



Agenda Item #: _____

Staff Report

City of Manhattan Beach

TO: Honorable Mayor Ward 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 7, 2006

SUBJECT: Consideration of 2005-2006 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 2005-2006, the City remains in good financial position. Revenues are performing above expectations, and expenditures approximate budget estimates. You may recall that, because of the current year State takeaway of approximately \$700,000 (similar to 2004-2005), and large increases in our pension costs, we drew upon the Pension Stabilization Reserve this year for \$682,641 resulting in a balanced budget. This being said, 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 early collection of the 2004 Vehicle License Fee (VLF) Gap loan from the state in the amount of \$615,000, (2) the positive performance of our key revenue sources above expectations, and (3) maintained operational expenditure controls. Our longer term view remains guarded given the escalating operational costs (labor, benefits, pension, and workers' compensation) reported as part of the 2005 audit. We are hopeful that pension costs will stabilize next year (albeit at high levels) and look forward to the end of the two-year State takeaway providing some relief in FY 2006-2007. Should these positive patterns continue, we are optimistic that the use of reserves may not be necessary next year, although we will not know definitively until we are farther into the 06-07 budget process.

Property Tax has been the revenue champion for us these past few years as we have enjoyed sizzling real estate market gains and extraordinary remodeling activity, both which add to the City's growing

assessed valuation and resulting tax revenue. Our second largest revenue source, sales tax, appears to be out-performing prior year levels and budget projections, showing the first sign of growth in the past two years (which is remarkable given the loss of two established car dealerships over the past few years). Hotel Tax is also showing nice gains. In whole, General Fund revenues are projected to exceed budget estimates at year end by 4%. On the other side of the equation, General Fund expenditures are 2% below budgetary estimates, and are trending very closely to the five year average patterns. All in all, we anticipate a surplus at the end of this year which we expect to come in near last year's \$3 million dollar level.

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 2005, we presented the results of the FY 2004-2005 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 further later in the report.

Our highest priority capital project, the Police & Fire facility, is adequately provided for, as are the scheduled Strand improvements. Metlox is completed and open for business. We remain in compliance with established financial and investment policies as set by City Council. Fund equity, reserves, and designation balances are at prudent levels and City funds are invested with safety and liquidity in mind. Expenditure trends within the Insurance Fund require our attention once again. The 2005 audit results and current year insurance trends suggest that a transfer will be needed from the General Fund to assure the maintenance of policy fund levels. The Insurance Fund needs will be reviewed during the 2006-2007 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 2005 are trending as expected (46% realized), and are ahead of last year at this time (44%). This revenue pattern is attributable to a number of factors including seasonal collections for property tax, sales tax and business license tax. Additionally, the State's diversion and reclassification of \$700,000 in tax revenue has added to the apparent revenue shortfall. Adjusting for the impact of these State driven changes, we are projecting General Fund revenues to exceed budget by 4% (\$1.6 million) for the full year.

Since this mid-year report property tax revenue in-lieu of sales tax and vehicle license fees have been received from the State in early January. 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 (33% of General Fund revenues - \$13.5 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 four years. The City's assessed valuation has increased over 40% from five years ago, and property tax collections have increased 52%. The current

year is continuing that trend. As it appears now, we are conservatively projected to exceed budget in this key source by 4% or nearly \$600,000. Recent trends seem to support forecasts that double digit housing increases may be approaching an end. Still others project another year of healthy increases. We continue to budget our largest revenue source conservatively.

Sales Tax makes up 18%, or \$7.4 million of General Fund revenues. Through December, we have collected 41% of our yearly total as compared to 43% last year. Like Property Tax, this revenue source has also been skewed by the State's shift of 25% of Sales Tax to Property Tax. Allowing for this shift, we are pleased to note that Sales Tax is trending better than expected and should come in 5% above budget estimates. As we view this projection, we caution that the State has been known to adjust these shifted dollars at year end given that their early year payments to us are based on estimates. Last year, we returned in excess of \$300,000 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 that are expected to add to our revenue base include renovations and new retailers at the Manhattan Village Mall and the newly opened Metlox commercial development and its expected 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 - \$2.5 million) again is doing well after several years of large declines following September 11th. Revenues are trending above peak FY 2001 levels, a clear sign that tourism is returning and hotels are filling once again. This particular year the Belamar Hotel is in full operation after an extensive remodel. Additionally, we are optimistic about the opening of the new Metlox boutique style inn, Shade, this past quarter. On a related note, percentage rent from the Marriot hotel is tracking at double digit increases above budget estimates. At mid year revenues in this category are trending 2% above budget estimates and 20% above prior year.

Other Revenue Sources:

Vehicle License Fee revenues (5% of revenues - \$2.3 million) have benefited from the early State reimbursement of the VLF Gap loan from 2003-2004 (\$615,000). This is welcome news that contributes to our projected surplus.

Interest Earnings (2% of revenues - \$800,000) have fallen greatly as expected given the use of over \$28 million in reserves to fund the Police & Fire Facility project coupled with the lower interest rate environment. This being said, current revenue patterns are in line with FY05-06 estimates.

Building permit revenue (2% of revenues - \$900,000) is exceeding budget by 4%. There continues to be an abundance of remodeling activity. Demolition permits, a leading indicator of future building permits, remains consistent, at approximately 10-15 per month.

Plan Check revenue (2% of revenues - \$864,000), which typically indicate future building permit revenues, is exceeding budget by 7%.

Real Estate Transfer Tax (1% of revenues - \$550,000), which is collected each time a parcel changes hands, has increased and is outpacing budget estimates at mid year by 6%.

Parking Citations (5% of revenues - \$1.9 million) are tracking 17% below budget estimates. This shortfall can be attributed to staffing vacancies which are actively being recruited at this time.

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

General Fund Expenditures:

General Fund expenditures through December 2005 are 2% under budget in line with a five year mid-year average. At the end of this year, we project an overall savings of 3% to 4% (\$1.4 million). Although we remain within established budget levels, it is clear that rising costs are a key theme again this fiscal year. A similar pattern and message was noted during the FY 2004-2005 audit presentation.

A review of expenditures indicates that City departments remain within budgetary appropriation limits at mid-year with a combined 48% utilization rate. Two departments (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. If these payments are backed out, Public Works meets its budget comfortably.

Personnel vacancies among all departments at mid year, which contributed to projected savings, amount to sixteen (16) positions. This is less than last year. As always, we carefully evaluate vacancies before recruiting to ensure the position is essential to our service levels.

General Fund expenditures at mid-year are projected to come in under budget at year end however, 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 exceed budget estimates. While parking citation revenues are trailing budget levels, parking meter revenues are performing near estimates and hotel bed tax revenue is above budget and exceeding prior year collections. Expenditures in the Capital Improvement Fund at mid-year are at 25% of budget. These costs include the Strand and El Porto Lot Wall improvements, City Hall roof repair, and the contribution to the Mira Costa all weather track.

With CIP fund revenues dedicated to paying debt service on the Police & Fire facility, and the funding of Strand reserves, the funding of future new capital projects is largely subject to our ability to generate General Fund surpluses. Reserves for our major capital projects have been provided for and are maintained with the full funding of the Police & Fire facility and the Strand.

Police/Fire Construction Fund:

The Police & Fire facility project is now budgeted and expenditures are being processed through the Police & Fire Construction Fund. In November 2004, \$12.9 million in bonds were sold completing the final element of the City's financing plan for this major facility. At the time of sale, the City transferred accumulated reserves of \$16 million into established construction trust accounts. These bond and reserve dollars, approximating \$28 million, cover the full estimated cost of construction when one considers that \$13 million of internal City reserve dollars were expended up to that point. Through mid-

year, we have spent \$30.5 million of the \$41 million total project budget which brings us to 75% of project cost. The project remains within budget. Debt service will begin in FY 2006-2007.

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, workers compensation costs are again rising. Our FY 2005 audit report displayed a negative fund balance of \$369,658 considering both short and long term reserves. **The Insurance Fund expenditures continue to track above budgetary estimates which will require remedial action in the FY2007 budget in the form of either an equity transfer from the General Fund or a plan to increase department charge outs or both.** Under any scenario, this is a significant expenditure challenge to be reckoned with. It is important to note that under the newly adopted Governmental Accounting Standards Board Statement #34, we are now required to recognize such internal fund transfers as expenses in the General Fund which will negatively impact any reported budget surpluses that may exist at year end. Staff continues to promote improvement in workplace safety with our new safety awareness program. The program's goal is to raise employee safety awareness in an effort to reduce both lost time accidents and workers compensation costs, and maintain a safe work environment for all employees. The program encourages a competitive spirit by posting the number of consecutive days without lost time due to injury. It also includes a rewards program and recognition for achieving safety.

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

Fiscal Policy Compliance:

As of December 31, 2005 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 2005-2006 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 that we develop action plans at this time given our tradition of maintaining a proactive 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 06-07 budget to City Council that will address the issues at hand.

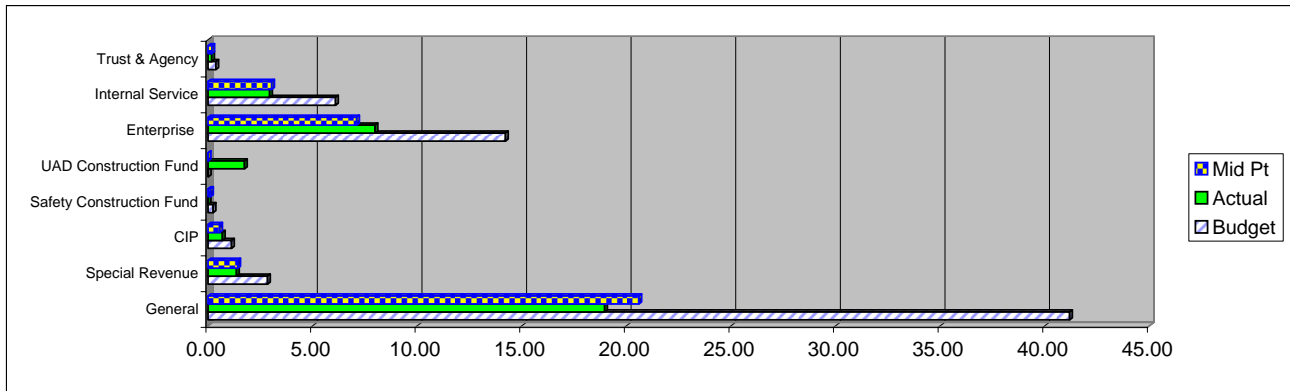
Agenda Item #: _____

- 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, 2005**

% of Year 50.00%

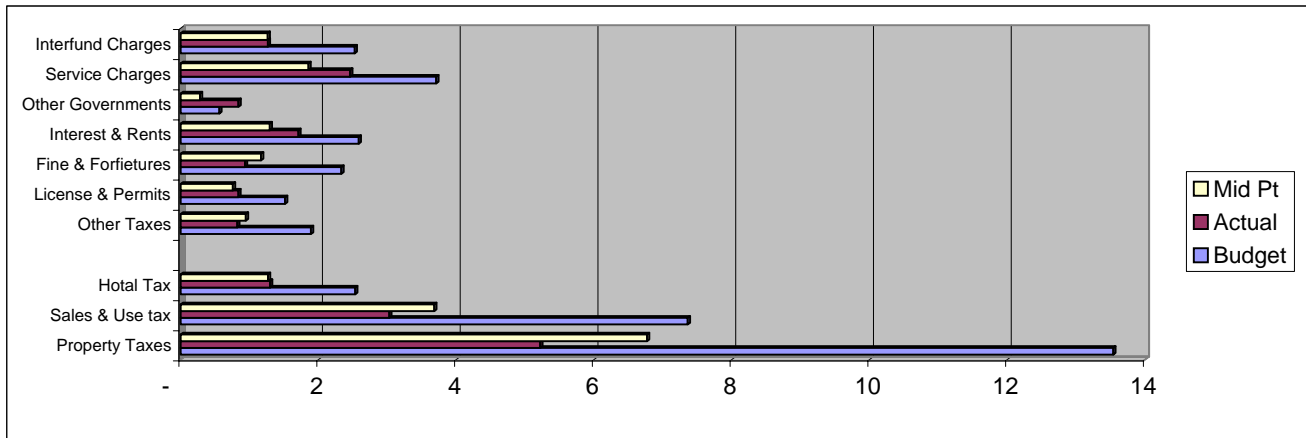
<u>Fund Title</u>	<u>Budgeted Revenue</u>	<u>YTD Revenues</u>		<u>Realized</u>	<u>5 yr Avg Realized</u>	<u>Prior Year %</u>	<u>Prior Year \$</u>	<u>YE Projection</u>	
		<u>Revenues</u>	<u>Realized</u>					<u>Year End Projection*</u>	<u>YE Realized</u>
General Fund	41,191,586	18,963,519	46%	48%	44%	17,325,469	42,835,040	1.04	
Special Revenue	2,850,586	1,364,720	48%						
Capital Improvement Fund	1,127,427	688,680	61%						
Safety Construction Fund	250,000	9,803	4%						
UAD Construction Fund	21,608	1,746,430	8082%						
Enterprise Funds	14,219,752	7,989,816	56%						
Internal Service	6,098,612	2,947,096	48%						
Trust & Agency	374,978	175,322	47%						
	66,134,549	33,885,386	51%						



**City of Manhattan Beach
General Fund Revenue By Type
As of December 31, 2005**

Fund Title	% of Year 50.00%					YE Projection	
	Mid Year Status			5 yr Avg Realized	Prior Year %	Year End Projection*	YE Realized
	Budgeted Revenue	YTD Revenues	Realized				
Property Taxes	13,539,000	5,219,013	39%	45%	41%	14,123,346	1.04
Sales & Use tax	7,361,000	3,027,289	41%	49%	43%	7,738,578	1.05
Hotel Tax	2,534,000	1,297,195	51%	53%	54%	2,594,390	1.02
Business License Tax	2,200,000	209,258	10%	8%	8%	2,266,000	1.03
Other Taxes	1,891,000	821,656	43%			1,893,312	1.00
License & Permits	1,514,726	837,893	55%			1,675,786	1.11
Fine & Forfeitures	2,332,300	932,747	40%			1,865,494	0.80
Interest & Rents	2,584,650	1,707,961	66%			3,019,922	1.17
Other Governments	561,310	838,856	149%			1,062,712	1.89
Service Charges	3,709,600	2,460,433	66%			3,709,600	1.00
Interfund Charges	2,526,000	1,264,767	50%			2,526,000	1.00
Miscellaneous	438,000	346,450	79%			359,900	0.82
	41,191,586	18,963,518	46%	50%	55%	42,835,040	1.04

* adjusted for State "Triple Flip" allocations



**City of Manhattan Beach
Expenditures by Fund Type
As of December 31, 2005**

% of Year 50.00%

<u>Fund Title</u>	<u>Budgeted</u>	<u>YTD</u>		<u>5 yr Avg</u>	<u>Prior</u>	<u>Prior</u>	<u>YE Projection</u>	
	<u>Expenditures</u>	<u>Expenses</u>	<u>Realized</u>				<u>Realized</u>	<u>Year %</u>
							<u>Projection*</u>	<u>Realized</u>
General Fund	42,485,365	20,534,118	48%	48%	48%	18,845,199	41,068,236	0.97
Special Revenue	6,158,838	1,502,836	24%					
Capital Improvement Fund	5,612,711	1,377,931	25%					
Safety Construction Fund	17,248,578	6,991,450	41%					
UAD Construction Fund	-	381,260	-					
Enterprise Funds	22,529,398	8,440,848	37%					
Internal Service	6,512,427	3,561,764	55%					
Trust & Agency	352,118	237,019	67%					
	100,899,435	43,027,226	43%					

