CITY OF ARROYO GRANDE

SECTION 1

BUDGET MESSAGE
June 2007

Honorable Mayor and Members of the City Council:

The staff of the City of Arroyo Grande are pleased to present the approved Bi-Annual City Budget for FY 2007-08 and FY 2008-09. Budgets for all funds are incorporated into the document. The budget is balanced, will continue to fund the high quality of services provided to the community, and will invest in the future through capital improvements and maintenance activities.

The budget incorporates a balanced and responsible approach to meeting the City’s short and long-term needs in a cost effective manner. The Bi-Annual City Budget is an important document because it serves as staff’s recommendation, and ultimately Council’s direction, for the work program for the upcoming two-year period. It also represents the collective recommendation of the executive team.

The Citywide total budget for FY 2007-08 is $24,632,260 and $25,255,158 for FY 2008-09. Proposed expenditures for salaries, benefits, services and supplies provide the best indication of the City’s management of its expenses. The total budgets for these categories for FY 2007-08 equal $19,218,641, which represents an increase of 4% over the prior year amended budget. Therefore, ongoing operational costs are being held relatively steady.

The Bi-Annual Budget was developed by incorporating budget goals and priorities recommended by staff and approved by City Council prior to the beginning of the budget process. These priorities were used as the basis for evaluating requests and developing recommendations. All budget priorities established have been addressed in the budget.

The most significant change in this year’s budget results from the approval of Measure 0-06, which established a half-cent local sales tax. As a result, the Bi-Annual Budget is not only balanced, but is the first to include long-range financial projections that fully fund critical forecasted needs. Revenue from this measure enables the City to dedicate funding to address four categories of important needs identified through the City’s long-range financial planning process, which include transportation projects; infrastructure maintenance and improvements; public safety equipment, facilities and staffing; and public facility improvements necessary to address Americans with Disabilities Act (ADA) requirements.
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Four advisory measures were also included on the ballot to determine community support for dedicating revenues to address each of the four areas of need. The results included Yes - 70.46%/ No - 29.54% for Transportation, Yes - 68.58%/ No - 31.42% for Infrastructure, Yes - 59.89%/ No - 40.11% for Public Safety, and Yes - 41.15%/ No - 58.85% for City Facilities. The voter response for these measures was utilized in prioritizing recommendations for the expenditure of this revenue.

As a result, the budget includes a substantial investment in transportation, street, drainage, creek, street tree, and public safety facility and equipment improvements. While the majority of funds are dedicated to capital projects, funding is also included for upgrade of a Fire Department Captain position to a Battalion Chief, a fire engine purchase, upgrade of a Police Patrol Officer position to an Administrative Sergeant, equipment for the Emergency Operations Center (EOC), and part-time Public Works street maintenance staffing. All such budgeted expenditures are consistent with the intent of the sales tax measure.

The City is committed to ensuring that the local sales tax revenues are utilized for the purposes communicated when the measure was proposed. As a result, maintaining existing service levels requires continued emphasis on cost control and efficiency. Staffing adjustments are limited and equipment purchases include only those most necessary. Funding for part-time staffing in the Fire Department is reduced based on historical data. However, if efforts to enhance the paid-call firefighter program are successful, a portion of this funding may need to be re-appropriated. In addition, changes are proposed to the Recreation after-school program in order to reduce the existing subsidy.

As part of the budget process, Departments were directed to increase operational expenses by no more than 2.5% in FY 2007-08 from the prior year and limit increases in FY 2008-09 to 3%. Items above this amount and/or staffing changes required submittal of a Service Level Change/Budget Amendment Request. The Service Level Changes/Budget Amendments included in the Bi-Annual Budget largely comply with the FY 2007-08/ FY 2008-09 Bi-Annual Budget goals and priorities.

Only a limited number of material budget changes are included that do not fall within the sales tax need categories and/or budget goals. First, a Community Development Planning Assistant position will be upgraded to a Planning Associate position with 50% of the position transferred to the Information Technology Services Division to oversee Geographic Information Services (GIS) and web site functions. Second, two part-time Parks maintenance worker positions will be added. These positions assume responsibility for care of areas previously maintained by contract and newly acquired areas funded through the formation of assessment districts. Therefore, these positions will have little impact on the General Fund. New part-time positions have been used in both Parks and Public Works operations to minimize the cost impact and increase future flexibility to respond to increasing or decreasing staffing demands.
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The Bi-Annual Budget was prepared in accordance with the City’s Fiscal Policy, first adopted by the City Council in September 1995, and last revised in conjunction with adoption of the FY 2005-06/ FY 2006-07 Bi-Annual Budget. While not all goals have yet been fully achieved, the Budget strives to achieve fiscal solvency, superior levels of service, and maximum cost effectiveness. Most importantly, recommendations are aimed at progress in meeting all the fiscal policy goals in the future.

For the first time, the budget makes progress toward meeting the policy goal of creating a vehicle replacement fund. The fund will be gradually established by adding vehicles that are purchased each year to the replacement schedule until all vehicles are included. As a result, funds are budgeted in FY 2008-09 to begin reserves for replacement of the vehicles purchased in FY 2007-08. Costs are amortized over a three-year period for Police patrol vehicles and a five-year period for most other vehicles.

Two policy changes have been approved this year. First, the General Fund policy for reserves has been changed from 20% to a goal of 20% and a minimum of 15%. The policy had previously been 15% until modified in FY 2003-04. A number of existing conditions make the adjustment appropriate at this time. The City’s budget has grown over the past several years, which has made it difficult to increase reserves sufficient to maintain the percentage even though the amount has remained relatively constant at an appropriate level. Since the local sales tax revenue is technically part of the General Fund, it is also recommended a reserve be gradually established from this revenue, which will enhance the reserve total. Finally, the vehicle replacement fund will constitute an additional reserve amount.

The second policy change is to pre-fund retiree medical benefit costs. The City is currently contracting for preparation of an actuarial analysis to determine the appropriate annual expense. As a result, funding is not yet budgeted, but will be proposed upon completion of the actuarial study. Due to concerns regarding the level of these costs, staff is also pursuing options to decrease this future liability.

Salary and benefit increases are included in the budget for Police and SEIU in FY 2007-08 and SEIU in FY 2008-09 pursuant to existing MOUs with those groups. Increases have not yet been included for Fire, management and part-time employees or for Police in FY 2008-09, which are still under consideration. The Bi-Annual Budget does provide for revenues in excess of expenditures sufficient to address some level of cost of living adjustments for these groups, as well as funds to begin to address the policy goal of pre-funding retiree medical benefits.

The Bi-Annual Budget uses the award-winning format that was initiated in FY 1997-1998. Of particular importance are the workload indicators for each department, which illustrates various activities conducted by the respective departments and the cost and/or success of implementing those activities.
GENERAL FUND
The primary focus of budget deliberations is normally on the General Fund, which finances the majority of what are considered traditional government services. It is funded from tax revenue sources that tend to have the least flexibility to adjust funding levels to meet expenditure needs.

The total approved General Fund budget (without transfers) is $14,295,218 for FY 2007-08 and $14,728,090 for FY 2008-09. This represents an increase of approximately 2% over the FY 2006-07 Amended Budget.

Revenues for the FY 2007-08 General Fund are estimated to meet budgeted expenditures. Revenue estimates are based upon reasonable and conservative projections in the growth of General Fund revenue sources, which are forecasted to be approximately $440,931 over the estimated actual revenues for FY 2006-07. The approved local sales tax revenue is not shown in the General Fund, but is listed separately in the Special Revenue section of the budget. The local sales tax measure is estimated to increase revenue by $1.5 million in both fiscal years of this budget.

The Bi-Annual Budget will be the 13th and 14th consecutive years revenues have increased. Though a portion is from one-time revenues, the majority is from reoccurring revenues, such as sales and property tax. Increases in reoccurring revenues enable the City to finance new services and programs.

The projected June 30, 2009 Fund Balance of the General Fund is $3,122,756, which exceeds the policy goal of 20% of the overall General Fund budget. However, this will decrease when compensation adjustments are complete, but is projected to continue to exceed the 15% policy minimum.

HISTORICAL TRENDS
Staff has presented balanced budgets for the last 11 years. After several years of financial challenges, the achievement of 11 balanced budgets is in large part the result of the City Council’s conservative fiscal policies, staff’s adherence to those policies, and a growing tax base. This growing property and sales tax base brings stability and allows the City to be less dependent on one-time revenue sources.

However, the diversity of the City’s revenue base remains limited, with property and sales tax representing well over 50% of total revenues. The City’s hotel/motel economic development strategy is designed to address this by enhancing transient occupancy tax as a major revenue source. With construction of the Hampton Inn and negotiations for a second hotel at Faeh Street and El Camino Real both under way, progress is being made towards implementation of this strategy.

The City has taken major steps over the past few years to create long-term financial stability. The current budget is a reflection of the progress that has been made to fund ongoing operations at an appropriate level despite
financial challenges. It is projected that the current revenue base is sufficient to accomplish this in the long-term future. Therefore, the 10-year long-range financial plan is balanced when addressing maintenance of existing service levels.

The City's long-range financial plan, incorporated within the budget document, has been updated to reflect the success in generating additional long-term revenue sources. As a result, this represents the first long-range financial plan that projects the ability to meet future projected needs. However, maintaining a balanced 10-year financial plan continues to require conservative operating expenditure growth and an ongoing commitment to cost control efforts. While projections accommodate modest growth necessary to maintain existing service levels and addresses previously identified long-term needs, any significant new program or project goals will likely require identification of a new funding source.

While the overall budget picture appears much more positive than the past several years, a number of concerns do remain that require monitoring and possible attention. First, normal sales tax growth trends have been disappointing. This past fiscal year, general sales tax revenues (not including the new local sales tax) are expected to finish 3% less than last year and are projected to grow by only 1.5% next year. Staff will continue to monitor closely to determine if this reflects a temporary downturn in specific markets or represents a loss of sales to surrounding areas, which has been identified as a concern in the past.

Second, given housing costs and other factors, personnel expenses and other increases continue to exceed normal revenue growth. This places ongoing pressures on maintaining a balanced budget and effective workforce. As mentioned previously, retiree medical costs represent a particular area that will need to be better managed in the future. As a result, strategies to modify the existing system will be necessary to better control these costs, which will require the cooperation of labor groups.

Third, building activity continues to decline in the City, which impacts a number of revenue sources related to permit and development impact fee payments. Downward adjustments to permit fee revenues have been necessary over the past couple years.

Fourth, it is becoming increasingly difficult to maintain the existing low level of water and sewer rates given capital project demands on these funds. Sewer upgrades and efforts to increase water supply will involve project costs that will cause significant rate pressures, particularly when combined with decreasing development facility fee revenue.
SEWER FUND
While balanced, the primary area of future concern is the Sewer Fund. Total expenditures for the Sewer Fund (Fund 612) are budgeted to be $824,767 in FY 2007-08 and $753,050 in FY 2008-09. The projected fund balance is estimated to be $214,290 in FY 2007-08 and $240,740 in FY 2008-09. Use of reserves will be necessary in both fiscal years in order to complete necessary capital projects. This is well below the City’s policy goal of 60 days of operating expenses plus $500,000. However, it has made progress since FY 2001-02 when the year ended with a negative fund balance.

A continued shortfall in revenues from the Sewer Facility Fund for capital projects due to decreasing development activity adds to these challenges. This is projected to result in an increased need to fund the majority of capital projects from ongoing sewer operating fees.

Revenue estimates are based upon a 3% rate increase in FY 2007-08 and a 3% increase in FY 2008-09, which were approved by the City Council as a result of recommendations of the existing 5-year sewer rate study. To address future concerns regarding the Sewer Fund, staff has proposed to prepare an updated Sewer Fee Study and will review the Cost Allocation Plan to determine whether a reduction in transfers from the Sewer Fund to the General Fund may be appropriate.

WATER FUND
Water Fund (Fund 640) revenues are estimated to be $2,262,650 for FY 2007-08 and $2,418,600 in FY 2008-09. Approved rate increases include 7% in FY 2007-08 and 7% in FY 2008-09. The Ending Fund Balance for the Water Fund is expected to be approximately $12,464,150 at the end of the two-year period, which is actually $2,280,274 after fixed assets are deducted. Therefore, the Water Fund reserves exceed the existing policy goal, but is also experiencing significant capital project expenditure demands over the course of the 5-year CIP.

CAPITAL IMPROVEMENT PROGRAM
The Capital Improvement Program (CIP) is funded from a wide range of revenue sources, including the General Fund, Sewer and Sewer Facility Funds, Water and Water Facility Funds, Park Improvement Fund and miscellaneous grants. While the Bi-Annual Budget provides operational funding for a two-year period, the CIP programs project funding on a 5-year basis. Since the local sales tax measure was designed primarily to support long-term capital needs of the City, the CIP is most impacted by the new revenue source.

The CIP for FY 2007-08 and FY 2008-09 consists of 55 new and continuing projects totaling $12,704,285. Of this total, $8,605,214 will be financed from new funding sources and $4,099,071 is from carry-over financing from previous fiscal years.
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The CIP is based largely upon the prior needs identified in the long-range financial plan and results of the advisory measures. In the area of transportation projects, full funding is budgeted in FY 2007-08 and FY 2008-09 for design of the Brisco Road – Halcyon Road/Highway 101 Interchange improvements. Funding for construction is programmed in FY 2010-2011 and FY 2011-12. However, full funding is contingent upon both State financial assistance and issuance of long-term debt using an ongoing portion of the local sales tax revenue for debt service.

Infrastructure maintenance and improvements have been identified as a high priority for funding allocation and focus on the areas identified in the sales tax measure arguments. These include street maintenance and improvements, drainage improvements, creek protection and restoration projects, and maintenance of the urban forest. Key projects include resurfacing of Brisco Road, Farroll Avenue, E. Grand Avenue, and El Camino Real; Newsom Springs and Valley Road drainage improvements; retention basin maintenance; an increase in street, sidewalk and street tree maintenance; and matching funds for grants for Tally Ho Creek, Arroyo Grande Creek and Meadow Creek preservation projects.

The primary public safety facility project funded is expansion of the Police Station. A feasibility study is currently under way. The CIP proposes to set aside sales tax funding each year for a portion of the construction costs. However, the proposed total cost and construction schedule will be based upon the results of the feasibility study. Once a decision to proceed is made, a comprehensive funding plan will be provided.

A variety of funding sources will fund implementation of streetscape and master plans, which have been approved over the past year. These include the E. Branch Streetscape Plan, Traffic Way Streetscape Plan, and Village Green Master Plan. Design of streetscape improvements for El Camino Real are also planned to begin in future years.

A number of park improvements are programmed and funded primarily from the Park Development and Park Improvement Funds. Most notable are upgrades to the Soto Sports Complex. These projects are being coordinated with local sports organizations to prioritize improvements and utilize voluntary efforts to maximize the impact from available funding.

Major sewer projects funded in the first two years of the CIP include the Fair Oaks Avenue Sewer Upgrade, Ash Street Sewer Upgrade, El Camino Real Sewer Upgrade, and East Branch Street Sewer Lining. Key water improvement projects consist of update of the Water Master Plan, Reservoir No. 6 Construction, Oro Booster Station Upgrade, Bell Street/Faeh Avenue Waterline Upgrade, completion of Water Well No. 10, Water Well No. 7 Rehabilitation, the Water Conservation Program, and the Desalination Feasibility Study.
REDEVELOPMENT AGENCY / COOPERATIVE AGREEMENT WITH THE CITY

In August 1996, the City Council approved the formation of the Arroyo Grande Redevelopment Agency. Because sufficient tax increments were not available during the early years of the Agency, it has been necessary for the Agency to borrow funds for operational purposes. Debt has historically taken place from internal City funds.

In January 2001, the City Council approved a plan to address the Agency's operating shortfall within a 5-year period, which was successfully completed in FY 2005-06. Staff is pleased to report that the Redevelopment Agency's first issuance of tax allocation bonds was completed in FY 2006-07, which enabled the Agency to repay all internal debt. As a result, the Agency now has a positive fund balance, projects to maintain ongoing tax increment revenue sufficient to meet all debt service payments, and will have excess revenue available for redevelopment projects and efforts. Staff now projects the Redevelopment Agency will become an important funding source over the next several years for public improvements, as well as economic development projects that will support citywide financial needs.

Initial projects funded include utility pole relocation costs associated with the E. Grand Avenue restaurant project, public improvements associated with the Faeh Street hotel project, Le Point Street parking improvements and El Camino Real improvements. In addition, staffing costs previously transferred to the General Fund are now fully funded by the Redevelopment Agency, which has assisted in achieving General Fund financial stability.

SUMMARY

The following budget represents the professional expertise of the entire department director team for proposed City services, operations and programs for the upcoming two fiscal years. It reflects both the Fiscal Policy and budget priorities established by the City Council. The overall objective is to meet the community's needs and provide services in the most effective, efficient and responsive manner.

After several years of hard work aimed at stabilizing the City's financial base and service levels, staff is proud to present a budget that meets both existing and long-term projected needs. To ensure this continues in the future, the budget is designed to address needs, but to do so prudently by managing ongoing costs, balancing priorities, and planning long-term. The Bi-Annual Budget is the work product of a dedicated and conscientious staff working under the leadership and direction of a fiscally responsible City Council. Staff is pleased to present the approved FY 2007-08/ FY 2008-09 Bi-Annual Budget.

STEVEN ADAMS
CITY MANAGER