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May 21, 2019

Honorable Mayor and Members of the City Council:

Introduction

I present for your consideration, discussion and approval the City's Proposed Budget for Fiscal Year 2019/20 and a financial plan for Fiscal Year 2020/21. The proposed budget implements the City Council strategic goals and priorities, provides a financial plan that continues to deliver high levels of service to the community and is responsive to the citizens and the business community of the City.

This is the City's first foray into a two-year budget process, which when fully implemented, should provide the City Council with additional information on the City's fiscal position to assist in financial and policy decisions. It should also streamline the budget preparation process internally, creating time for staff to provide more in-depth analyses of fiscal issues and more significant monitoring of budgetary trends.

The budget is the primary policy document for the organization; it establishes the financial and human resources necessary to accomplish community objectives, sets citywide service levels, and implements capital projects. The allocation of this budget builds upon the goals and priorities identified by the Council by focusing on infrastructure investments, fine-tuning of the city organization to make the best possible use of existing staff and resources, and balancing prudent spending to address community needs while providing a high level of service. The ongoing allocation of resources were developed in conjunction of the City's long-term financial forecast, which is described in greater detail in this budget document. The proposed budget was developed with an eye toward a future correction in the economy, modest revenue growth assumptions, minor adjustments to baseline budget and the ongoing need to address the City's long-term obligations (infrastructure improvements, pension costs, and other post-employment benefits costs). The long-term forecast model further illustrates the City's fiscal cornerstones, revenue and appropriations assumptions and the short-term and long-term fiscal challenges.

Like most other California cities, Davis is not immune to budgetary challenges. The City continues to grapple with maintaining current levels of service, in an era where costs are rising more rapidly than revenues. Certain cost increases, such as pension or other post-employment benefit increases, are largely outside of the City's direct control. Increasing or seeking new revenue sources has limitations and can be a lengthy process. Hiring, training and retaining staff to deliver the key City services with innovation, efficiencies and professionalism takes both time and money.

Fortunately, the City has a solid budgetary foundation that should allow it to withstand negative impacts. We have a fiscally responsible City Council; a dedicated staff; engaged city commissions; a stable property value/assessment base; one voter-approved one percent sales tax measure and two parcel tax measures; a successful record in competing for state and federal grants; a solid groundwork for harnessing technology to improve efficiencies, with additional room to improve; a long term forecast model to help in decision making; and most importantly, a very limited and strategic approach to ongoing increases in costs to provide services.

The Proposed Budget includes several organizational shifts intended to improve customer service with minimal increased costs. With this budget, we are formally splitting the Public Works Department, currently our largest and most varied department, into two separate departments, one focused on Engineering and Transportation and the other covering Utilities and Operations. The Engineering and Transportation Department will be able to focus on planning, preparing and completing construction projects, while the Utilities and Operations Department will concentrate its efforts on maintaining the water, wastewater, drainage, lighting and other pieces of the City's infrastructure functioning. The division into two departments will allow for a more pro-active and nimble response to public input and need, and provide a tighter "span of control" for oversight of department responsibilities. In the same vein of improved customer service, the Proposed Budget restructures the City's Volunteer Coordinator position from the Police Department to Parks & Community Services. Relocating this position will maximize the position's effectiveness to harness the energies of community members willing to assist the City in keeping the community a great place to live, play, work and visit. The Police Department VIPS (Volunteers in Police Service) program will remain with the Police Department. Finally, the Proposed Budget includes resources to improve both customer service and communications with the community, ensuring that the work we do is informed and understood by those it is intended to benefit.

2018/2019 Accomplishments

The 2018/2019 Fiscal Year has been one of great activity and progress. A few highlights are outlined below:

- Proposed division of Public Works into two new departments: Public Works – Engineering and Transportation and Public Works – Utilities and Operations
- Secured labor contracts with Davis City Employees Association and Fire Local 3494, and began labor negotiations with Davis Police Officers Association
- Made significant progress on advancing the preparation of the Downtown Plan
- Restructured solid waste rates to accommodate increased service provision costs
- Completion of the Third Street corridor between B Street and UC Davis, providing an attractive and safe connection between the two jurisdictions.
- Approved conditional use permits for five cannabis dispensaries, as well as approvals for three delivery-only locations, two manufacturers, and one research and development facility.
- Developed a comprehensive grant program and secured over \$13 million in outside grant funding over the past two years.

- Developed a Memorandum of Understanding with UC Davis to address growth impacts and student-oriented housing.
- Finalized decisions about downtown parking changes and parking guidance system.
- Adopted an ordinance to provide discretionary review of large home additions with required noticing to surrounding neighbors.
- Issued building permits for construction of the Marriott hotel, Nugget Market corporate headquarters, and initiated review of construction plans for the Hyatt House hotel and Lincoln 40 student-oriented housing project.
- Approved student-oriented housing development Davis Live and the workforce-oriented housing 3820 Chiles Road Apartments.
- Completed a successful City Council goal setting retreat, resulting in the City Council “7 Focus Items” with monthly updates.
- Filled key strategic positions in the City organization, including the Finance Director and the Communications & Customer Service Manager roles.
- Adopted the first Legislative Platform to prioritize and guide strategic City interests in legislation and funding pursuits.

Cost Containment and New Revenue Measures:

The City continues to implement cost cutting measures, seek new revenue sources, and look for opportunities to cost share projects with State and Federal partners. Below are some of the highlights since the great recession that have allowed the City to bridge gaps in funding:

- a. Cannabis: Approximately \$620,000 in cannabis revenues have been added to the overall budget for the General Fund.
- b. Grant revenues: The City continues to successfully secure grant funds to advance the rehabilitation and replacement of the City’s aging infrastructure. Below are some of the grant funds the City has secured in the last few years:
 - i. Fourteenth Street and Villanova: \$932,000
 - ii. Pole Line and Olive Drive: \$3.5 million
 - iii. Third Street Surface Improvements: \$3.0 million
 - iv. I-80 and Richards Blvd Interchange: \$5.0 million
 - v. Urban Greening Grant: \$2.9 million (new award for FY 2019/20)
- c. Economic Development Projects:
 - i. Marriott Residence Inn construction
 - ii. Hyatt House (made possible from the City led economic development incentive to finance fees through a statewide pool bond SCIP).
 - iii. Nugget Market Corporate Headquarters
 - iv. MARS Cocoa R&D Facility
- d. Refunding of the City’s Debt
 - i. The City refunded its water loan from a variable rate with a maximum interest of 12% to a fixed interest loan at 3.30%. This resulted in a net savings to the Water Enterprise Fund of \$5.6 million and eliminated the exposure to the rate payers to continue to pay for the increase in interest payments from the variable rate.

- ii. Redevelopment Successor Agency Tax Allocation Bonds refunding (in progress) will result in a cumulative present value savings of \$18.0 million. This refunding will allow the City to access 35% (\$5.5 million) of the bond proceeds held in trust since 2011 towards an eligible capital improvement project.
- e. Pension and Other Post-Employment Benefits: Labor agreements with three of the City's labor groups (Davis City Employees Association, Program Administrative and Support Employees Association, and Individual Management) have a newly-negotiated cost sharing agreement for any increases in the annual pension normal cost rate.
- f. Organizational improvements: As noted earlier, staff is always considering organizational adjustments that will improve efficiencies and provide better customer service. For example, the City has recently added three Firefighter positions, which should significantly reduce overtime and, generate a net savings of potentially \$300,000 or more.

FY 2019/20 and FY 2020/21 Budget Summary

In summary, the FY 2019/20 and FY 2020/21 Budget for all City funds, including Enterprise Funds and Capital Budget totals \$231,056,557 and \$177,803,896, respectively. The General Fund Operating Budget is \$68,322,361 for FY 2019/20 and \$63,445,762 FY 2020/21.

The City's revenues across most City Funds continues to perform better than prior year actuals. The City net position (net worth) continued to increase due to the solid financial policies and fiscal management. The projected General Fund balance for Fiscal Year 2018/19 is \$17.4 million (26.3%), Fiscal Year 2019/20 is \$10.7 million (15.8%) and Fiscal Year 2020/21 is \$9.5 million (14.9%).

FY 2019/20 Budget Summary- Revenues

Total All Funds Revenue for FY 2019/20 is budgeted at \$195,857,763 with General Fund revenues totaling \$61,346,054. Citywide revenues continue to increase at a modest level from prior year. The total change in citywide revenues were \$11,588,990 or 7% while the General Fund were \$647,307 or 1%. Below are the highlights of the major revenues sources of the City.

- General Fund:
 - Property taxes (secured): Property taxes increased by \$540,000 (4.3%) in FY 2018/19, \$787,224 (6.0%) in FY 2019-20 and \$586,000 (4.2%) in FY 2020/21. This increase is primarily attributable to a combination of factors including a 2% increase in the property value base valuations and new construction or property transfers during the year. Property taxes are projected to increase modestly due to the cost of living adjustment and projected new hotel projects and other developments.
 - Sales taxes (Local tax and District Tax (Measure O): Sales taxes are projected to increase slightly in Fiscal Year 2019/20.
 - Transient Occupancy Taxes (TOT): TOT revenues are projected to increase by \$255,000 in Fiscal Year 2019/20 and \$504,000 in Fiscal Year 2020/21.

The majority of the increase is due to the construction of two new franchise hotels/motels in the City: Marriott Residence Inn and Hyatt House.

- Cannabis Revenues: Receipts from cannabis sales to the City are expected to total \$400,000 for the Fiscal Year 2018/19. The forecast includes a reasonable estimate of \$500,000 in cannabis sales receipt and \$120,000 in manufacturing fees.
- Gas Tax Funds, including SB1: The City share of the gasoline taxes are projected to increase by \$430,000 in Fiscal Year 2019/20. The majority of the increase is due to the increase in fuel costs.
- Transit Development Act revenues: The Local Transportation Funds are projected at \$3.6 million for Fiscal Year 2019/20, an increase of \$600,000 or 22% from prior year. Approximately \$200,000 of the proposed increase will be used to offset the Yolo County Transportation District proposed increase in expenditures.

FY 2019/20 and 2020/21 Budget Summary - Expenditures

Total All Funds Expenditures for the City in FY 2019/20 are budgeted at \$204.0 million with General Fund expenditures totaling \$59.2 million. The financial forecast has a total programmed budget of \$177.8 million in FY 2019/20 of which General Fund is \$60.45 million. The proposed budget for Fiscal Year 2019/20 are approximately \$26.2 million higher than Fiscal Year 2020/21 due to the fact that fund balances are used to fund the on capital projects that run into multiple fiscal years.

The City is primarily a service-based agency, which requires people as its backbone. The total salaries and benefits expenditures in the proposed budget for General Fund for FY 2019/20 and FY 2020/21 is \$41.2 million and \$42.8 million, respectively. This expenditure category accounts for 70% of the total General Fund Budget. As per the long-term financial forecasting model, 2% cost of living adjustment assumptions have been incorporated. Pension costs are determined by PERS; for the 2019/20 year, we have budgeted \$13.0 million, a \$1.90 million (18%) increase over last year. As detailed in the Financial Forecast section of this document, we anticipate these costs will continue to grow for the next two decades before they are likely to subside. Retiree medical costs are estimated at \$6.8 million for the coming fiscal year, a slight increase from the \$6.3 million amount owed in 2018/19.

The long range forecasting model for the General Fund assumes up to one new position per fiscal year as a guideline. In this proposed budget, I am recommending for funding 3 new Firefighter I positions, a 75% Safe Routes to School position and a 50% Police Services Specialist. The addition of these positions are strategic and will better enable the City to address crucial public health and safety service needs, while creating offsetting savings in overtime expenditures and reducing overtime “burnout” (Fire Department staff). The new positions are described briefly below:

- General Fund
 - **\$497, 547**, 3 New Full Time Equivalent (FTE) Firefighter I positions. These costs will be offset by actual overtime expenditures incurred by the General Fund. Based on the current overtime trend, the addition of three new firefighters may result in a budget savings of approximately \$382,832.

- **\$100,901**, 0.75 FTE Program Coordinator to coordinate the Safe Routes to Schools efforts. This effort has been grant-funded for the past three years, and the grant concludes June 1. The program works closely with local schools, educates children and families about safe cycling, and encourages families to bike or walk to school.
- **\$26,135**- 0.5 FTE Police Service Specialist to support the homeless outreach and code enforcement efforts.

Including the additional staffing adjustments as describe above, I am recommending a total of \$1.2 million in additional new funding, based on citywide departmental needs. Of this, \$605,000 is offset by corresponding revenue. As relates to the General Fund, ongoing General Fund costs equal \$227,710, onetime costs of \$366,046 and cost neutral (revenue credits offset increased expenditures) of appropriation \$605,000. The process used to prioritize supplemental requests included the cost to the General Fund, ongoing costs and offsetting revenue; expenditures that addresses priority areas for Council; and costs that were specifically safety and/or technology related.

Supplemental funding highlights include funding for:

- **\$500,000** (one time allocation) for initiation of a comprehensive update to the City Climate Action & Adaptation Plan (CAAP)
- **\$23,911** Continued funding for the increased capacity Sustainability Coordinator position.
- **\$60,800**, Funding of \$45,000 in temporary part-time salaries and benefits in the Parks Division to assist in maintaining the upcoming new downtown restrooms, recycle/trash bins, and irrigation in neighborhood parks. Funding of \$15,800 in temporary part-time salaries and benefits in Urban Forestry Division to assist with emergency storm response and annual block pruning.
- **\$175,000**- New funding request to absorb the increase in cost of election services due to new state mandates including improved certified election technologies, postage pre-paid ballots, etc. The City of Davis consolidates elections.
- **\$150,000**- New funding requests for the costs related to public safety, including implementation of a new tablet-based records management system in the Fire Department (\$9,000 ongoing); Personal Protective Equipment replacement (\$40,000 ongoing); enhanced evidence storage in the Police Department (\$34,000 one-time); and replacement of police safety equipment (\$67,000 one-time).
- **\$50,000***- New funding request based on the 2018-2020 memorandum of understanding (MOU) between City and Cool Davis
- **\$60,000** – New funding for a combination of items to use technology to be more efficient and responsive. A total of \$50,000 is being requested to pay for the cost of the software for plan review, support to implement real time inspection scheduling and update the status of the electronic plan review. A total of \$10,000 appropriation is to pay for the costs of tablets, phones, monitors, and other hardware needed as part of the electronic plan review.
- **\$117,000**- New ongoing funding for a Police Service Specialist- Homeless Outreach and Services (PSS-HOS). This new full time equivalent position in the Police Department will focus on the homeless outreach and services efforts. This

position will supplement the need to deliver services to clients 7 days a week; expand the office hours at the downtown substation (Hunt Boyer), increase ability to provide client transportation, improve caseload ratios, increase capacity to apply and manage grants, and increase ability to manage encampments.

**Offsetting revenue*

Technology Options/Implementations. City departments are continuously looking for opportunities to enhance or add new technologies to increase efficiencies and reduce costs. Examples include mobile data collection for Fire and Building, increased availability of online credit card payments and improved use of GIS data in service delivery. The City has commenced the process to replace or enhance the City's current backbone, the Enterprise Resource Planning (ERP) system. The FY 2019/20 budget allows the City staff to begin the evaluation of the proposed systems and determine the best fit for the organization, with a proposed launch by January 2021.

Labor. The City has been in negotiations with labor groups throughout 2018/19 and continues to try to reach mutually agreeable contracts with each of the labor groups. The City Council continues to explore opportunities to incorporate structural cost sharing through appropriate bargaining processes and a "total compensation" approach.

Capital Projects. Once again, the Proposed Budget emphasizes the importance of maintaining our existing infrastructure with a total of 54 new capital projects over the course of the year. Total capital expenditures account for \$66,041,880 of the All Funds Expenditures, with \$32,767,478 (50%) of the projects dedicated to transportation, \$24,739,272 (38%) to water/wastewater/drainage, and \$8,535,130 (13%) for parks/facilities/greenbelts. The proposed FY 2019/20 budget includes several projects to rehabilitate and upgrade aging wastewater infrastructure, Richards Blvd interchange project, downtown parking improvements, and upgrade to parks and recreation amenities. The Proposed Budget also includes funding for the Civic Center Gym roof truss repair and roofing replacement.

General Fund Reserve

The Council has set the General Fund reserve policy between 10-15%, with funds between the 10-15% available for consideration for capital projects or other one-time expenditures. The proposed budget anticipates a reserve of \$10.6 million (15.6%) at the end of FY 2019/20 and \$9.3 million of expenditures (14.6%), at the end of the FY 2020/21. A 10% Reserve would equal \$7.2 million, a difference of \$2.1 million. It is important to note that the reserve balance above the 10% minimum provides the City the ability to absorb any losses in revenue sources, help fund unforeseen capital expenditures (for example the Gymnasium repair), and settle any other expenses not included as part of the base budget.

Unfunded Liabilities/Ongoing Needs

The City has identified unfunded liabilities for employees, related primarily to pension and retiree medical costs and unfunded needs for infrastructure issues, whether roads, bike paths, parks or facilities. During 2017/18, staff completed studies to assist in further defining and pinpointing the city's unfunded liabilities and ongoing needs.

Pensions. CalPERS dictates the cost to an employer, and they are in the midst of increasing employer rates, decreasing their discount rate to 7.0%, and amortizing actuarial gains over 20 years rather than over 30. It is important to note that approximately 61% of all PERS retiree benefits are paid from the investment earnings; therefore, a decrease in discount rate has a substantial impact to the City's budget. As of June 30, 2017 valuation, the City of Davis unfunded accrued liability for all the pension plans are \$121.4 million, or 65.5% funded. CalPERS is currently 68% funded. The propose budget include an increase of \$1.5 million in FY 2019/20 and \$900,000 for FY 2020/21 in General Fund. Each of these actions results in higher costs to the City, with the City's projected pension costs to double by 2024/25. The good news is, that between the actions PERS is taking and the changes to state law related to retirement plans for new hires (also known as PEPPRA), the City's eventual unfunded pension gap will decrease toward the end of this financial model 20-year timeframe.

Other Post Employment Benefits (OPEB). The City continues to fully fund its current annual OPEB obligation, leaving a \$57.9 million unfunded liability.

Infrastructure. As discussed in the Long-term Forecast model chapter of the budget book, the City's infrastructure replacement costs continues to grow year over year. The City will need to add special funding sources to ensure that the infrastructure improvements are funded adequately in the near future. We will continue to have in-depth conversation with the Council on infrastructure needs and funding in the upcoming fiscal year.

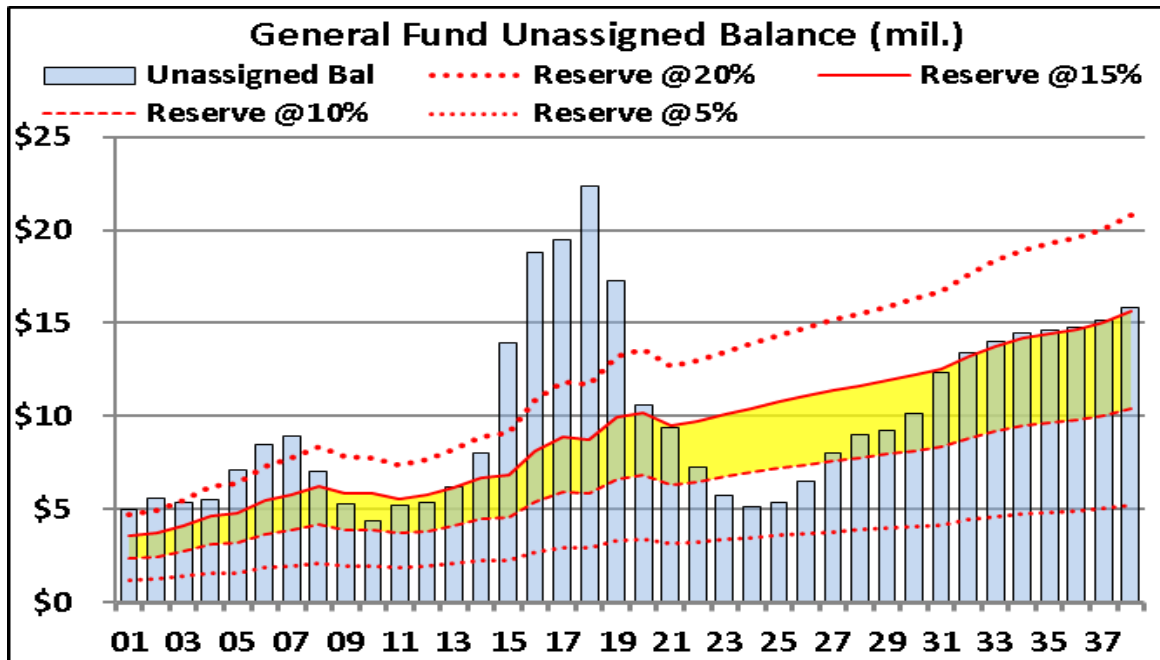
Financial Forecasting

In 2017, the City contracted with Bob Leland of Management Partners to develop a long-term, comprehensive financial forecasting model to assist staff in recommending, and the City Council in making, policy decisions. This model has been used throughout 2019/20 and 2020/21 to look at the General Fund effects of potential decisions and was also utilized in the development of the 2018/19 proposed budget. Although greater detail about the financial forecast can be found in Chapter 4 of this document, the forecast bears mention here.

Revenue projections in the model are based on private sector activities (business growth, property turnover, etc.) and public sector policies. The forecast makes the following major assumptions:

- existing taxes are maintained at their current levels
- recessions are every seven years (which begs the question as to whether we are overdue for a recession)
- property tax will grow at 2% with a 4% annual turnover, and sales tax growth is roughly 2.5%
- inflation is 2% annually
- staffing increases no more than one full-time equivalent per year, with annual cost of living adjustments of 2%
- employer costs from CalPERS for retirement benefits

The chart below comes from the Financial Forecast chapter. While only focusing on the General Fund, the chart depicts the city's general financial health over the next two decades.



Infrastructure Needs and Funding

The City has a major investment in its infrastructure – streets, bike paths, parks and public buildings – which is valued on the city's books at \$367.6 million as of June 30, 2018. Although these public investments are depreciated for accounting purposes, the reality is that most of this infrastructure will never be replaced outright at the end of its theoretical "useful life", but rather will be continuously maintained, so that it will be around long after that useful life of 25 to 75 years, depending on the asset. The City has various revenues that are earmarked for infrastructure maintenance and improvements, such as the park tax, the construction tax, and the state gas tax (which was recently increased by SB 1). Development fees for streets, parks, and buildings are dedicated to infrastructure improvements needed to mitigate the effects of new development, but these one-time fees can't be used to maintain pre-existing infrastructure.

The following table summarizes the funding plan for infrastructure over the forecast period. It identifies the funding need by infrastructure category, shows the major funding sources, including the General Fund, and shows the resulting funding gap.

Infrastructure Needs Summary (FY 2015-16 through FY 2037/38)								
(\$ in Millions)		(1) Streets	Bike Paths	(2) Traffic	Park Maint	Public Facilities	Parking Lots	Totals
Funding Need		182.2	25.2	106.8	100.1	27.0	4.3	445.6
Funding Sources	General Fund	55.6	15.3	26.6	14.8	13.9	0.0	126.1
	Meas H Park Tax	0.0	0.0	0.0	40.6	0.0	0.0	40.6
	SB 1 Gas Tax	27.2	0.0	0.0	0.0	0.0	0.0	27.2
	Cons Tax/Impact Fee	21.6	0.0	0.0	0.0	0.0	0.0	21.6
	Gas Tax/Grants	7.6	0.0	0.0	0.0	0.0	0.0	7.6
Total Funded		112.1	15.3	26.6	55.3	13.9	0.0	223.2
Net Funding Gap		70.1	9.9	80.2	44.7	13.2	4.3	222.4
% Funded		62%	61%	25%	55%	51%	0%	50%
(1) excludes curbs, gutters, sidewalks								
(2) includes curb, gutter, sidewalks, signs, striping, pavement marking, signals and street lighting								

The Council has agreed to the forecast assumption setting the overall funding level at 50% of the identified total need. While acknowledging that this is not full funding, the City has taken a major step to understand its long-term needs and to work toward long-term solutions. Continued progress on implementing service delivery efficiencies, cost containment, and revenue generation through economic development and other measures will be crucial to reducing the funding gap over time.

Conclusion

The 2019/20 Proposed Budget and 2020/21 Financial Plan addresses Council priorities and achieves or sets in motion many of my goals as City Manager. It sets the tone for a productive and respectful city organization, where outstanding customer service is paramount; communication both internally and externally, is clear, transparent, and effective; staff are well-trained and skilled at their jobs; technology is harnessed for effective service delivery; and where city policies help to promote, rather than hinder, a diverse and resilient local economy.

We must balance our need to address long-term liabilities with the equally pressing need to serve the citizens, visitors and businesses of Davis today. The budget must be able to position the organization well to handle both tasks.

The budget each year is a team effort, with employees in every department working with our budget staff to compile numbers, projects, achievements and goals. The efforts that go in to creating this document should not be overlooked. Finally, I would like to thank my Executive Team and city staff for their dedication to service and their continued efforts towards innovations and efficiencies to implement council goals and vision.

Respectfully submitted,



Michael Webb
City Manager