



June 2009

Honorable Mayor and Members of the City Council:

The staff of the City of Arroyo Grande is pleased to present the Biennial City Budget for FY 2009-10 and FY 2010-11. Budgets for all funds are incorporated into the document.

Like most cities throughout California and around the country, projected revenues for the City of Arroyo Grande have been significantly impacted by the severity of the existing recession. This resulted in a shortfall of approximately \$1 million the prior year and a projected deficit of nearly \$2 million for FY 2009-10. Combined, this has represented nearly 20% of the City's General Fund budget.

As a result, in March 2009, staff developed and Council approved a comprehensive plan to address the projected shortfall. The budget reflects all the strategies of the plan, including staffing reductions, one-time revenues through grants and the sale of excess property, renegotiation of labor agreements, and operational

efficiencies. Recommendations were based on a commitment to balance the budget while maintaining critical service levels and moving forward with important projects to meet the needs of the community.

An important feature of the budget plan is that no General Fund revenue increases are proposed through new or increased fees or taxes above normal annual inflationary adjustments. This was established as a basic assumption in the City's budget planning due to the financial impact of the recession on many of the community's residents and businesses.

The FY 2009-10 budget is balanced, will continue to fund high quality services provided to the community, and will invest in the future through capital improvements and maintenance activities. However, due to the reliance on one-time revenues to fund a portion of the shortfall, a projected deficit remains in the General Fund for FY 2010-11. As a result, the City Council is only being requested to consider adoption of the FY 2009-10 Annual Budget at this time. Staff will continue to develop recommendations for additional measures aimed at balancing the budget for the following year during the upcoming few months.

The proposed budget plan will result in the reduction of nine positions. By obtaining vacancies through a "Golden Handshake" retirement program, only two will require layoffs. In order to maintain key services to the community, a comprehensive restructuring program is proposed, which will combine a number of functions, reduce the number of departments, and cross train staff to perform multiple responsibilities. In many cases, this

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may result in improvements to services through better coordination. However, there will be reductions in ongoing park and street maintenance, police community education programs, permit processing times, street tree trimming and the ability to prepare in-house analysis of land use and capital project items.

Under the restructuring plan, the Public Works Department will be eliminated. Engineering Services will become a division within the Community Development Department. Streets, Water, Sewer and Fleet Maintenance operations will all be transferred to the Parks, Recreation & Facilities Department, which will now be named the Community and Maintenance Services Department. All maintenance services will be coordinated and staff will be cross trained. Human Resources will be transferred to the Financial Services Department, which will now be named Administrative Services. The former Administrative Services Department, which is headed by the City Clerk, will be renamed the Legislative and Information Services Department. A number of staffing changes are included that will coincide with these modifications to the City's organizational structure.

The Citywide total budget for FY 2009-10 is \$29,047,291 and \$29,977,228 for FY 2010-11. 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 2009-10 equal \$19,980,976, which represents a decrease of 2% over the prior year amended budget.

Therefore, ongoing operational costs are being held relatively steady.

As part of the budget process, Departments were directed to maintain operational expenses at the same amounts budgeted in FY 2008-09. No Service Level Change/Budget Amendment Requests were considered this year due to the projected shortfall.

Despite the projected General Fund deficit, the City remains committed to utilizing local sales tax revenues for the purposes communicated when the measure was proposed and approved in 2006. As a result, a number of project budget goals were proposed to the City Council and approved, which are all reflected in the budget recommendations. They are designed to maintain an aggressive capital improvement program to meet a variety of infrastructure and facility needs that had been deferred prior to the proposal of the local sales tax measure.

Two financial policy changes have been proposed this year. First, the City Council approved a phased approach of transferring Lopez ongoing operational and maintenance costs into the Water Fund and rates. Therefore, it is proposed to establish a reserve policy for the remaining items that will continue to be funded from the Lopez Fund. Secondly, staff has proposed use of lease arrangements to finance vehicle purchases. As a result, the vehicle replacement fund financial policy is proposed to be deleted. Lease financing will accomplish

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the same goal of maintaining more consistent annual vehicle replacement costs.

Salary and benefit increases are reflected in the budget for Police and SEIU in FY 2010-11 pursuant to existing Memorandums of Understanding (MOUs) with those groups. No other increases are budgeted. Staff has negotiated a number of adjustments to existing MOUs in order to delay salary increases and reduce retiree medical benefit costs. FY 2009-10 salary costs also include three non-paid furlough days for SEIU and management employees. This will result in closure of City offices on days between the Christmas and New Year holidays.

The Biennial 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 \$13,589,467 for FY 2009-10. This

represents a decrease of approximately 7% from the FY 2008-09 Amended Budget.

Revenues for the FY 2009-10 General Fund are estimated to meet budgeted expenditures. Revenue estimates are based upon reasonable and conservative projections, which are forecasted to be approximately \$531,500 under the estimated actual revenues for FY 2008-09.

The two primary General Fund revenue sources, Property Tax and Sales Tax, are projected to decrease by 5% and 3% respectively when compared to the estimated revenues for FY 2008-09. This represents a decrease of 10% and 13% from FY 2007-08. Another major impact has been to revenues generated from building activity. When combined, all building related permit fees are projected to be \$306,200, a 57% decrease from FY 2007-08.

The projected June 30, 2010 Fund Balance of the General Fund is \$1,770,672, which equals approximately 13% of General Fund appropriations, slightly below the City's minimum policy level of 15%. However, with effective cost control measures, staff believes the actual balance may be close to or achieve the policy amount.

Recommendations were drafted utilizing State funding assumptions based upon the Governor's proposed budget. The budget does not address potential borrowing of local funds by the State under provisions of Proposition 1A following failure of ballot measures

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necessary to implement the Governor's budget. If borrowing is proposed and approved by the State legislature, the City will at that time need to determine whether to implement additional budget reductions or reduce existing projected reserves.

### **HISTORICAL TRENDS**

Staff has presented balanced budgets for the last 13 years. Given several years of financial challenges, the achievement of these balanced budgets is in large part the result of the City Council's conservative fiscal policies, staff's adherence to those policies, and a commitment to implementing changes necessary to increase efficiency while maintaining service levels.

Over the past few years, the City has taken major steps to confront issues that could threaten long-term financial stability. These include reform of the City's retiree medical insurance program to control long-term benefit costs, the local sales tax measure to fund long-term infrastructure and facility needs, joint fire operations to maintain the feasibility of a partial reserve force, and economic development efforts to maintain a strong and viable business community.

However, the severity of the recession and related impacts has resulted in new challenges well beyond what was foreseen in the past. Staff is projecting sales tax decreases to level off beginning in FY 2010-11, but to not return to former levels in the near future. A decline in property tax revenues is projected to continue, but level off shortly thereafter. If economic development efforts

are successful and planned projects proceed despite the economic climate, the City could experience building permit revenues above budgeted projections. However, long-term forecasts indicate lower revenue levels as the City approaches build-out.

Meanwhile, significant increases in PERS retirement costs are expected beginning in FY 2011-12 due to investment losses in the statewide system. Therefore, personnel costs will continue to rise despite efforts to negotiate control over salary cost increases with the respective unions.

The City's long-range financial plan, incorporated within the budget document, has been updated to reflect the current challenges. As a result, long-range projections indicate expenditures will continue to exceed revenues and a negative fund balance will occur. In reality, these numbers will not be accurate because the operating deficit will have to be addressed. However, their purpose is to highlight the need to resolve existing financial trends.

The key to addressing the 10-Year Financial Plan will be to develop recommendations that address the projected shortfall for FY 2010-11 and then maintain minimal increases to costs thereafter while revenues begin to recover. Continued use of one-time revenues to balance the budget during this period of economic decline should be acceptable as long as projections demonstrate that revenues begin to increase at a rate greater than costs and an acceptable Unappropriated Fund Balance can be

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maintained in the long-term. Therefore, actual revenues in FY 2009-10 will be key to determining whether reserves can be used for FY 2010-11 budget strategies.

Staff believes that any significant further reductions in staffing levels will result in unacceptable levels of service. Therefore, long-term financial stability will rely on: 1) recovery to some level of modest revenue growth; 2) efficiencies through consolidation and joint efforts with other jurisdictions; 3) cost control and/or reduction in salary and benefit levels; 4) continued emphasis on economic development; and 5) identification and pursuit of new creative and innovative revenue generating sources.

These strategies are reflected in the Long Range Financial Plan Scenario II. However, the amount of additional revenue and savings identified as necessary to maintain a balanced budget in the long-term demonstrate the level of financial challenges that lie ahead.

### **SEWER FUND**

Expenditures in the Sewer Fund exceed revenues in FY 2009-10, but will be balanced by FY 2010-11 due to adjustments recommended by the recent rate study. Total expenditures in FY 2009-10 for the Sewer Fund (Fund 612) are budgeted to be \$968,783 and projected revenues are \$891,600, leaving an estimated ending fund balance of \$184,271. This is well below the City's policy goal of 60 days of operating expenses plus \$500,000. However, the fund balance is projected to gradually increase under the recommendations of the

rate study completed this past year. A continued shortfall in revenues from the Sewer Facility Fund for capital projects due to decreasing development activity has added to the challenges faced by this fund.

### **WATER FUND**

Water Fund (Fund 640) revenues are estimated to be \$2,976,600 for FY 2009-10 and total expenditures are estimated to be \$4,414,493. The Ending Fund Balance for the Water Fund is expected to be \$11,217,022, well above the minimum policy goal. However, a significant amount of this funding is programmed to address needs in the 5-year Capital Improvement Program.

### **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 Biennial 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, it has been the primary source of funding for general project needs.

The CIP for FY 2009-10 consists of 49 new and continuing projects totaling \$13,135,049. Of this total, \$6,988,150 will be financed from new funding sources and \$6,146,899 is from carry-over financing from previous fiscal years.

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Improvements to the Brisco Road-Halcyon Road Highway 101 Interchange continue to be one of the City's top priorities. Full funding is budgeted in FY 2009-10 for design if approval of the PA&ED and design exceptions can be obtained from Caltrans in order to proceed. Additional funding is programmed in remaining years sufficient for debt service to finance the City's share of the project costs.

Increases in major street projects will continue. In addition to the annual pavement management slurry seal projects, goals include resurfacing of West Branch Street, El Camino Real and the Orchard Street neighborhood within the next two-year period. Funds are budgeted for the City's share of costs to extend Castillo Del Mar from Orchard Street to Fair Oaks Avenue. However, construction of the project has been delayed until private development funds are received per the Memorandum of Understanding with the Busick Tract developer.

A major investment in both City and grant funding will be made in sidewalk projects over the next two year period, which include Crown Hill, Elm Street, Tally Ho Road, and Montego Street. Beginning in FY 2010-11, staff recommends dedicating local sales tax funding to increase sidewalk repairs for a two-year period before programming additional new sidewalk projects.

Two major City facility projects are proposed, but funding plans have been developed to minimize the use of local sales tax funding. A proposal to upgrade the City Hall Complex involves renovation of the existing City Hall

building and trading other existing properties for the 111 South Mason Street office building, along with a payment for the difference in appraised value. Utilizing a USDA long-term loan program, staff has developed budget recommendations that would require only \$50,000 in annual local sales tax funding to complete the project. This option will result in significant long-term savings when compared to other options to address City Hall space, Americans with Disabilities Act (ADA) and structural office issues.

Schematic design and property acquisition is under way on a new Police Building project at West Branch Street and Rodeo Drive. A funding plan included in the budget will program close to \$6 million through long-term financing of Redevelopment Agency and local sales tax funds over the next two-year period, but will depend on value engineering recommendations to make the project financially feasible.

Major park projects include lighting at Don Roberts Field, installation of a centralized Citywide irrigation system, Soto Sports Complex turf renovations, and replacement of the roof at the Elm Street Community Center. Use of Community Development Block Grant funds are also proposed for ADA improvements to the Elm Street Community Center.

Given limited available resources, sewer capital project needs are proposed to be gradually phased over several years. Project priorities proposed for funding over the next two-year period include replacement of Lift Station

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No. 3 and The Pike Sewer Upgrade, as well as an update to the Sewer Master Plan.

A variety of water projects are proposed in order to both upgrade and maintain the system, as well as to increase water supply. FY 2009-10 projects proposed for funding include Reservoir No. 6 construction, water line installation at Chilton and El Camino Real, Oro Booster Station Upgrade, Waterline Upgrade on Bell Street and Faeh Avenue, Water Well No. 10 construction, Strother Park Irrigation Well Testing, Reservoir No. 7 Construction, and Test Well No. 11 Feasibility Study and Construction. These projects are being funded through a combination of the Water Fund, Water Facilities Fund and Water Availability Fund.

### **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. 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 has excess revenue available for redevelopment projects and efforts. The budget programs the majority of this fund balance for construction of El Camino Real streetscape improvements and the Le Point parking lot, as well as design of the new Police Facility. Funding construction of the new Police Facility will require issuance of an additional long-term financing of tax increment funds. Redevelopment Agency funds are also budgeted to provide financial assistance for development of a "Green Center" commercial venture tentatively planned to include a compressed natural gas (CNG) fueling station and sale of alternative fuel vehicles and other "green" products.

### **SUMMARY**

The following budget represents the professional expertise of the entire department director team for proposed City services, operations and programs. 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.

Staff cautions that the budget should not be viewed as a plan to resolve long-term financial challenges facing the City due to the current nationwide economic condition. However, staff does believe strongly that it represents the most effective and comprehensive approach to maintain financial solvency, adequate service levels, and progress in addressing long-term infrastructure and capital needs

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over the next year while additional strategies can be developed and implemented.

Staff is pleased to present the FY 2009-10/ FY 2010-11 Biennial Budget, which has been approved by the City Council.



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**STEVEN ADAMS  
CITY MANAGER**