Agenda Item #:______________________________

Staff Report
City of Manhattan Beach

TO: Honorable Mayor Tell and Members of the City Council

THROUGH: Geoff Dolan, City Manager

FROM: Bruce Moe, Finance Director
Russell J. Morreale, Assistant Finance Director
Henry Mitzner, Controller

DATE: February 6, 2007

SUBJECT: Consideration of FY2006-2007 Mid-Year Budget Review

RECOMMENDATION:
Staff recommends that the City Council receive and file this report.

FISCAL IMPLICATION:
There is no budgetary impact from receiving and filing this report.

DISCUSSION:

Executive Summary of the Mid-Year Budget Results

As we enter the second half of FY 2006-2007, the City remains in good financial position. Revenues are performing above expectations, and expenditures are running right at budget estimates. We are pleased to report that we anticipate a healthy operational surplus in the current year as a result of three economic factors: (1) the cessation of state takeaways in the current year, (2) the positive performance of our key revenue sources above expectations, and (3) maintained operational expenditure controls. This being said, the City's surplus is projected to come in at half of the amount realized last year given escalating operational costs (labor, benefits, pension, and workers' compensation) discussed in last year's mid-year review and the 2006 audit report.

Our largest revenue source, Property Tax, is performing well again this year as we enjoy strong real estate market gains and remodeling activity. This is reflected in our growing assessed valuation base and resulting tax revenue. Our second largest revenue source, Sales Tax, appears to be out-performing budget projections, but is projected to remain flat at prior year levels. Transient Occupancy (Hotel) Tax continues its trend from the past two years and is expected to bring in double digit gains over budget estimates and prior year results. Interest income is also a solid performer given favorable short term interest rates. In whole, General Fund revenues are projected to exceed budget estimates at year end by 4.6% ($2.1 million) and will meet our long term projections. On the other side of the equation, General Fund expenditures are projected to come in less than 2% below budgetary estimates, and are trending above average patterns. All in all, we anticipate a surplus at the end of this year of $2.2 million, more than originally forecasted but less than half of the $4.1 million actually realized in FY2006.

Despite our conservative budgeting practices and strong financial controls, year end surpluses in the General Fund have been diminishing over the past few years. In December 2006, we presented the results of the 2006 audit which indicated continuing financial health, tempered by rising expenses, particularly in the areas of salary and benefits, and insurance costs. These are recurring issues for us in the current year as well, which we will discuss later in the report.

Our highest priority capital project, the Police & Fire facility, is completed and results in savings over $1 million which has been returned to the Capital Improvement Fund. Metlox is open for business and Strand Improvements remain within budget. We remain in compliance with established financial and investment policies as set by City Council. Fund reserve balances remain at prudent levels, and City funds are invested with safety and liquidity in mind.

Coming off of good performance last year, expenditure trends within the Insurance Fund are again pacing high and will exceed budget estimates. Both higher premiums and claim reserve levels are the cause of this fund's escalating costs. You may recall that City Council acted proactively in the FY2006-2007 budget to address this issue by reassigning the remaining Pension Stabilization Fund of $1.3 million to the Insurance Fund. This has provided immediate relief, however the long term needs of this fund will be reviewed during the FY2007-2008 budget process.

Further discussion of mid-year revenue and expenditure performance, fiscal policy compliance, future financial challenges, and contingency plans are presented below.

Financial Review

General Fund Revenue:

General Fund revenues through December 2006 are trending as expected (44% realized), and approximate last year levels at this time (45%). This revenue pattern is attributable to a number of factors including seasonal collections for Property Tax, Sales Tax and Business License Tax. The State's diversion and reclassification of triple-flip Property and Sales Tax revenue has made prior year comparisons difficult. Adjusting for the impact of these State driven changes, we are projecting General Fund revenues to exceed budget by 4.6% ($2.1 million) for the full year.

Property Tax revenue in-lieu of Sales Tax and Vehicle License Fees have been received from the State in early January. Prior to the Triple-Flip, these revenues were received monthly, making for a more consistent and predictable revenue stream. Based upon those receipts, we are pleased to report that we are on target to exceed our original General Fund estimates. A discussion of key revenues follows:

Property Tax (36% of General Fund revenues - $16.3 million) revenue continues to outperform all other revenue sources. The active housing market, coupled with vigorous remodeling activity has created large gains for this revenue in each of the past several years. The City's assessed valuation has increased over 50% from ten years ago. The current year is continuing that trend. As it appears now, we are conservatively projected to exceed budget in this key source by 6% or slightly over $1 million. Recent trends support forecasts that double digit housing increases may be ending. We continue to budget our largest revenue source conservatively.

Sales Tax (17% of General Fund revenues - $7.8 million) collected through December is 39% of budget realized as compared to 41% last year. Once adjusted for the effects of the State tax shift noted above, we are pleased to report that Sales Tax will meet budget estimates. On the other hand we do not anticipate growth over last year's results. As we view this projection, we caution our readers that the State has been known to make year end adjustments of their early year estimated payments to cities. Two years ago, we returned in excess of $300,000 to the State in the form of an estimate-to-actual adjustment.

Sales Tax is seasonal, with holiday shopping sales receipts from November-December arriving later in February, so the effects of this past holiday season will remain unknown for a few more weeks. While Sales Tax trends in the last few years have been relatively flat, positive developments have added to our revenue base including Manhattan Village Mall renovations, and the Metlox development and the overall downtown synergy. Nonetheless, Sales Tax revenue remains locally sensitive as a significant percentage of our Sales Tax base is derived from a small number of businesses.

Transient Occupancy Tax (TOT or Hotel Bed Tax) (6% of revenues - $2.7 million) is very strong. Revenues are trending at record levels, a clear sign that tourism is vibrant and hotel rooms are full. The opening of the new Metlox boutique style inn, Shade, is a significant addition to this growth pattern, and the Marriott continues to do very well. At mid year, revenues in this category are trending 14% above budget estimates and 15% above prior year. This year revenues are projected to exceed $3 million for the first time. Of course, this revenue benefits both the General Fund and Capital Improvement Fund as a dedicated funding source.

Other Revenue Sources:

Interest Earnings (2% of revenues - $961,000) have increased nicely with some dramatic increases in short term rates. This being said, current revenue patterns are projected to come in 27% above budget and 26% above last year results ($1.2 million).

Ground Lease Rents (1% of revenues - $640,000) from both the Marriot and the Tolkin Group will meet budget and exceed prior year levels by over $200,000 given a full year accrual of the Metlox development rent.

The majority of **Vehicle License Fee (VLF)** revenues have been reclassified to property tax as a result of the state Triple-Flip. The remaining true VLF ($285,000) represents less than 1% of General Fund revenue on a stand-alone basis. Because the bulk of the reclassified VLF ($2.5 million) is now tied to Property Tax, we now can expect property tax growth rates for this revenue stream. These results are now part of the property tax trends discussed above and will be so from this year forward.

While **Building Permit** revenue (2% of revenues - $900,000) is expected to meet budget, it will fall below prior year levels as originally estimated. Demolition permits, a leading indicator of future building permits, remains consistent, at approximately 10-15 per month.

Plan Check revenue (2% of revenues – $1 million), which typically indicates future building permit revenues, is performing 14% below budget. This may be a leading indicator of the overall slowdown in the realty market, although remodeling activity remains strong in Manhattan Beach at the moment. This can change direction with the start of major commercial projects. Possible future projects include additional mall enhancements, redevelopment of the Blockbuster Video site on Sepulveda, the Versailles restaurant site and northwest and southeast parcels at Sepulveda and Manhattan Beach Boulevard.

Real Estate Transfer Tax (1% of revenues - $625,000), which is collected each time a parcel changes hands, has decreased and is projected to under pace budget estimates 9%.

Parking Citations (4% of revenues - $1.9 million) are tracking 13% below budget estimates but 10% above 2006 results. This shortfall may be attributed to staffing vacancies which are actively being recruited at this time. Additional parking availability in the downtown may also be impacting citation revenue.

Exhibits A&B present revenue trends at the fund and key source level.

General Fund Expenditures:

General Fund expenditures through December 2006 are right on budget and above prior year mid-year averages. At the end of this year, we project an overall savings of less than 2%, a smaller margin than in past years. Although we remain within established budget levels, it is clear that rising costs are a key theme again this fiscal year. A similar pattern was noted during the 2006 audit presentation.

A review of expenditures indicates that City departments remain within budgetary appropriation limits at mid-year with a combined 49.2% utilization rate. Three departments (Fire, Recreation & Public Works) are tracking over budget at mid-year. For Recreation, expected cost patterns from the summer season (early in the FY) give the appearance of going over budget, but will normalize as the year progresses. The Public Works budget is skewed by the payments of underground district advances which are recovered once the districts are formed. This department is also experiencing increased labor costs given a heavy load of internally scheduled remodel costs. The Fire department has incurred additional costs given involvement in regional fires resulting in higher overtime costs. However, some of these costs are reimbursable by the State.

Personnel vacancies among all departments at mid year, which contribute to projected savings, amount to twenty (20) positions. Most of these are in safety. As always, we carefully evaluate vacancies before recruiting to ensure the position is essential to our service levels.

While General Fund expenditures are projected to come in under budget at year end, it is clear that rising costs have narrowed our budget-to-actual margins. Having said this, expense control becomes ever more important given the current rising costs.

Capital Project Fund:
The Capital Improvement Fund (CIP) revenue is expected to meet budget estimates with Hotel Tax leading the way. The parking citation revenue component of this fund's revenue is trailing budget levels by 2%, as is parking meter revenue. Expenditures in the Capital Improvement Fund at mid-year are at 32% of budget. The most material project costs include Strand improvements and the City Hall remodel.

The CIP fund is now incurring debt service for the Police/Fire facility and civic center improvements. With CIP fund revenues dedicated to paying this debt service, the funding of future new capital projects is largely subject to our ability to generate General Fund surpluses. Reserves for our major continuing capital projects have been provided for.

Other Funds:
All other City fund revenues are at expected rates at mid-year. Citywide expenditures for all other operating funds are pacing well below budget levels on a combined basis. The City's Special Revenue, Enterprise and Internal Service Funds, with the exception of the Insurance Reserve Fund, are also operating as expected and remain in line with budget expectations.

With respect to the City's Insurance Fund, insurance costs are again rising and is mostly apparent in premiums and liability claims. Our FY2006 audit report displayed a negative fund balance of $202,125 considering both short and long term reserves. Although this is an improvement over FY2005 results, the Insurance Fund expenditures continue to track above budgetary estimates. This prompted proactive funding by City Council in the FY2006-2007 budget. Under any scenario, insurance costs remain a significant financial challenge to be reckoned with. **It is important to note that Governmental Accounting Standards Board Statement #34 now requires us to recognize such internal fund transfers as expenses when government wide financial statements are consolidated on a full-accrual basis resulting in a negative impact on any reported surplus that may exist at year end.**

As reported in the 2006 audit results, the Parking and Street Lighting funds could benefit from a review of rates and voter approved increase in assessments respectively. Developing another long-term utility rate study would also serve us well in re-affirming a proactive multi-year capital infrastructure plan for this enterprise group.

Exhibit C attached presents a high-level summary of expenditure performance by fund.

Fiscal Policy Compliance:
As of December 31, 2006 the City remains in compliance with all aspects of the established financial and investment policies for all funds. In particular, the City remains in compliance in the following key areas:

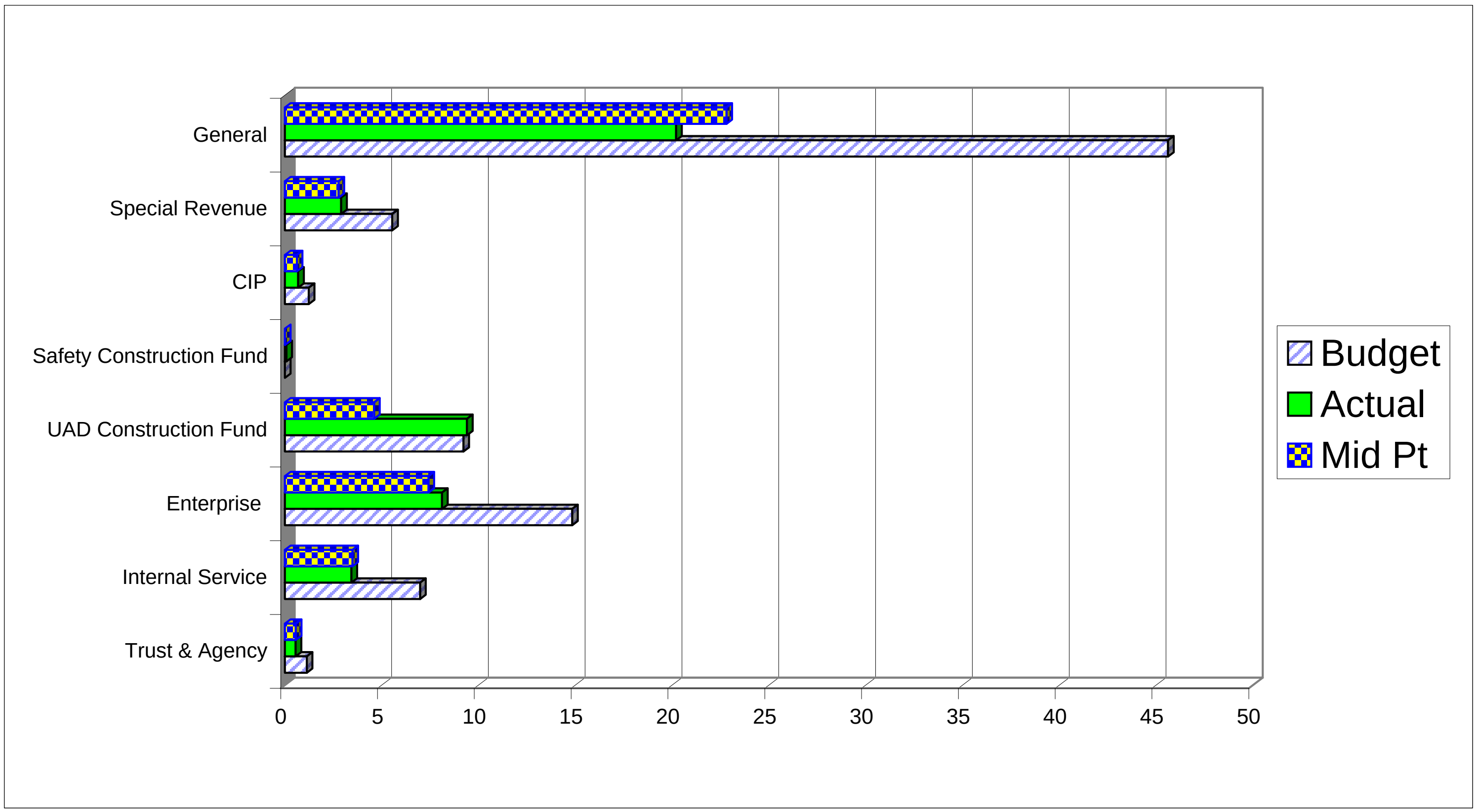
- The General Fund is projected to be balanced.
- General Fund working capital reserves, as set by policy, have been maintained.
- Reserves for approved capital projects have been recorded and maintained.
- Budget control at the fund level has been maintained citywide.
- We remain in compliance with the City's investment policy.
- Restricted cash balances in Special Revenue, Enterprise and Internal Service Funds continue to be safeguarded and monitored for appropriate use.

CONCLUSION:
The City remains in a sound financial position and current trends indicate that we will out perform budget estimates for the 2006-2007 year. Current economic trends and rising costs require that we aggressively plan to address the many financial challenges we face. Significant labor cost increases, which are a certainty in the coming years, demand our attention as we develop the City's long term financial plan. We will approach the budget in the same comprehensive and conservative manner we are accustomed to. In doing so we will present a FY 07-08 budget to City Council that will address the issues at hand.

Attachments: A. Revenues by Fund Type
B. General Fund Revenue by Type
C. Expenditures by Fund Type

City of Manhattan Beach
Revenues By Fund Type
As of December 31, 2006

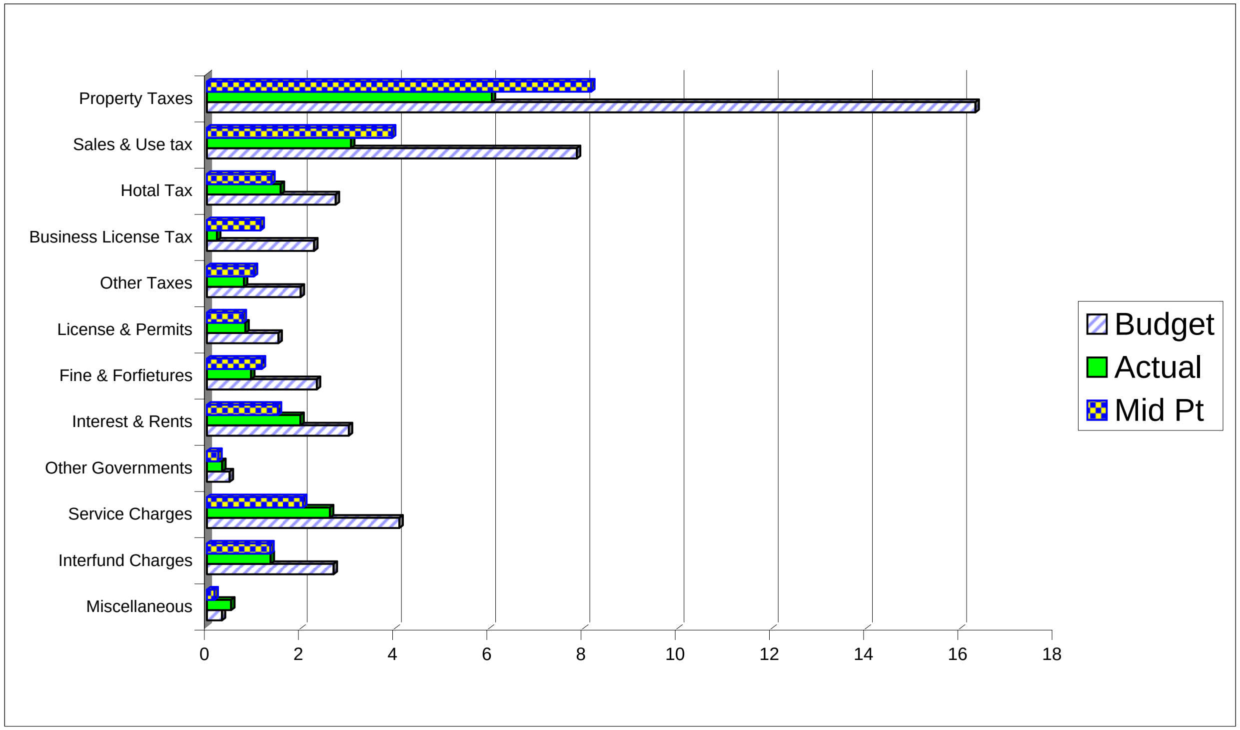
		% of Year	50.00%					
		Mid Year Status					YE Projection	
Fund Title	**Budgeted Revenue**	**YTD Revenues**	**Realized**	**2 yr Avg Realized**	**Prior Year %**	**Prior Year $**	**Year End Projection***	**YE Realized**
General Fund	**45,613,818**	**20,210,584**	**44%**	**45%**	**46%**	**18,963,804**	**47,723,294**	**104.6%**
Special Revenue	5,545,129	2,908,917	52%					
Capital Improvement Fund	1,237,061	689,033	56%					
Safety Construction Fund	-	80,194	-					
UAD Construction Fund	9,222,103	9,407,635	102%					
Enterprise Funds	14,840,980	8,115,481	55%					
Internal Service	6,987,671	3,439,297	49%					
Trust & Agency	1,130,534	558,964	49%					
	84,577,296	45,410,105	54%					



City of Manhattan Beach
General Fund Revenue By Type
As of December 31, 2006

		% of Year	50.00%				
		Mid Year Status				YE Projection	
Fund Title	Budgeted Revenue	YTD Revenues	Realized	2 yr Avg Realized	Prior Year %	Year End Projection*	YE Realized
Property Taxes *	16,318,000	6,049,585	37%	***37%***	39%	17,356,000	106.4%
Sales & Use tax *	7,857,000	3,061,027	39%	***42%***	41%	8,208,000	104.5%
Hotel Tax	2,735,000	1,564,949	57%	53%	54%	3,130,000	114.4%
Business License Tax	2,277,000	213,819	9%	9%	8%	2,277,000	100.0%
Other Taxes	1,990,000	783,466	39%			1,935,000	97.2%
License & Permits	1,517,400	816,037	54%			1,565,300	103.2%
Fine & Forfietures	2,332,300	938,009	40%			1,975,000	84.7%
Interest & Rents	3,012,400	1,982,322	66%			3,665,400	121.7%
Other Governments	481,018	321,439	67%			611,010	127.0%
Service Charges	4,085,700	2,613,179	64%			4,000,584	97.9%
Interfund Charges	2,690,000	1,352,774	50%			2,690,000	100.0%
Miscellaneous	318,000	513,978	162%			310,000	97.5%
	45,613,818	20,210,584	44%	45%	46%	47,723,294	104.6%

* adjusted for State "Triple Flip" allocations



City of Manhattan Beach
Expenditures by Fund Type
As of December 31, 2006

Fund Title	Budgeted Expenditures	YTD Expenses	Realized	2 yr Avg Realized	Prior Year %	Prior Year $	Year End Projection*	YE Realized
		% of Year	50.00%					
	Mid Year Status						YE Projection	
General Fund	46,207,604	22,755,383	49%	48%	48%	20,540,555	45,510,766	98.5%
Special Revenue	9,158,873	1,442,510	16%					
Capital Improvement Fund	6,388,662	1,906,705	30%					
Safety Construction Fund	3,399,205	2,205,558	65%					
UAD Construction Fund	11,794,602	11,061,959	94%					
Enterprise Funds	20,673,672	7,877,317	38%					
Internal Service	7,739,980	4,658,150	60%					
Trust & Agency	1,066,140	241,138	23%					
	106,428,738	52,148,720	49%