

Financial Plan

Introduction

This section depicts the City's multi-year financial plan, strategies and policies used to manage the City's General Fund for the next four-year Fiscal-Year period. This is the second year for the City's financial planning process; and, Council held a public study session to discuss parameters surrounding the foundation of establishing a multi-year Financial Plan Policies.

The financial plan for the General Fund contains:

1. **Summary:** A summary of the major issues occurring in the fund.
2. **Fund Structure:** A description of the fund's purpose, including major services financed, major sources of revenues and major sources of expenditures. The General Fund is reported on a modified accrual basis. This system recognizes revenue received in the reporting period and expenditures, plus unliquidated obligations during the same period. It is a conservative reporting method which ensures resources are available to pay all outstanding commitments.
3. **Projected Year End Budget Assumptions:** A plan for revenues and expenditures in the current Fiscal Year.
4. **Proposed Fiscal Year Budget Assumptions:** A plan for revenues and expenditures in the upcoming Fiscal Year.
5. **Multi-Year Revenue and Expenditure Projections:** The multi year plan is designed to show the financial ramifications of policy decisions. The General Fund plan is projected through Fiscal Year 2010-2011.

Financial Policies and Strategies

The financial and resource allocation policies, which are intended to guide the City Council's discussions, have been combined in this section. Brief summaries, for the City's General Fund are found in this section. In Fiscal Year 2006-2007, City Council was presented with proposed policy questions to aid in facilitating thorough discussions in order to establish the formal policies. As the City Council discusses, develops, and adopts the policies and detailed strategies, they will be incorporated in the *City of East Palo Alto Policy Guidebook*. (A summary of the policies are listed in this section).

Summary: The City of East Palo Alto Multi-Year Financial Planning Process

For many years the City has experienced expenditures exceeding its revenue sources. At the conclusion of most years, a loan repayment, from the Redevelopment Agency (RDA) Fund, has covered the General Fund deficit. While the RDA Fund has resources to repay the loan another year, it is projected that those funds will not be able to randomly cover the General Fund deficit on a long-term basis; thus, requiring the identification of methods and procedures to balance subsequent expenditures with available revenues.

The City Council agreed to proceed with developing a multi-year financial planning process in order to avoid the reoccurrence of a structural deficit going forward. Currently, the City Council is discussing a cash reserve policy. The FY 2007-2008 Budget will mark the second year that the City of East Palo Alto would have implemented a multi-year financial planning process in order to proactively plan for the management of its resources and to address financial

challenges in a methodical fashion. After many years of confronting a structural deficit, faced with layoffs and general financial instability, the new approach is being recommended to continued. First and foremost, that financial planning process calls for a stable level of basic services. To achieve that stability in the long-term, the policies surrounding the establishment of a cash reserve will, be necessary.

The plan calls for the creation of a cash reserve (instead of services) in the good revenue years and reducing the reserves (not services) in the more challenging years.

It is anticipated that a multi-year financial planning process will work well for many years to come. It is projected that the City would have a stable level of services, avoid layoffs, during the periods the economy is not well, and the process would increase the opportunity for infrastructure investments. The proposed multi-year plan for Fiscal Year 2007-2008 through Fiscal year 2010-2011 marks the second Multi-Year Financial Plan for the City.

The Fund Structure

The General Fund is the source of funds which provide general purpose government services to the citizens. While some services are provided by Special Revenue Funds, if such revenues fall short of expenses, the services would be supported by General Fund dollars.

Major Services

The major services financed by the General Fund include:

- a. Public Safety services including community policing, criminal investigations, dispatch services, code enforcement and animal control.
- b. Maintenance of streets, public right-of-way, traffic and street signage.
- c. Building Inspection, engineering and planning services.
- d. Parks, landscaping and median maintenance.
- e. General government services.
- f. Capital infrastructure improvements.

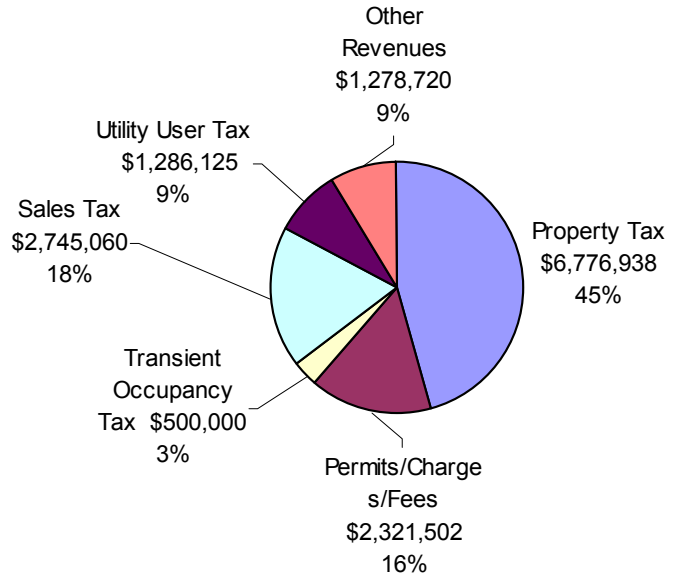
Major Sources

The major revenue sources comprising the General Fund and the percent each contributed in Fiscal Year 2007-2008 are represented, along with the major

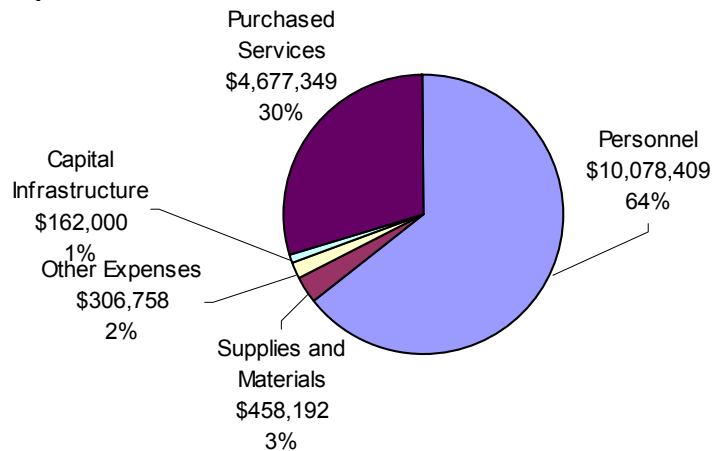
expenditure categories and the percent expended in each category during Fiscal 2007-2008.

The Projected Fiscal Year 2007-2008 Proposed Budget

Revenues



Expenditures



The 2007-2008 through 2010 - 2011 Financial Goals

Each Fiscal Year of the Financial Plan, it is expected to have revenue outpace the expenditure growth. On the other hand, revenues are not as manageable as expenditures, which should be maintained below inflation. Ideally, City Council policies will provide guidance on how to establish and use a Cash Reserve. During the budget process this year, the City Manager's office began meeting to determine how the organization would respond to the very real deficit we faced going into a financial planning period. The first order of business was to determine what policies

would be recommended to City Council in order to manage the City’s fiscal health. A new managing the budget policy was presented for City Council consideration:

- a. Personnel costs will be fully supported by the two local taxes: sales and property tax. This places an automatic maximum amount that can be spent to pay for labor costs.
- b. Overtime costs will not exceed 5% of total personnel costs. In this way, overtime will rise with increased wages, not by increased activities.
- c. Medical expenses will not exceed 7% of total personnel costs. Over the past several years, City Council has taken major steps toward establishing fair and equitable contributions to the health benefits for employees in all employee groups. As of January 2007, the City contributes the full premium costs for employees and up to 80% of the dependent costs, of the lowest plan available.

This policy statement also continues to identify public safety as one of the top priorities and Focus Areas of City Council.

Indeed, the City has not had the resources, in the General Fund, to make the types of investments it would like to have made; and, it is generally recognized that City General Fund resources have not been the primary funding source for new initiatives. A focus of any new ventures will be to find partners to help finance such new initiatives.

The most important policy of all is to ensure that at the end of every year of the financial plan it will maintain a minimum cash reserve level. There would never be less than six-weeks worth of operating costs available at the end of each fiscal year. This policy would allow the City to prepare and manage a plan of action in the event the City could not meet its obligations within its available resources.

With these recommended guidelines, the method to balance the budget will be in place. There are four major objectives the plan is proposed to meet:

- a. it will balance the budget through Fiscal Year 2010-2011 with a minimum cash reserve balance;
- b. it will cover the total cost of personnel with local taxes;
- c. it will control the growth of expenditures since it is much more difficult to control the growth of revenues; and
- d. it will provide enough time to phase in any adjustments in services so that there would be

no unexpected service disruptions or personnel layoffs.

When these objectives are clearly established and using expenditure control instead of depending on the luck of the economy, several limits to expenditures will be explored. Normal overall expenditure growth should not exceed the Consumer Price Index (CPI-W) for the San Francisco, Oakland, and San Jose Metropolitan Area. City Council may want to consider placing a 3% cap on expenditure growth which could assist in providing cash balance at the end of each fiscal year of the Plan.

Limiting expenditure growth rate to 3% throughout the financial plan period achieves all the objectives of the financial plan, meets the proposed policies to manage the budget, begin to secure the jobs of our employees and balances the budget through Fiscal Year 2010-2011. Most importantly, it begins to stabilize our services to the citizens of East Palo Alto. (See Table 1)

One of the main purposes of a multi-year financial plan is to review a snapshot of the organizations financial future. It is a planning tool, which allows the City Council to make informed decisions and to take the necessary actions, up front, to avoid a crisis situation, resulting in actions that will not permit the opportunity to respond in a transitional mode.

FY 2007-2008 to FY 2010-2011 Financial Goals

Table 1

(All numbers shown in millions)

Major Revenue Categories	FY 2006-07 PROJECTED	FY 2007-08 PROPOSED	% CHANGE	FY 2008-09 ESTIMATE	FY 2009-10 ESTIMATE	FY 2010-11 ESTIMATE
Sales Tax	\$2.679	\$2.745	2.5%	\$2.827	\$2.912	\$3.000
Property Tax	\$6.605	\$6.776	2.6%	\$6.979	\$7.189	\$7.404
Permits, Fees & Charges for Services	\$2.386	\$2.321	-2.7%	\$2.391	\$2.462	\$2.536
Utility User Tax	\$1.265	\$1.286	1.7%	\$1.325	\$1.364	\$1.405
Transient Occupancy Tax	\$0.500	\$0.500	0.0%	\$0.500	\$0.500	\$1.375
Other Revenues	\$2.029	\$1.278	-3.7%	\$1.278	\$1.278	\$1.278
Total Revenue	\$15.464	\$14.906	-3.6%	\$15.300	\$15.705	\$16.998

NOTE: Numbers may not add due to rounding

Major Expenditure Categories	FY 2006-07 PROJECTED	FY 2007-08 PROPOSED	% CHANGE	FY 2008-09 ESTIMATE	FY 2009-10 ESTIMATE	FY 2010-11 ESTIMATE
Personnel Costs	\$9.071	\$ 9.876	8.9%	10.172	10.477	10.792
Purchased Services	\$4.956	\$ 4.583	-7.5%	4.720	4.862	5.008
Supplies and Materials	\$0.424	\$ 0.439	3.5%	0.452	0.466	0.480
Other Expenses	\$0.451	\$ 0.300	-33.5%	0.309	0.318	0.328
Total Operating Budget	\$14.902	\$ 15.198	2.0%	15.654	16.124	16.607
Capital Improvements	\$0.448	\$ 0.162	-63.8%	0.162	0.162	0.162
Total Expenditures	\$15.350	\$ 15.360	0.1%	15.816	16.286	16.769

Yearly Balance	\$0.114	\$ (0.454)	-	\$ (0.516)	\$ (0.581)	\$ 0.229
Cash Reserve	\$0.114	\$ -	-	\$ -	\$ -	\$ 0.03
Min. Reserve Policy	\$1.719	\$ 1.754	-	\$ 1.806	\$ 1.860	\$ 1.916

NOTE: Numbers may not add due to rounding.

NOTES:

1. Based on the expenditure history, the following assumptions are made in the various categories;

- a) Personnel Costs = 98% of budget (\$10.878M)
- b) Purchased Services = 98% of budget (\$4.677M)
- c) Supplies and Materials = 96% of budget (\$0.458M)
- d) Other Expenses = 98% of budget (\$0.306M)

2. The contribution to the Cash Reserve reflects a total of six weeks worth of Yearly Balances. Council could elect to transfer the total Yearly Balance to the Cash Reserve.

Revenue Assumptions

1. **Sales Tax** - is levied on good and services at the point-of-sale. Currently, the sales tax 8.25% of which approximately 1% is returned to the City for those sales that take place in East Palo Alto. This is the second largest revenue source to the City; and it is projected to experience growth at a rate of 2.5% during FY 2007-2008, and 3% during the life of the plan.
2. **Property Tax** - is collected by the County of San Mateo County Assessor and is apportioned to various agencies. Homes, businesses and other taxable real and personal property are subject to property tax of 1% of the assessed value. In FY 2004-2005 a new category "property tax in lieu of vehicle license fee" was added as a result of the triple flip, whereby a portion of the 2% vehicle license fee (VLF) was swapped for property tax. This revenue source is up in FY 2005-2006 primarily due to a one-time refund from the County Educational Revenue Augmentation Funds (ERAF). The FY 2007-2008 projection reflects a 2.6% growth factor. The balance of the plan assumes a 3% growth.
3. **Permits, Fees & Charges for Services** - are collected for staff services, licenses and permits issued. This source is down as a result of a decline in major project development. The 2007-2008 projects a reduction of approximately -2.7% as the result of an economic slowdown; and in out years project a 3% increase in revenue source due to the anticipated development in the Ravenswood Business District (RBD).
4. **Utility User's Tax** - In November 2005, the voters overwhelmingly passed the ballot initiative to continue the Utility Tax. This source generates approximately \$1.3 million. The plan assumes that the Utility Tax is going to grow slightly (1.7%); however, some Utility companies continue their fight to discontinue this tax. The utility tax is on electric, gas, telephone, and cable television services. Due to the vulnerability of this source, it is projected to remain flat over the life of the plan.
5. **Transient Occupancy Tax** This new source of revenue comes from the taxes levied on over-night hotel visitors. A recent settlement resulted in the city receiving a portion of the

tax, beginning in January 2007. Each year thereafter, the receipt in this category shall remain at \$500K until FY 2009-2010. Upon receipt of these revenues, a portion is committed for programs focused on children, youth, seniors and families. The plan reflects flat receipts until January 2010 when the negotiated agreement terminates and the full range of collected Transient Occupancy Tax (TOT) will be paid to the City; anticipated to be approximately \$1.375 million.

6. **Other Revenues** - These sources of fund include reimbursements from other governmental agencies, earned interest on investments, and contributions. This source of revenue is projected to decrease -37% in FY 2007-2008 and is projected to remain flat over the life of the plan.

Expenditure Assumptions

1. **Personnel Costs** - This is the largest cost center the City has. Approximately 65% of City resources goes toward Personnel Costs. The FY 2007-2008 is projected to increase 8.9%. Based on previous expense patterns, the financial plan anticipates that 98% (\$9.9million) of the total budgeted amount of (\$10.1million) will be spent during the year. The out years project a 3% increase in this category.
2. **Purchased Services** - The costs associated with contract professional services are anticipated to reduce by -7.5% during FY 2007-2008, and each year of the plan thereafter will increase no more than 3%.
3. **Supplies and Materials** - This category is expected to increase by 3.5% and increase no more than 3% in out years.

Yearly Balance

The annual balance each year is simply calculated the total revenue sources and subtracting total expenditures. In good years, the balance, or a portion thereof, may be added to the cash reserve.

Cash Reserve

The section of the Tables depicts the amount projected to be added to the Cash Reserve at the end of each fiscal year. For the purposes of this table, a six week portion of the yearly balances is added to the cash reserve. However, Council could elect more or less.

Minimum Reserve Policy

This reflects the amount of reserve that would be necessary to ensure the stability of services for a minimum period of 6 weeks. The amount is derived from dividing the Total Operating Budget by fifty-two weeks and multiplying that by six weeks.

Vulnerabilities to the FY 2006-2007 through FY 2010-2011

The financial plan projections are based on the best information available at the time the plan is developed. However, there are a number of known vulnerabilities in this plan. Those known vulnerabilities which could negatively affect the projections are outlined below:

- Unplanned expenditures such as contributions, property purchases, and new initiatives requiring General Fund support.
- Results of labor negotiations exceeding parameters.
- Excessive increases in medical insurance costs.
- Unfunded mandates from State and/or Federal agencies.
- Unanticipated delays in developing the Ravenswood Business District (RBD).
- Lawsuit settlements exceeding available funds.
- The administration will work diligently to manage revenues and expenditures according to City Council direction; however, there may be events which occur which are beyond our control. As always, the City could experience unknown disasters that could negatively impact this plan, i.e. natural events or disasters or unfunded mandates.
- Potential loss of Utility User Tax revenues.

Conclusion

- Any unfunded occurrence may require the use of the cash reserve to balance the budget, although the City Council direction to balance will be top priority.
- Unless actions are taken, the minimum cash reserve will be considerably below the pending policy level.

- The Plan is strongly contingent on having a growing economy, and maintaining our development fee comparable to the market.
- Rightsizing the organization is required if we are to meet our financial plan goals.
- All Essential/Non-Essential and Mandated service levels need to be reviewed.

Financial Policies

Proposed Policies

The financial plan policies for City Council consideration and deliberation are as follows. These policies are intended to set forth the framework for the overall fiscal management of the City. Operating independently of changing circumstances and conditions, this policy assist the City Council's decision-making process; and, guides Administration's implementation of the policies. These policies also provide guidelines for evaluating both current activities and proposals for future programs.

The following policies establish long-standing principles, traditions and best practices which are intended to guide the City and maintain financial stability over four years. These policies will be reviewed annually.

Managing the Budget Policies

(Reviewed by Council April 3, 2007)

1. The City will establish and maintain at least the minimum cash reserve levels established by policy (6-10 weeks of operating costs).
2. To ensure that the two largest revenue sources shall cover the largest expenditure item, personnel costs shall not exceed actual receipts from sales and property taxes.
3. Medical insurance shall continue to be a shared responsibility between the City and its employees and expenditures shall be contained to no more than 7% of personnel costs. Overtime expenditures shall be no more than 5% of personnel costs. Total worker's compensation expenditures shall not increase as a percent of payroll.
4. The City Council shall allocate resources to ensure public safety. As long as this policy is necessary, the resulting impact on the budget will mean other services areas may be reduced.
5. No new or expanded services shall be implemented without implementing trade-offs of expenses or revenue at the same time. This applies to personnel, equipment, and any other peripheral expense associated with the service.
6. The City shall aggressively seek regional, state and federal partners to support the public safety efforts, and major discretionary capital projects which remain unfunded. Co-production of services with our citizens, the business community, and other local jurisdictions shall be encouraged.
7. The City shall update and maintain a scheduled level of maintenance and replacement of its infrastructure and fleet. Expansions to the fleet must be offset through reductions in other equipment and/or costs.
8. The City shall support investments which reduce future operating costs.

Revenue Policies

(Reviewed by Council April 3, 2007)

1. The City will make every attempt to maintain a diversified and stable revenue system to shelter it from short-run fluctuations in any one revenue source.

2. The City will attempt to obtain additional major revenue sources as a way of ensuring a balanced budget.
3. The City will establish all user-charges and fees at a level related to the full cost of providing the service (operating, direct, indirect, and capital).
4. The City will review fees / charges annually and will design or modify revenue systems to include provisions that automatically allow charges to grow at a rate that keeps pace with the cost of providing the service.
5. The City will consider market rates and charges levied by other public and private organizations for similar services in establishing tax rates, fees, and charges.

Cash Management/Investment Policies

(Adopted by Resolution #2669 January 1, 2007)

1. The City will deposit all funds no later than the next business day from receipt of funds.
2. Investments of City funds will emphasize preservation of principal; the yield objective will be to match or exceed an index weighted 75% for the yield of two-year treasury notes and 25% for the yield of six-month national Certificates of Deposit less 30 basis points.
3. The City will collect revenues aggressively, including past due bills of any type.

Debt Policies

(Adopted by Resolution #FA2005-01 July 19, 2005)

1. The City will issue bonds for capital improvements and moral obligations.
2. The City will not issue notes to finance operating deficits.
3. The City will publish and distribute an official statement for each bond and note issued.
4. General obligation debt will not be used for enterprise activities.
5. The City will ensure that it sets aside the appropriate amount of debt obligation for the purpose of repayments.

Reserve Policies

(Reviewed by Council April 3, 2007)

1. The City will establish and maintain a reserve in the General Fund which represents 10% to 20% of the funds expenditures.
2. The City will maintain a revenue reserve in the Rent Stabilization Fund which represents 25% of the Fund expenditures.

Accounting, Auditing and Financial Reporting Policies

(Adopted by Resolution #2634, November 8, 2006)

1. An independent audit shall be performed annually.
2. The City will produce annual financial reports in accordance with Generally Accepted Accounting Principles (GAAP) as outlined by the Governmental Accounting Standards Board (GAAB).
3. The City will maintain a strong internal audit capability.

Capital Budget Policies

(DRAFT Policy to be presented to Council in FY 2007-2008)