particularly volatile and therefore, warrants a conservative projection.

Redevelopment Fund – Redevelopment activities are funded by property tax growth in Redevelopment areas in excess of amounts received in the year the Redevelopment area was founded (base year). This growth is called Tax Increment (TI). In FY 04, the net Tax Increment (TI) revenues in the Redevelopment Funds increased by almost 52 percent, or $14,243,271 over FY 03, with the largest increases reflected in the North and Central Project Areas. The increases in TI are due mainly to significantly higher property values and new developments, including growth at the Port of Long Beach (North Redevelopment Area).

The statutory pass-through payments (the amount the North and Central project areas of Long Beach Redevelopment Agency contribute to the City's General Fund to compensate, in part, for lost property tax revenue) for FY 04 totaled $1,716,016. While these payments provide a benefit to the General Fund, such revenue has not kept pace with the demand for general municipal services associated with commercial and residential growth in these areas.

FY 04 EXPENDITURE PERFORMANCE – ALL FUNDS

The City established a clear goal of cost reduction and streamlined service delivery at the outset of FY 04, to begin addressing its structural deficit in the General Fund. The optimization and downsizing of the organization citywide, while impacting the General Fund, has a positive impact on all City funds. With the fiscal year complete, the unaudited results appear to be positive.

Performance By Fund

The City's Adopted FY 04 expenditure budget for all funds was $1.66 billion. Combined with multi-year carryover funding for citywide capital projects and amendments made during the fiscal year by the City Council, the total Adjusted City Budget was $2.16 billion. Citywide actual expenses came in at $1.73 billion, down $436 million (or 20.1 percent) from the adjusted budget. This decrease, as with the revenue above, can be attributed in large part to multi-year projects not completed within the fiscal year, which are accounted for in separate "All Years" subfunds.

Please see **Attachment C** for a breakdown of citywide expenditures by fund, and **Attachment D** for a breakdown of citywide expenditures by department. Listed below are funds that require further detail than the attachments include. A specific discussion of General Fund expenditure performance can be found in the next section of this report.

Housing Authority – The fund balance for the Housing Authority Fund at the end of FY 04 indicates expenditures exceeded revenues by approximately $1.7 million. This is mainly due to the increased cost of housing in Long Beach, which has outpaced statutory reimbursement levels for the federally funded Section 8 program. To address the shortfall, the Housing Authority reduced administrative costs, curtailed the number of vouchers issues and entered into a long-term loan with the City for $2.9 million. The source of funding for the loan was program income from an affordable housing grant from the U.S. Department of Housing and Urban Development (HUD), known as the Rental Rehabilitation Program. While it is unknown at this time what congressional funding will be allocated in FY 05 for the Section 8 Housing Assistance Program, or what the impacts will be on Long Beach, the City continues to advocate with HUD for appropriate funding and reimbursement policies, and will continue to take operational steps to bring the Section 8 program and support in-line with available resources.

Tidelands – Despite strong performance within the oil operations, ongoing revenue sources are not adequate to keep pace with ongoing expenses in the Tidelands areas. The cost of the operations to maintain the Tidelands area, including beach cleaning and maintenance, lifeguards, police, fire service, lease management, and other support functions are dependent on the revenues generated in the Tidelands Area, primarily consisting of Marina slip fees, property lease and waterfront concession revenue. This revenue has not been sufficient to fund the rising costs in the area. This ongoing shortfall has contributed to the continued fiscal strain experienced in the Tidelands Fund since the State take-away of oil revenue through Chapter 138, Statutes of 1964.

These factors have had a significant impact, such that the Tidelands Fund faced a $1.41 million deficit going into the FY 05 Budget Adoption. With the aid of increased oil revenue at year-end, departments operating within the Tidelands areas came together to identify cost reductions and revenue enhancements totaling $828,147 to bring the Fund into balance for FY 05. The additional oil revenue allowed departments to avoid deeper cuts in the their operating budgets that would have required impacting positions that are currently filled, and would run counter to the directive of the City Council. Details regarding these deficit reduction measures will be brought to the City Council for their approval as first quarter budget adjustments. Additional structural solutions will be devised during the year to ensure solvency of the Fund in FY 06 and beyond.

Insurance – The Insurance Fund supports the City's property, general liability and workers' compensation programs. Over the past several years, escalating costs in both general liability and workers' compensation have exhausted the Fund's balance to minimum operating levels. During FY 04, internal changes for insurance services were set at pay-as-you-go levels, to both cover the true cost of these services as well as to save money for departments when possible. Combining these internal financial arrangements with cost reductions identified through a business process review of workers' compensation practices, the Fund saw the beginning of a much-needed fiscal improvement with increased attention being paid to how the City manages City workers' compensation operations. Also during FY 04, a major outside review of workers' compensation and safety practices was undertaken, which resulted in a comprehensive set of recommendations. Once fully implemented, these process improvements, along with legislative changes, are expected to save in excess of $5 million over the next four years. Due to continued cost increases for General Liability insurance and recent legal judgments against the City, savings in the Workers Compensation have been largely offset.

FY 04 GENERAL FUND PERFORMANCE

General Fund Revenue

The FY 04 adopted General Fund revenue estimate was $350.8 million. Through the acceptance of various grants as well as better than expected performance in key revenue sources, the FY 04 adjusted revenue estimate was $366.7 million. Better than expected performance included additional revenue of $1.1 million in Real Property Tax, $900,000 in Pipeline Franchise Fee, $230,000 in Oil Production Tax and penalties, $993,000 from lease-finance proceeds for the purchase of Fire Department ambulances, and $200,000 in Transient Occupancy Tax.

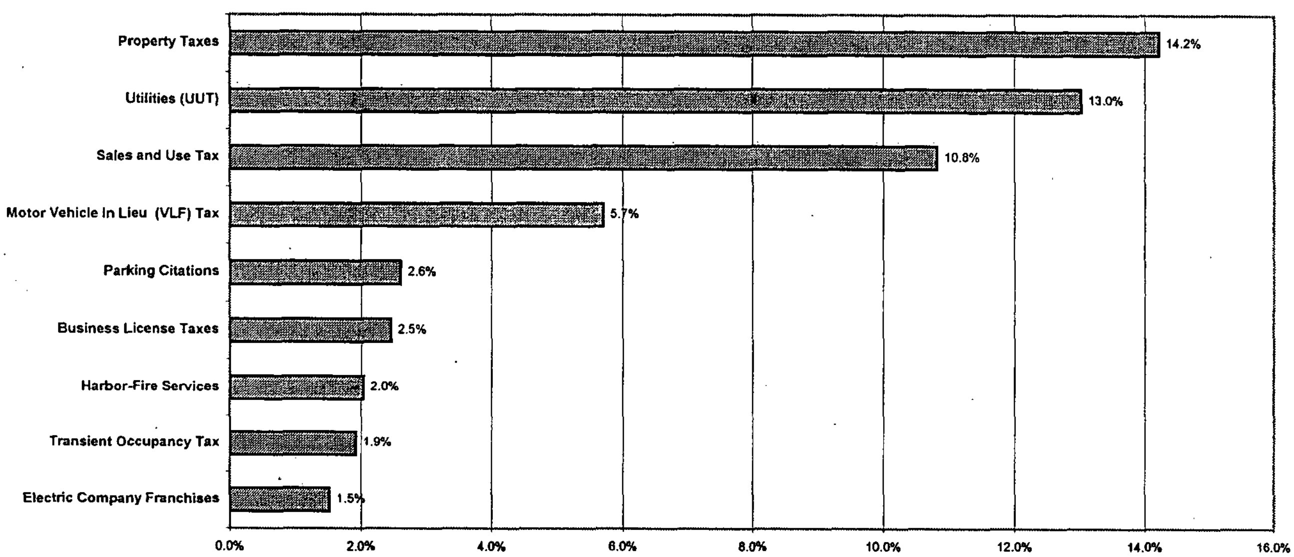
Of the total adjusted budget, one-time revenue sources totaling $20.6 million were used to support FY 04 operations, mitigate State take-aways, and generate $10.9 million ending fund balance. The Plan anticipated the use of $19.6 million in one-time revenues in FY 04, but due to better than expected revenues sources, such as the Upland Oil Revenue Fund transfer discussed above, the availability of one-time revenues was $1.0 million higher than the original planned amount. FY 04 one-time revenues included:

- General Services Fund Transfer ($4,242,469)
- Employee Benefits Fund Transfer ($1,900,000)
- Airport Repayment to General Fund ($500,000)
- SERRF Refinancing ($5,000,000)
- SERRF Transfer (2,201,735)
- Towing Transfer ($750,000)
- Advanced Airport Repayment ($500,000)
- RDA Promissory Note Repayment ($1,159,000)
- Upland Oil Revenue Fund Transfer ($3,575,558)
- Fleet Fund Transfer ($743,000)

Year-end Actuals also include several major revenue losses, including the $6.7 million deferral of Vehicle License Fee (VLF) payments by the State, $1.8 million loss of Sales Tax due to the implementation of the Triple Flip, $1.0 million loss of Electric UUT due to the State Power Rebate, and $1.0 million shortfall in projected marketing revenue. With the exception of these uncontrollable revenue losses, ongoing base revenues exhibited slight growth (2.9 percent) over budget.

Exhibit 1 below shows the City's Top 10 General Fund revenue sources in FY 04 as a percentage of total General Fund Revenue.

Exhibit 1 – Top 10 FY 04 General Fund Revenue Sources as a Percentage of Total General Fund Revenue



A summary of all General Fund revenue can be found in **Exhibit 2** below; a breakdown of FY 04 General Fund revenue by department can be found in **Attachment E** and a chart showing the Top 40 FY 04 General Fund revenues is included as **Attachment F**.

Exhibit 2 – Summary of All General Fund FY 04 Revenue

FY 03 Year-end Actuals	FY 04 Final Adjusted Estimate	Unaudited FY 04 Year-end Actuals
$366,850,248	$366,720,705	$366,980,703

Other General Fund performances of note, at the department-level, are as follows:

- Library Services came in $204,364 (or 26 percent) under projected revenue due to unrealized revenue from the Public Library Foundation. These funds will be received in FY 05 and an Accounts Receivable has been set up in the FY 05 Budget.
- Technology Services came in nearly $500,000 (or 50 percent) under projected revenue from unfulfilled CityPlace parking garage fees.
- Public Works came in $1.2 million over its projected revenue due to increased CIP billings associated with staff project work.

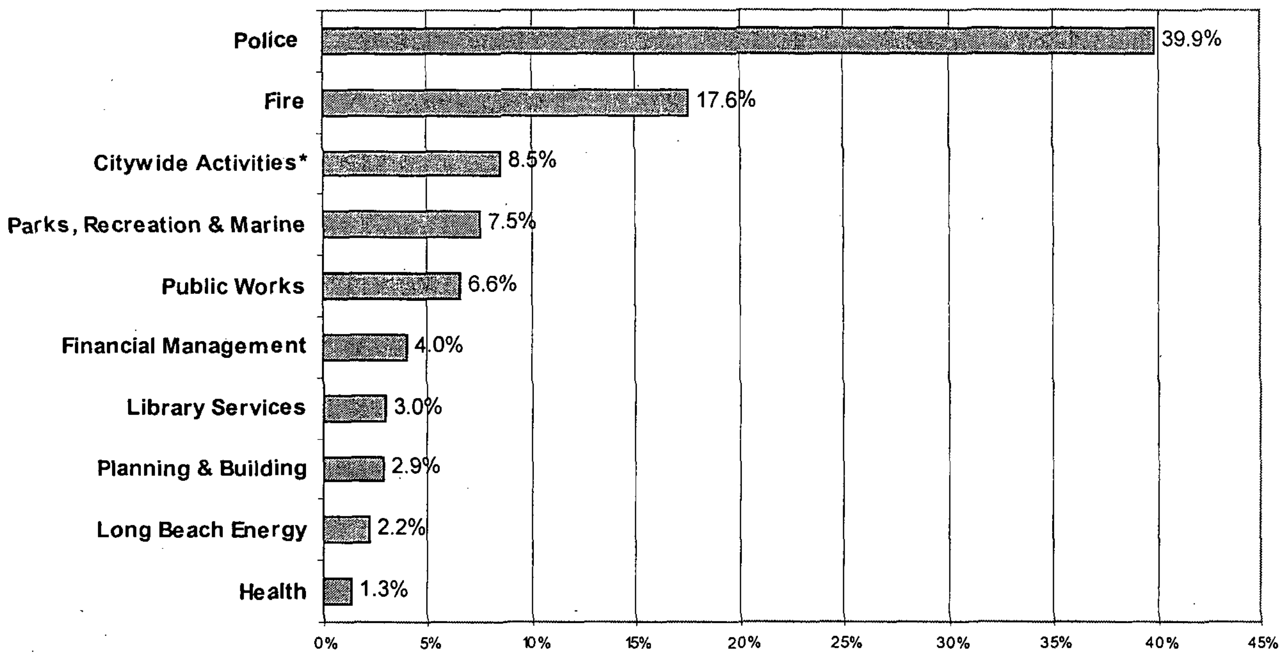
General Fund Expenditures

The Adopted General Fund expenditure budget for FY 04 was $360.6 million. The City Council approved amendments to accommodate mid-year revenue and expenses such as grants and the purchase of Fire Department ambulances, which increased the budget by $17.7 million, for a total adjusted budget of $378.3 million. Under the guidelines of the City Council's adopted Financial Policies, through strict adherence to the City Manager's hiring freeze and purchasing curtailment measures, all departments generated savings in their General Fund budgets during FY 04. In line with the Plan, the citywide General Fund savings rate was 3.1 percent, creating a carry-over fund balance of approximately $10.9 million used to help balance the FY 05 budget. This balance was contemplated when the City Council adopted the budget and is being carried-over into FY 05 to help balance that budget. Please see **Attachment G** for the Fund Balance Analysis for the General Fund, which details the reserved and unreserved aspects of the ending fund balance.

Performance by Department

Reflecting the City Council and community's stated priorities, the majority of General Fund expenditures support public safety activities. The Police Department (39.9 percent) and Fire Department (17.6 percent) expenditures comprised 57.5 percent of the total General Fund actual expenditures in FY 04. Other public safety expenses, such as costs related to the City's prior (pre-PERS) pension plan and the City Prosecutor's office, brought the cost of public safety to approximately 60 percent. Parks, Recreation and Marine (7.5 percent) and Public Works (6.6 percent) had the next two largest portions of General Fund expenditures during FY 04. **Exhibit 3** below shows the Top 10 department expenditures in the General Fund for FY 04, as a percentage of the whole. Please see **Attachment H** for a breakdown of FY 04 General Fund expenditure performance by department.

Exhibit 3 – Top 10 FY 04 General Fund Expenditures by Department, as a Percentage of Total Expenditures

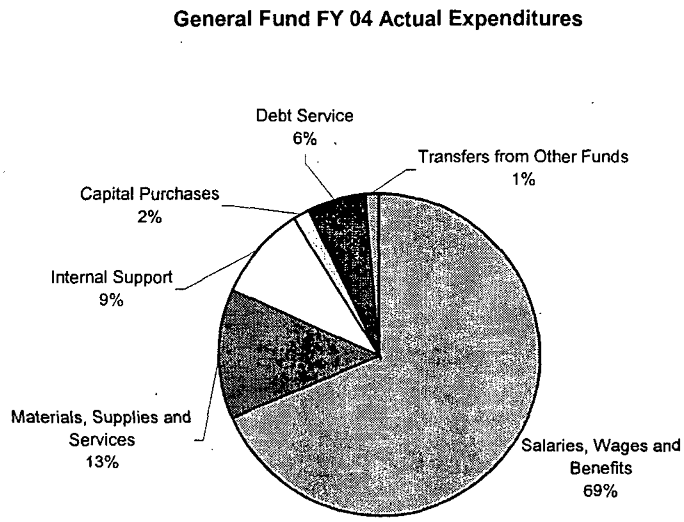


* Citywide Activities includes debt payments, pass through transactions, Police and Fire pension plans, etc.

Performance by Category of Expenses

Salaries, Wages and Benefits continued to be the largest portion of actual expense in the General Fund. In FY 04, 69 percent of the General Fund was expended for employee compensation, benefits and overtime compared to 67 percent in FY 03. This increase occurred due to an inflationary cost environment, including escalating health care and workers' compensation costs compared to FY 03. Materials, Supplies and Services was the second largest category of expense, totaling 13 percent of FY 04 General Fund expenditures. Typical expenditures in this area include utilities, contracts, office supplies, etc. All remaining expense categories, including Internal Support (9 percent), Capital Purchases (2 percent), Debt Service (6 percent), and Transfers from Other Funds (1 percent) totaled 18 percent of the General Fund expenses. **Exhibit 4** provides a graphic representation of General Fund expenditures by category of expense.

Exhibit 4 – FY 04 General Fund Expenditures by Category of Expense



Year One of Three-Year Financial Strategic Plan

FY 04 represents the first year of the Plan, devised to gradually address the City's growing structural budget deficit in the General Fund (estimated to be $102 million between FY 04 and FY 06). In FY 04, the City reduced the structural deficit by $41 million, with $28 million in expenditure reductions and $13 million in additional revenue. In accordance with the City Council's financial policies, the City also decreased its reliance on one-time resources from $43 million in FY 03 to $20.6 million in FY 04. The City successfully negotiated $3.4 million in General Fund savings with the public safety unions and eliminated over 170 positions (including 28 management positions), while transferring impacted employees into available vacancies to avoid layoffs. Other examples from the myriad of expenditure reductions to the organization included eliminating over 225 vehicles in the City's fleet, and hundreds of thousands of dollars worth of cell phones, pagers and other equipment. The City implemented a rolling closure model for libraries, where each branch library strategically reduced one day of service on the day that other libraries in the area would be open. This model saved significant dollars while mitigating the impact to the community by providing an opportunity for library patrons to utilize other libraries in the area. The Library also eliminated Sunday service at the Bay Shore and Main Libraries.

Furthermore, as recommended in the Plan, the FY 04 Budget included reductions in non-core City services. The City reduced recreation spending to outside agencies such as the Forklorico youth dance program, Pools of Hope swimming program, and the Long Beach Unified School District's summer recreational playground program. Other recreation reductions included the staffing at the Nature Center, Senior Olympics and OlympiKid programs. The City also began reductions in spending for the arts, with $530,000 in total reductions to the Public Corporation for the Arts, the Long Beach Museum of Art, the Municipal Band and other related arts support costs.

Higher fees were imposed for certain services to improve cost recovery and to avoid increasing taxes on the community. Revenue targets were determined for marketing and sponsorship opportunities, which staff began developing over the last year. Finally, increases in parking citations and fees to match those of comparable cities generated additional revenue for the City.

To generate General Fund operational savings and additional revenue for the future, four outside optimization studies of key services were conducted. The studies explored Fire Services, Emergency Communications and Dispatch, Code Enforcement/Nuisance Abatement, and Workers' Compensation/Occupational Health. While immediate savings were realized in the areas of Workers' Compensation and Code Enforcement, a comprehensive set of recommendations from Dispatch and Fire Services are yet to be determined.

FY 05 BUDGET CHALLENGES

Increased Costs

In FY 05, increased pension costs are estimated to cost over $33 million in the General Fund alone and $50 million citywide. The City will continue to face challenges with increasing costs for general liability insurance as well as health care, though recent changes in Health Insurance programs should help to control these costs. The City and its employees are taking direct action to define measures to mitigate this trend, notably through the citywide Optimization Study of the City's health care benefit system. It is envisioned that through the gradual downsizing of the City's workforce, employee participation in the cost of their benefits and through increased preventive health measures, and improved coordination and management, the City will do all it can to mitigate cost growth in this area.

State Impacts for FY 05

The State's FY 05 budget again failed to fully address its own revenue and expenditure challenges. As expected, there were no tax increases, and budget reductions to State programs were not significant. As in the past, the budget was once again balanced by shifting money away from local governments. There are currently two main mechanisms by which the State tapped into local government coffers: the sales tax "Triple Flip" and the Vehicle License Fee (VLF) in Lieu payments. The "Triple Flip" was authorized through the voter-approved Proposition 57 and went into effect on July 1, 2004, while the VLF in Lieu payments went into effect with the adoption of the FY 05 budget.

In an effort to keep the State from making similar raids in the future, local government leaders throughout California negotiated a compromise with Governor Schwarzenegger (Proposition 1A) where local governments would help the State one last time in exchange for long-term constitutional protection from future revenue raids by the State. One key element of the compromise is a two-year contribution to the State's General Fund from local governments starting in FY 05, totaling $10 million ($5 million annually) for the City of Long Beach. Proposition 1A was made official via a constitutional amendment approved by voters during the November 2004 election. The compromise will have significant financial impact in the short-term in exchange for long-term fiscal stability.

Factoring in these losses and commencement of State in-lieu payments, the combined effects of the VLF in Lieu payments, the "Triple Flip" and the contribution to the State's General Fund are expected to cost the General Fund a net of approximately $4.1 million in FY 05. The Governor has also agreed to provide local governments significant flexibility as they make these payments. As such, the City has arranged for a $4 million interest-free loan from its Subsidence Fund (a restricted fund for the mitigation of subsidence from oil operations, to be paid back in $500,000 annual payments starting in FY 08), as well as a project contribution from the Redevelopment Agency, freeing up General Fund resources to offset this loss.

CONCLUSION

Overall, FY 04 was a very positive year. Despite significant budget reductions, as recommended by the Plan, service impacts to the community were minimized. This performance can be directly attributed to the significant effort put forth by all employees. Every department and all employees worked together to optimize service delivery to generate savings that contributed to a $10.9 million ending Fund Balance, which is a critical resource for the gradual elimination of the structural budget deficit. The fiscal health of other funds, including the Insurance Fund, Tidelands Fund and Housing Authority Fund is being proactively addressed, ensuring the delivery of services to employees and the community in FY 05. With years two and three of the Plan ahead, the City is well placed to continue its creative and collaborative transition into a high performance organization, aligning the community's resources and services to ensure the City can make the necessary investments and provide essential services to ensure a continued quality of life for all Long Beach residents.

TIMING CONSIDERATIONS

Council action on this matter is not time critical.

FISCAL IMPACT

There is no fiscal impact associated with the recommended action.

IT IS RECOMMENDED THAT THE CITY COUNCIL:

Refer this report to the Budget Oversight Committee.

Respectfully submitted,

for

MICHAEL A. KILLEBREW
ACTING DIRECTOR OF FINANCIAL MANAGEMENT

MK:DW

APPROVED:

Christine F. Shippey

for GERALD R. MILLER
CITY MANAGER

Attachments