City of Westminster Financial Review

Irwin B. Bornstein, CPA
Financial Consultant to the City
November 2015

Topics to be Discussed

- How Big Are The Deficits?
  - General Fund
  - FYs 2015-16, 2016-17 and 2017-18
  - Original estimates vs revised estimates
  - "Budget Deficits" vs "Structural Deficits"
- How Much Time Do We Have to Solve the Budget Problem?
- Underlying Causes of the Deficits
- Possible Solutions

Part I. How Big Are The Deficits?

- Definitions
  - "Budget Deficit"
    - Shortfall of <u>annual</u> inflows vs annual outflows
    - <u>Includes</u> "budget band-aids" (e.g., using other funds' reserves) and one-time revenues
    - Annual budget presentations typically focus on "budget deficits"
  - "Structural Deficit"
    - Shortfall of <u>ongoing</u> inflows vs ongoing outflows
    - <u>Excludes</u> "budget band-aids" and one-time revenues
    - Includes long-term expenditure needs
- Focusing on how to fund a "budget deficit" gets you through each year, one year at a time
- Focusing on the "structural deficit," especially controlling any projected growth in the "structural deficit," solves the budget problem for the long-term

FY 2015-16 "Budget Deficit"

- As presented in the FY 2015-16 Adopted Budget (June 2015)

General Fund	Amount
Revenues	$ 45.4 million
Expenditures	-55.3 million
Difference Between Revenues and Expenditures	- 9.9 million
Other Financing Sources/(Uses)	4.5 million
Net Change in Fund Balance	- 5.4 million
Transfer from Reserve Fund (Fund 800)	1.6 million
"Budget Deficit"	**$ - 3.8 million**

FY 2015-16 "Budget Deficit"

- A different way of looking at the same numbers
- Rearranged to separate external revenues from internal revenues
- Provides better picture of net operating expenditures

FY 2015-16 General Fund Budget (Rearranged)		Amount
External Revenues		$ 44.9 million
Gross Operating Expenditures	$ -55.2 million	
Staff Allocations to Other Funds	3.9 million	
Net Operating Expenditures		-51.3 million
Net Operating Expenditures Over External Revenues		**- 6.4 million**
Overhead Charges to Other Funds		1.1 million
Transfers to Other Funds		- 0.1 million
Transfers from Reserve Fund (Fund 800)		1.6 million
"Budget Deficit"		**$ - 3.8 million**

Review of FY 2015-16 Budget

- All budgets are a "snapshot" in time; more information is now available
- Revenues were very conservatively estimated
- Reasonable to assume an additional $1.1 million will be received
  - Property tax (+$0.6 million) – 8% actual growth in assessed valuation
  - Sales tax (+$0.8 million) – revised estimates from HdL, inclusion of Costco and Dillon RV in estimate
  - Other revenues (Utility User Tax [UUT], Administrative Allowance from Successor Agency to Westminster Redevelopment Agency [SAWRA], various other sources) (-$0.3 million net)
- Expenditure estimates generally appear reasonable
- OCFA costs for FY 15-16 were over-estimated by $0.1 million
  - Based on final amount from OCFA, not available at the time of budget adoption
- Revised "Budget Deficit" for FY 15-16 = $2.6 million
  - $3.8 million - $1.1 - $0.1 = $2.6 million

FY 2015-16 "Budget Deficit" - Revised

General Fund	Adopted (As Rearranged)	Changes in Estimates	Revised
External Revenues	$44.9 million	$1.1 million	$46.0 million
Net Operating Expenditures	- 51.3 million	0.1 million	- 51.2 million
Net Operating Expenditures Over External Revenues	**- 6.4 million**	**1.2 million**	**- 5.2 million**
Overhead Charges	1.1 million		1.1 million
Transfers To Other Funds	- 0.1 million		-0.1 million
Transfers From Other Funds	1.6 million		1.6 million
"Budget Deficit"	**-$ 3.8 million**	**$1.2 million**	**- $2.6 million**

FY 2016-17 "Budget Deficit"

- Projection of $-3.9 million was included in the FY 2015-16 Adopted Budget

	Amount
Revenues	$ 45.0 million
Expenditures	-56.7 million
Difference Between Revenues and Expenditures	-11.7 million
Other Financing Sources/(Uses)	4.3 million
Net Change in Fund Balance	- 7.4 million
Transfer from Reserve Fund (Fund 800)	2.2 million
Transfers from Other Funds	1.3 million
"Budget Deficit"	**$ - 3.9 million**

FY 2016-17 "Budget Deficit"

- FY 2016-17 Budget rearranged in the same way as the FY 2015-16 Budget:

FY 2016-17 General Fund Budget (Rearranged)		Amount
External Revenues		$ 45.1 million
Gross Operating Expenditures	$ -56.7 million	
Staff Allocations to Other Funds	3.9 million	
Net Operating Expenditures		-52.8 million
Net Operating Expenditures Over External Revenues		**- 7.7 million**
Overhead Charges to Other Funds		0.4 million
Transfers to Other Funds		- 0.1 million
Transfers from Reserve Fund and Other Funds		3.5 million
"Budget Deficit"		**$ - 3.9 million**

Review of FY 2016-17 Budget

- Revenues very conservatively estimated
- Reasonable to assume an additional $1.3 million will be received
  - Revised HdL estimates for property and sales tax revenue (+$2.1 million)
  - Lower estimates for other taxes, charges for services and SAWRA admin allowance (-$0.8 million)
- Expenditures over-estimated by $0.5 million
  - Fire contract cost based on final OCFA estimate, rather than maximum 4.5% growth (-$0.4 million)
  - Police transfer to SLESF was double-counted in Adopted Budget (-$0.1 million)
  - Does not account for any changes that may result from future employee negotiations

FY 2016-17 "Budget Deficit" - Revised

General Fund	Adopted (as Rearranged)	Changes in Estimates	Revised
External Revenues	$ 45.1 million	$ 1.3 million	$ 46.4 million
Net Operating Expenditures	- 52.8 million	0.5 million	- 52.3 million
Net Operating Expenditures Over External Revenues	**- 7.7 million**	**1.8 million**	**- 5.9 million**
Overhead Charges	0.4 million		0.4 million
Transfers to Other Funds	- 0.1 million		- 0.1 million
Transfers from Other Funds	3.5 million		3.5 million
"Budget Deficit"	**$ - 3.9 million**	**$ 1.8 million**	**$ - 2.1 million**

FY 2017-18 "Budget Deficit"

- Projection of $-9.6 million was included in the FY 2015-16 Adopted Budget

(in $ millions)	Amount
Revenues	$ 45.8 million
Expenditures	-58.5 million
Difference Between Revenues and Expenditures	-12.7 million
Other Financing Sources/(Uses)	3.1 million
Net Change in Fund Balance	- 9.6 million
Transfer from Reserve Fund	-
Transfers from Other Funds	-
"Budget Deficit"	**$ - 9.6 million**

FY 2017-18 "Budget Deficit"

- FY 2017-18 Budget rearranged in the same way as the FY 2015-16 Budget:

FY 2017-18 General Fund Budget (Rearranged)		Amount
External Revenues		$ 45.7 million
Gross Operating Expenditures	$ -58.5 million	
Staff Allocations to Other Funds	3.5 million	
Net Operating Expenditures		-55.0 million
Net Operating Expenditures Over External Revenues		**- 9.3 million**
Overhead Charges to Other Funds		0.4 million
Transfers to Other Funds		- 0.7 million
Transfers from Reserve Fund (Fund 800)		-
"Budget Deficit"		**$ - 9.6 million**

Review of FY 2017-18 Budget

- Revenues very conservatively estimated
- Reasonable to assume an additional $1.7 million will be received
  - Based on FY 17-18 HdL estimates for property and sales tax revenue (+$2.3 million)
  - Lower estimates for other taxes, charges for services and interest (-$0.6 million)
- Expenditures over-estimated by $1.5 million
  - Police costs appear to be over-estimated ($0.7 million)
    - 2.5% had been the assumed growth over FY 16-17, while other departments based on 1% growth
    - PERS cost increase over-estimated
  - Fire contract cost also appears to be over-estimated ($0.3 million)
    - Using more current OCFA estimate of 3.87% increase, vs previous estimate of 4% growth over FY 16-17
  - Staff allocations to General Benefits Fund had been reduced to zero due to lack of funds; now funds are projected to be available through FY 17-18 ($0.4 million)
  - Elections budget can be reduced (non-election year) ($0.1 million)
  - Does not account for any changes that may result from future employee negotiations

FY 2017-18 “Budget Deficit” - Revised

General Fund	Adopted (as Rearranged)	Changes in Estimates	Revised
External Revenues	$ 45.7 million	$ 1.7 million	$ 47.4 million
Net Operating Expenditures	- 55.0 million	1.5 million	- 53.5 million
Net Operating Expenditures Over External Revenues	**- 9.3 million**	**3.2 million**	**- 6.1 million**
Overhead Charges	0.4 million	-	0.4 million
Transfers to Other Funds	- 0.7 million	-	- 0.7 million
Transfers from Other Funds	-	-	-
“Budget Deficit”	**$ - 9.6 million**	**$ 3.2 million**	**$ - 6.4 million**

Projected “Budget Deficits” - Revised Summary

General Fund	Original Estimates	Revised Estimates
FY 2015-16	$ - 3.8 million	$ - 2.6 million
FY 2016-17	- 3.9 million	- 2.1 million
FY 2017-18	- 9.6 million	- 6.4 million
Total	**$ - 17.3 million**	**$ - 11.1 million**

- Net improvement of $6.2 million over three years

Projected "Budget Deficits" – Revised Detail

General Fund	FY 2015-16	FY 2016-17	FY 2017-18
External Revenues	$ 46.0 million	$ 46.4 million	$ 47.4 million
Net Operating Expenditures	- 51.2 million	- 52.3 million	- 53.5 million
Net Operating Expenditures Over External Revenues	**- 5.2 million**	**- 5.9 million**	**- 6.1 million**
Overhead Charges	1.1 million	0.4 million	0.4 million
Transfers to Other Funds	- 0.1 million	- 0.1 million	- 0.7 million
Transfers from Other Funds	1.6 million	3.5 million	-
"Budget Deficit" - Revised	**$ - 2.6 million**	**$ - 2.1 million**	**$ - 6.4 million**
"Budget Deficit" - Previous	**$ - 3.8 million**	**$ - 3.9 million**	**$ - 9.6 million**

What is a “Structural Deficit”?

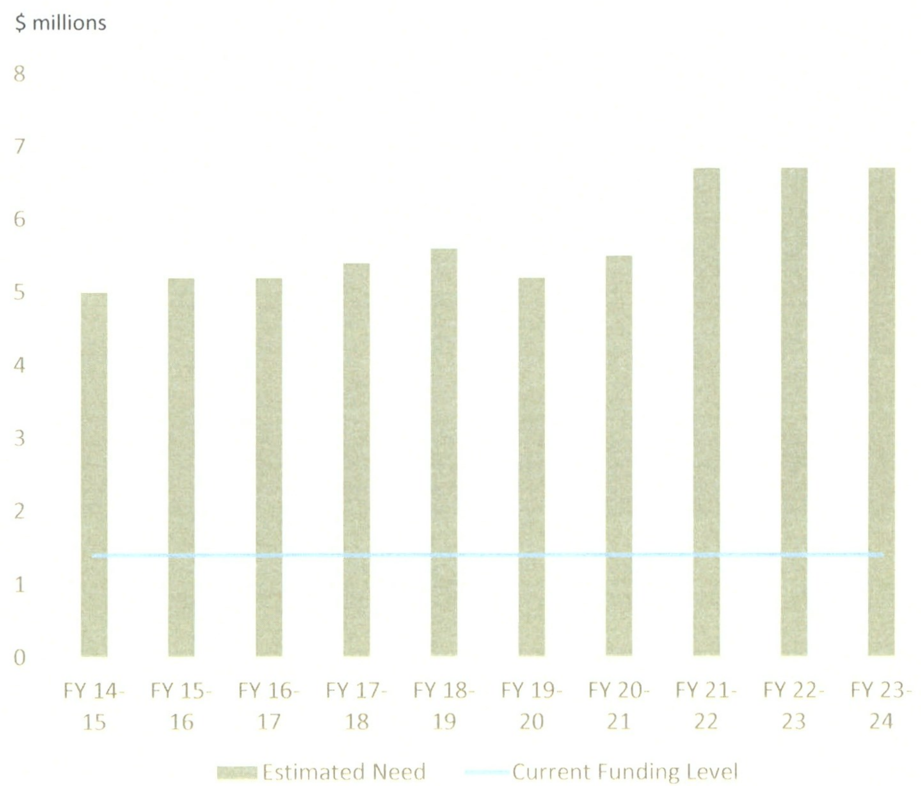
- Start with the “Budget Deficit”
- Remove one-time revenues and expenditures, and revenues that are unreliable for the long-term
- Remove the “band-aid” fixes (for example, use of reserves)
- Add in long-term expenditure needs not currently being fully addressed
  - Infrastructure needs - streets
  - Other post-employment benefits (retiree health benefits)
  - There are others (such as capital asset replacement) not addressed in this presentation

Importance of the "Structural Deficit"

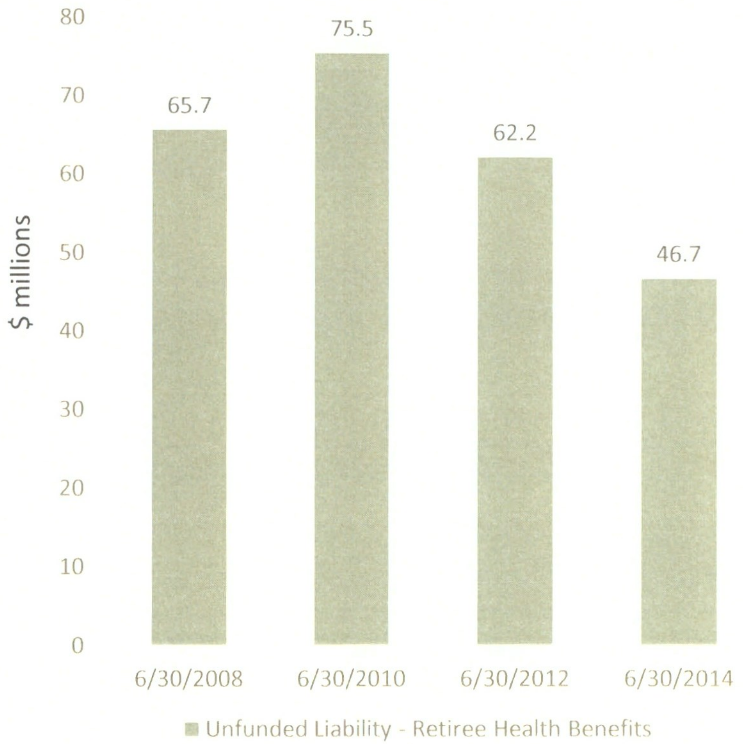
- The "Structural Deficit" is the big budget issue that needs to be addressed to achieve long-term fiscal sustainability
- Budget difficulties will persist until the "Structural Deficit" problem is solved
- Solving the "Structural Deficit" problem can be difficult and can take time
- The keys to long-term fiscal sustainability
  - Eliminating the "Structural Deficit"
    - Ongoing revenues need to be greater than or equal to ongoing expenditures
  - Preventing the recurrence of a "Structural Deficit"
    - Going forward, the growth in ongoing expenditures needs to be kept in line with the growth in ongoing revenues

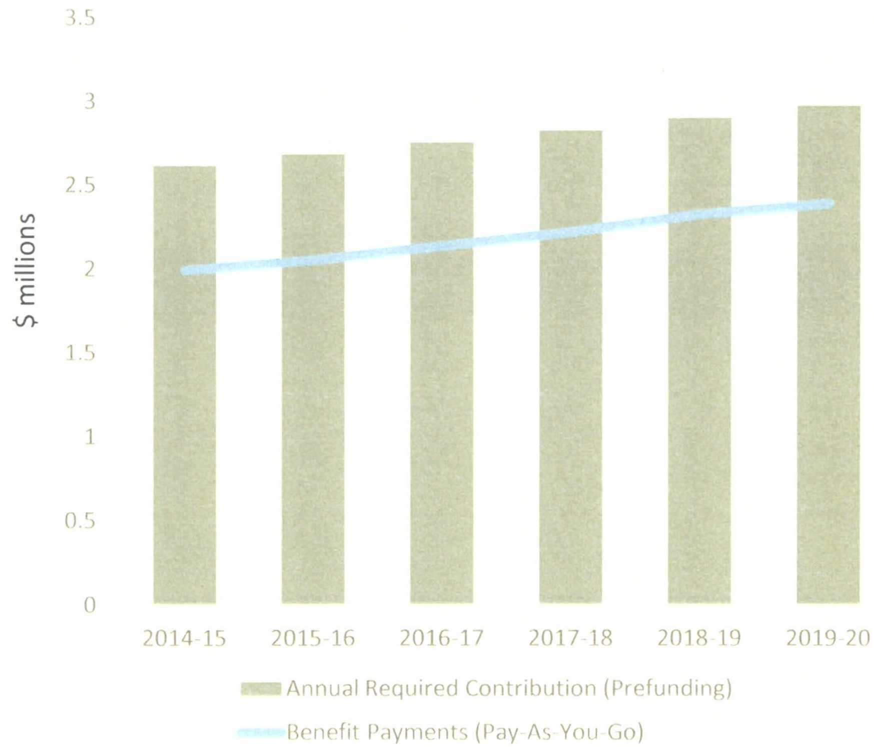
Infrastructure Needs - Streets

- Based on 2014 Pavement Management Study by Bucknam and Associates
- Pavement condition has declined in recent years, but still “Good” (PCI = 76.7)
- $5.0-$6.7 million per year needed to address all streets during the next 10 years
- Only $1.4 million available from Gas Tax and Measure M revenues
- Redevelopment’s IRP program used to provide $5 million per year
- $3.8-$4.0 million per year funding gap for next three years
- These expenditures will improve PCI to 79.6



Other Post-Employment Benefit (OPEB) Obligations





FY 2015-16 "Structural Deficit"

FY 15-16 General Fund "Budget Deficit" (revised)	$ -2.6 million
Sales Tax "Triple Flip" wind down (extra payment this year only)	- 1.0 million
SERAF repayment (short-term reduction in residual property tax revenue)	0.2 million
SAWRA administrative charge (amount declining)	-0.2 million
Overhead charges to other funds (unreliable for long-term)	-1.1 million
Stipend payment to employees (one-time expenditure)	0.3 million
Transfer from Reserve Fund (short-term solution only)	-1.6 million
Under-charges from Internal Service Funds (short-term budget fix)	-2.2 million
Infrastructure Needs – Streets -- additional funding needed to prevent further decline and slightly improve overall condition level	-3.8 million
Other Post-Employment Benefit (OPEB) – actuarial prefunding of retiree health insurance obligation vs pay-as-you-go (addresses a significant unfunded liability)	-0.6 million
FY 15-16 General Fund "Structural Deficit"	**$ -12.6 million**

FY 2016-17 "Structural Deficit"

FY 16-17 General Fund "Budget Deficit" (revised)	$ -2.1 million
SERAF repayment (short-term reduction in residual property tax revenue)	0.2 million
Overhead charges to other funds (unreliable for long-term)	-0.4 million
Transfers in from Reserve Fund and other funds (short-term solution)	-3.5 million
Under-charges from Internal Service Funds (short-term budget fix)	-2.2 million
Infrastructure Needs – Streets -- additional funding needed to prevent further decline and slightly improve overall condition level	-3.8 million
Other Post-Employment Benefit (OPEB) – actuarial prefunding of retiree health insurance obligation vs pay-as-you-go (addresses a significant unfunded liability)	-0.6 million
FY 16-17 General Fund "Structural Deficit"	**$ -12.4 million**

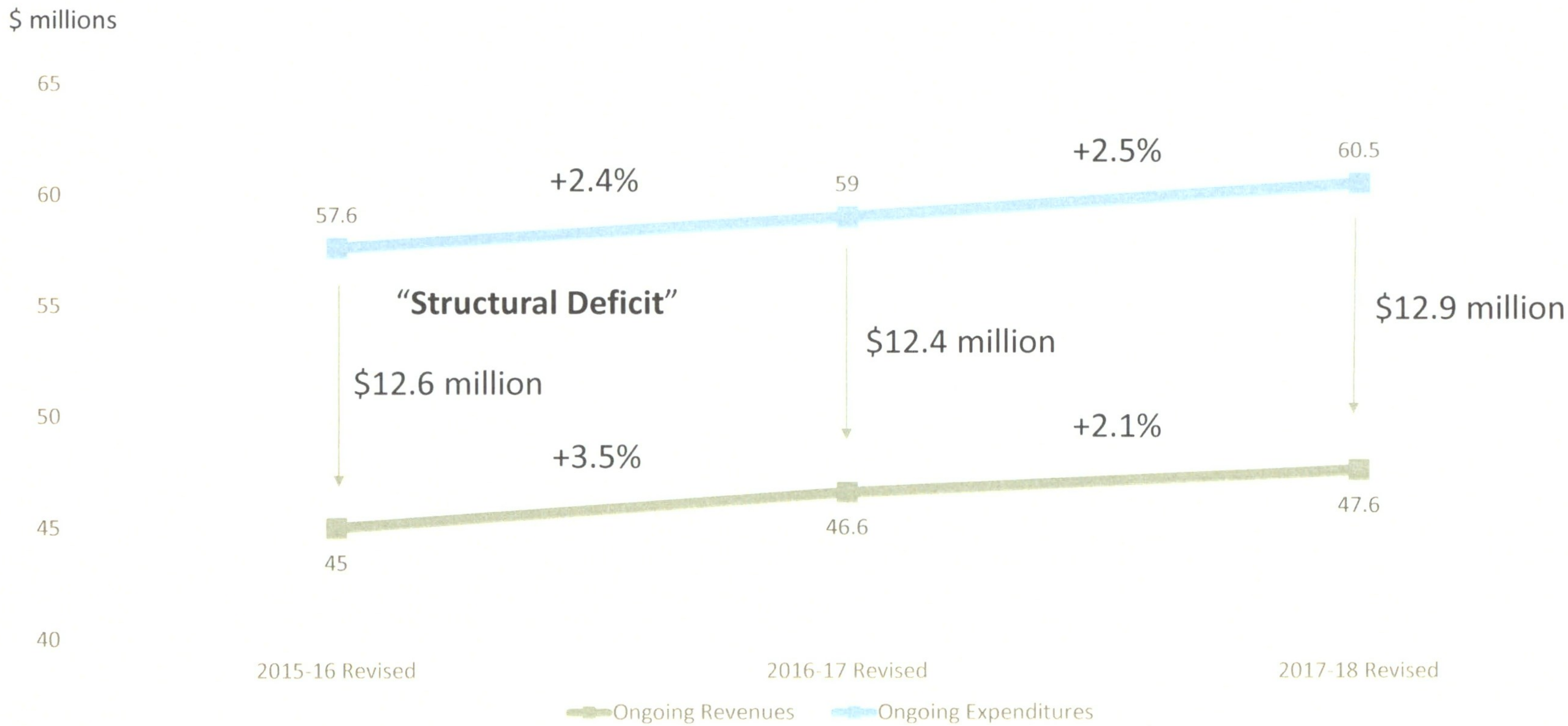
FY 2017-18 “Structural Deficit”

FY 17-18 General Fund “Budget Deficit” (revised)	$ -6.4 million
SERAF repayment (short-term reduction in residual property tax revenue)	0.2 million
Overhead charges to other funds (unreliable for long-term)	-0.4 million
Transfer to Information Technology Fund (included on next line)	0.5 million
Under-charges from Internal Service Funds (short-term budget fix)	- 2.2 million
Infrastructure Needs – Streets – additional funding needed to prevent further decline and slightly improve overall condition level	- 4.0 million
Other Post-Employment Benefit (OPEB) – actuarial prefunding of retiree health insurance obligation vs pay-as-you-go (addresses a significant unfunded liability)	-0.6 million
FY 17-18 General Fund “Structural Deficit”	**$ -12.9 million**

"Budget Deficits" vs "Structural Deficits"

	"Budget Deficit" (original estimates)	"Budget Deficit" (revised estimates)	"Structural Deficit"
FY 2015-16	$ -3.8 million	$ -2.6 million	$ -12.6 million
FY 2016-17	-3.9 million	-2.1 million	-12.4 million
FY 2017-18	-9.6 million	-6.4 million	-12.9 million
Totals	**$ -17.3 million**	**$ -11.1 million**	**$ -37.9 million**

Projected "Structural Deficits" - FY 2015-16 to FY 2017-18



Part II. How Much Time Do We Have to Solve the Budget Problem?

- Available fund balances are the major determining factor for how much time is available to solve the "Structural Deficit" problem
- Most fund balances are either restricted by outside parties or represent capital assets that are not spendable

	Amount
Total fund balances/net position at 6/30/14 (per CAFR)	$ 128.3 million
FY 2014-15 results – all funds combined	- 7.6 million *
Total fund balances/net position at 6/30/15	120.7 million
Less: Restricted by outside parties or capital assets	- 81.9 million *
Less: 800 MHz project set-aside	- 3.7 million
Total available fund balances at 6/30/15 – all funds	**$ 35.1 million ***

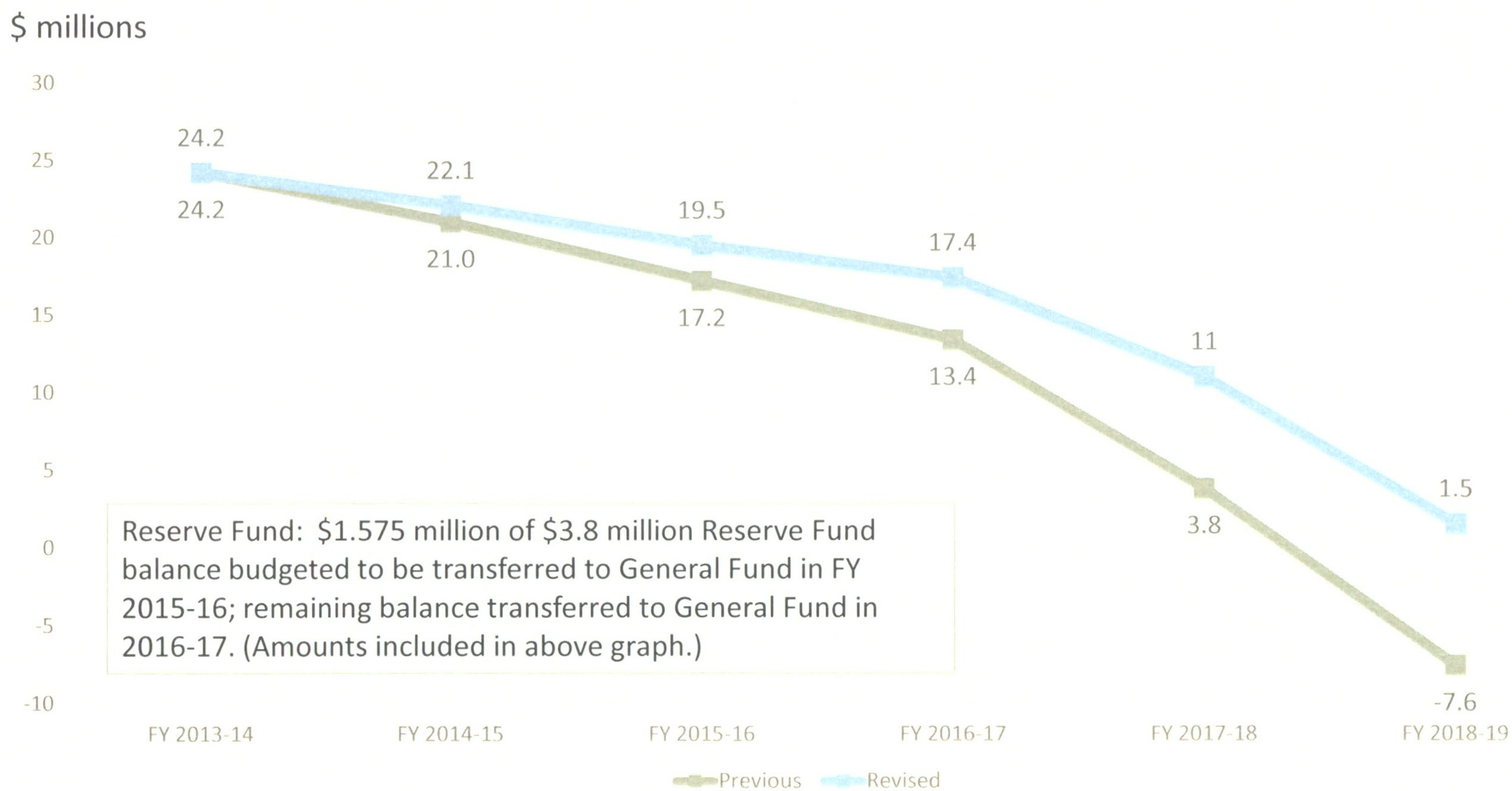
* Preliminary - unaudited

Available Fund Balances at 6/30/15

- The Capital Projects Fund balance includes balances for projects underway as well as for projects not yet started
- The Rose Center/800MHz Fund balance covers remaining debt service obligations
- Gas Tax and Street Improvements deficit will be remedied from restricted revenue
- Internal Service Funds, Reserve Fund and General Fund balances are the most available - $31.8 million

	Amount
Total available fund balances at 6/30/15 – all funds	**$ 35.1 million**
Capital Projects Fund – CIPs	*2.2 million*
Rose Center/800 MHz Debt Service Fund	*1.4 million*
Gas Tax and Street Improvements Funds deficit	*- 0.3 million*
Internal Service Funds - combined	5.9 million
Reserve Fund – Fund 800	3.8 million
General Fund	22.1 million

General Fund – Fund Balance Projections

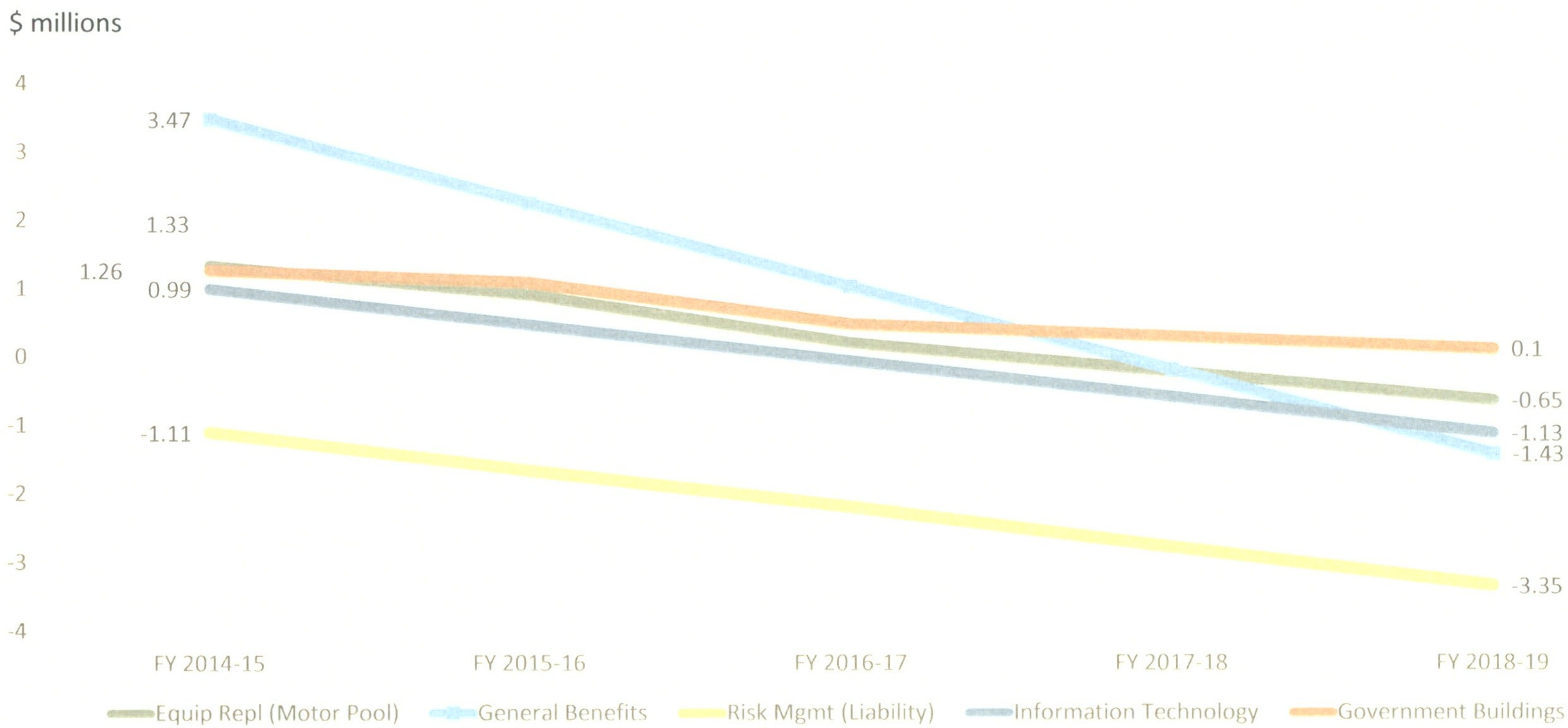


Internal Service Fund Balances

- Internal Service Funds are being used to help finance the General Fund budget deficits
- Departments are being under-charged for various services, to provide General Fund relief
- Fund balances in Internal Service Funds are being transferred to the General Fund
- These are short-term fixes that are not sustainable

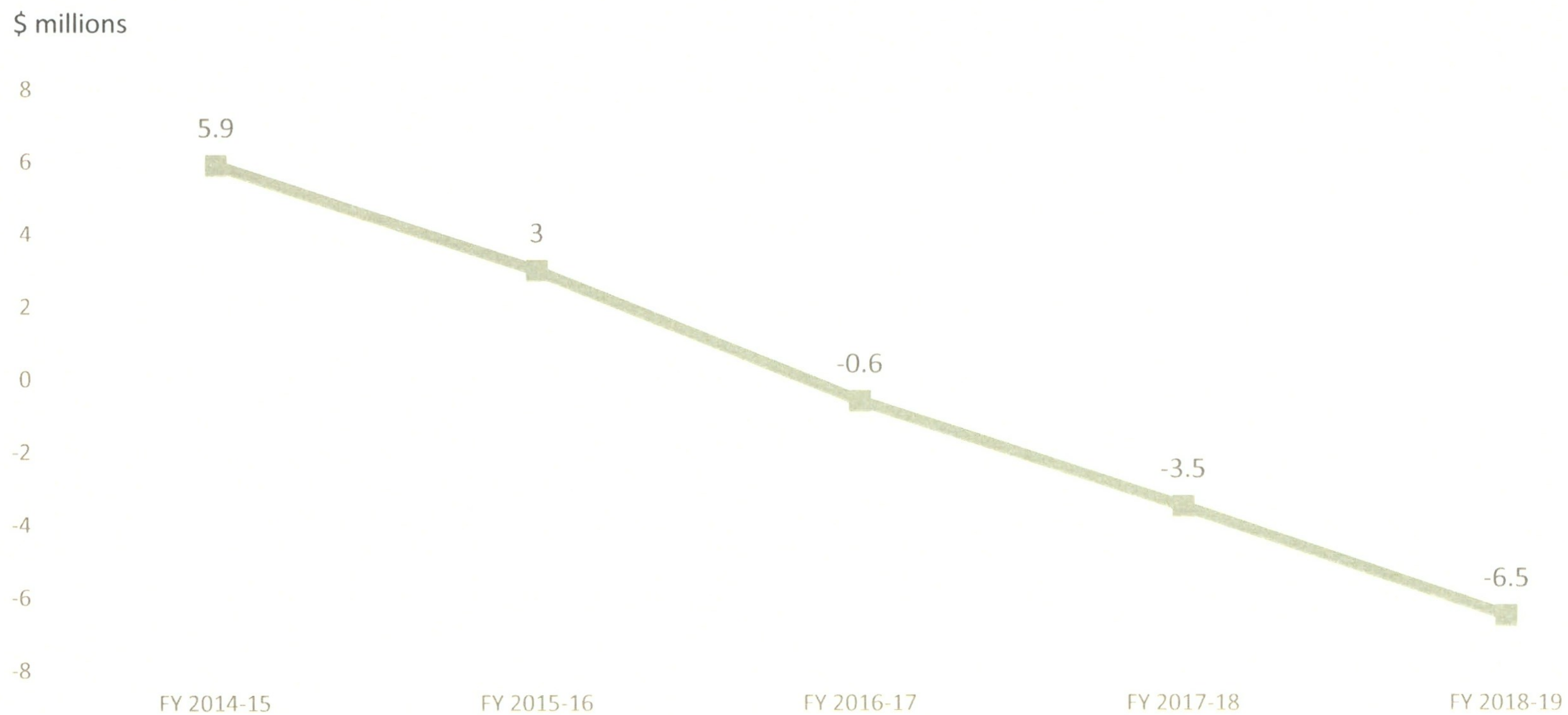
Fund	Fund Balance at 6/30/15
Equipment Replacement (Motor Pool)	$ 1,326,570
General Benefits	3,468,287
Risk Management (Liability)	-1,108,731
Information Technology	991,006
Government Buildings	1,258,478
Total	**$ 5,935,610**

Internal Service Fund Balance Projections
(based on Status Quo)



Internal Service Funds – Combined Fund Balance Projection

(Based on Status Quo)



Internal Service Fund Deficits

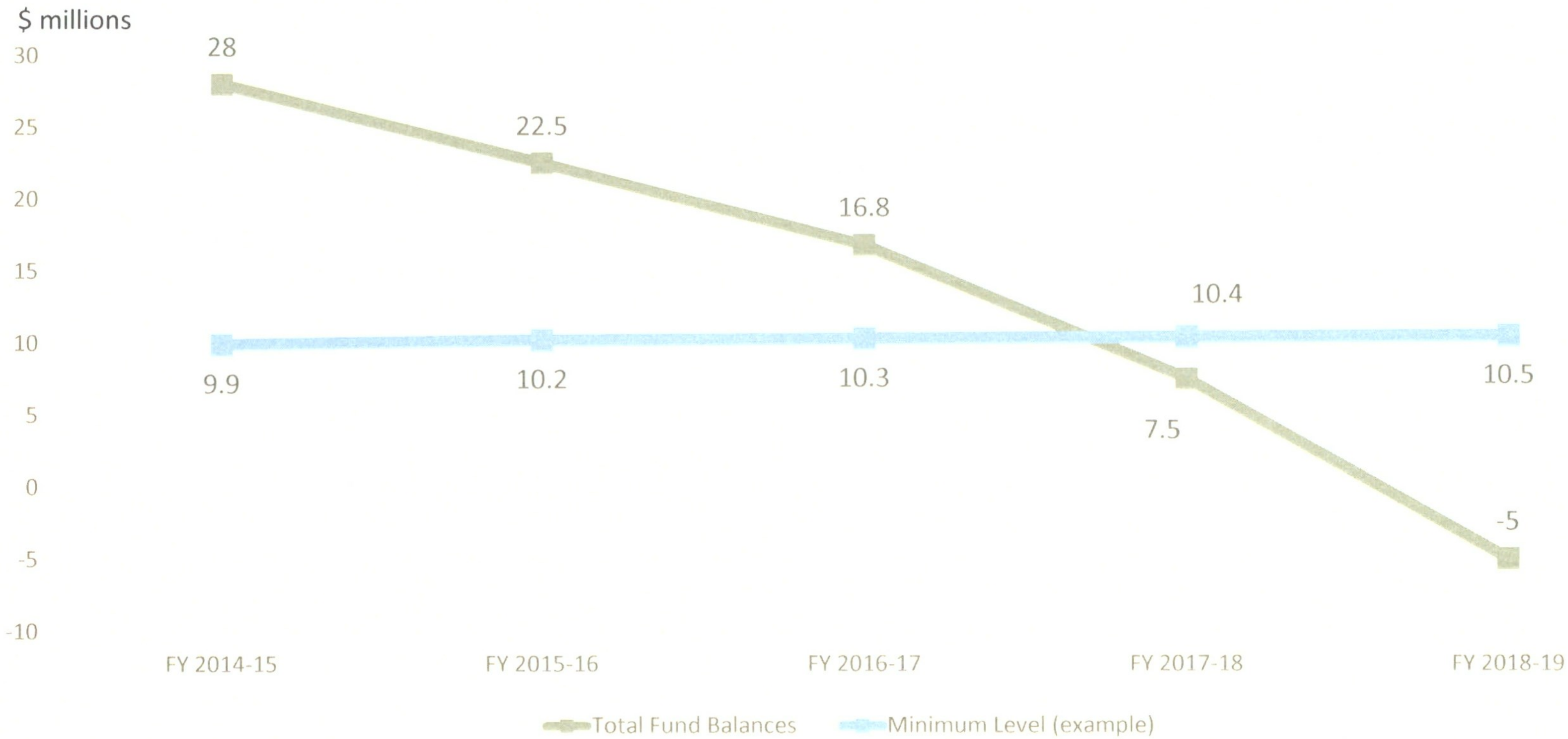
- Deficits are projected in the combined Internal Service Funds in FY 16-17, FY 17-18 and FY 18-19
- Deficits in Internal Service Funds are essentially borrowings from the General Fund
- Therefore, combining the General Fund and Internal Service Funds available balances provides the best picture of available resources

General Fund and Internal Service Funds -- Combined Fund Balances Projection

How Far Can Fund Balances Be Drawn Down?

- Having a certain amount of reserves is essential for operations
  - Cash flow requirements (uneven revenues and expenditures during the year)
  - Economic uncertainties (e.g., actual revenues less than budgeted)
  - Claims (e.g., additional resources may be needed for discrimination lawsuit)
- Government Finance Officers Association of US and Canada recommends a minimum fund balance in the General Fund equaling two months of revenues ($7.7 million in FY 15-16; $7.9 million in FY 17-18)
- City has previously targeted a minimum fund balance in each Internal Service fund of $0.5 million ($2.5 million total)
- The combined minimum fund balance amount of $10.4 million for FY 17-18 is greater than the combined projected ending fund balances at June 30, 2018

Total General and Internal Service Funds Combined Fund Balances Projection



Part III. Underlying Causes of the Deficits

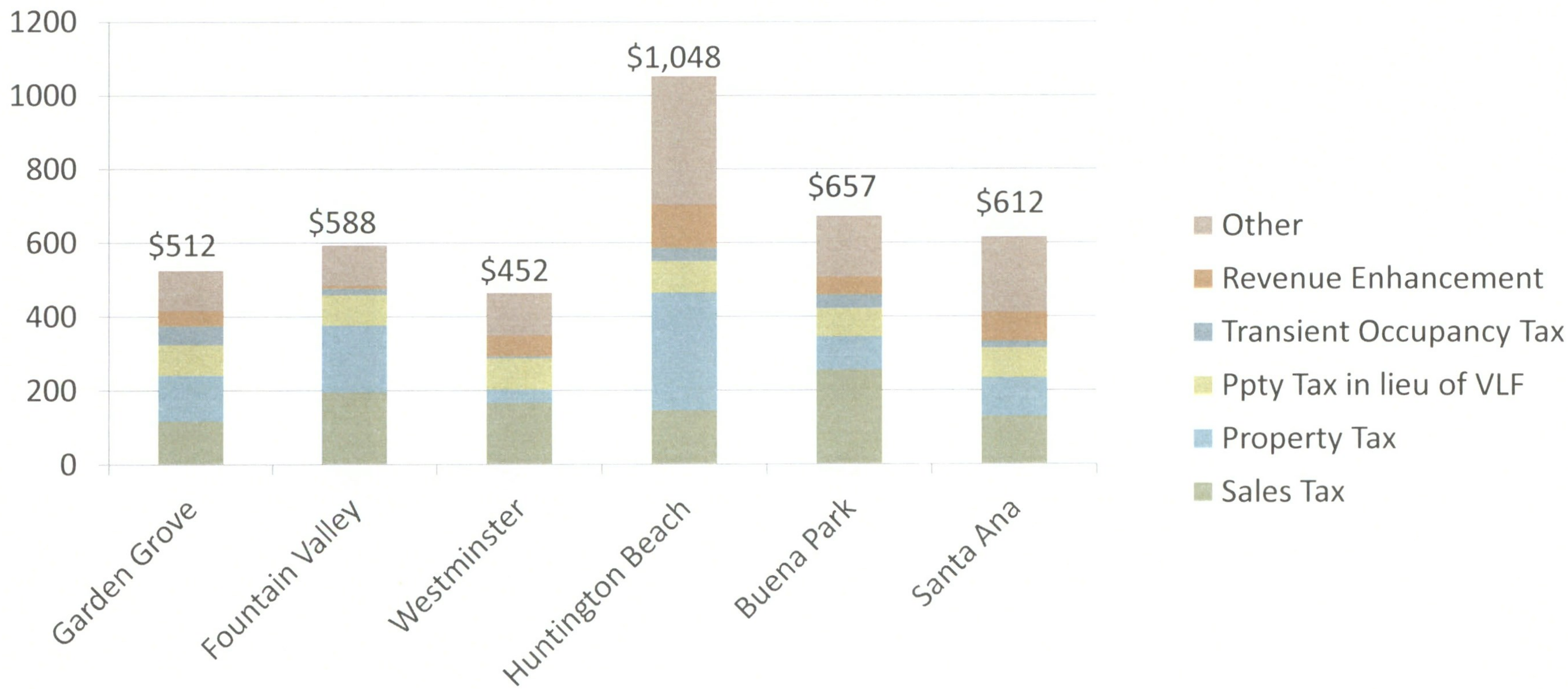
- General Fund deficits are not new
- General Fund "Budget Deficits" have gradually increased, but, more importantly, estimated "Structural Deficits" have declined over the past 3 years

	FY 2011-12	FY 2012-13	FY 2013-14	FY 2014-15
"Budget Deficit" (actual)	$ - 0.4 million	$ - 1.0 million	$ - 1.8 million	$ -2.0 million
"Structural Deficit" (estimated)	$ - 12.9 million	$ -10.5 million	$ - 10.1 million	$ -9.8 million

One Underlying Cause of the Deficits – Westminster's Revenue Base

- There are major weaknesses in Westminster's general revenue base
  - Study by Rosenow Spevacek Group in FY 2014-15
  - Total general revenues per capita of $452, compared to an average of $683 for five neighboring cities (FY 2014-15)
    - Garden Grove, Fountain Valley, Huntington Beach, Buena Park and Santa Ana
  - Westminster is a "low property tax" city
    - City receives just 7.8 cents of every property tax dollar paid by property owners
      - For a median home value of $500,000, just $390 per year goes to the City in property tax revenue
    - $37 of property tax revenue per capita per year, compared to an average of $164 for the five neighboring cities
  - Fewer hotel rooms per capita than the neighboring cities
    - Transient occupancy tax (TOT) revenue of $6 per capita, compared to an average of $32

General Revenues Per Capita



Rosenow Spevacek Group, May 2015 (based on FY 2014-15 adopted budgets)

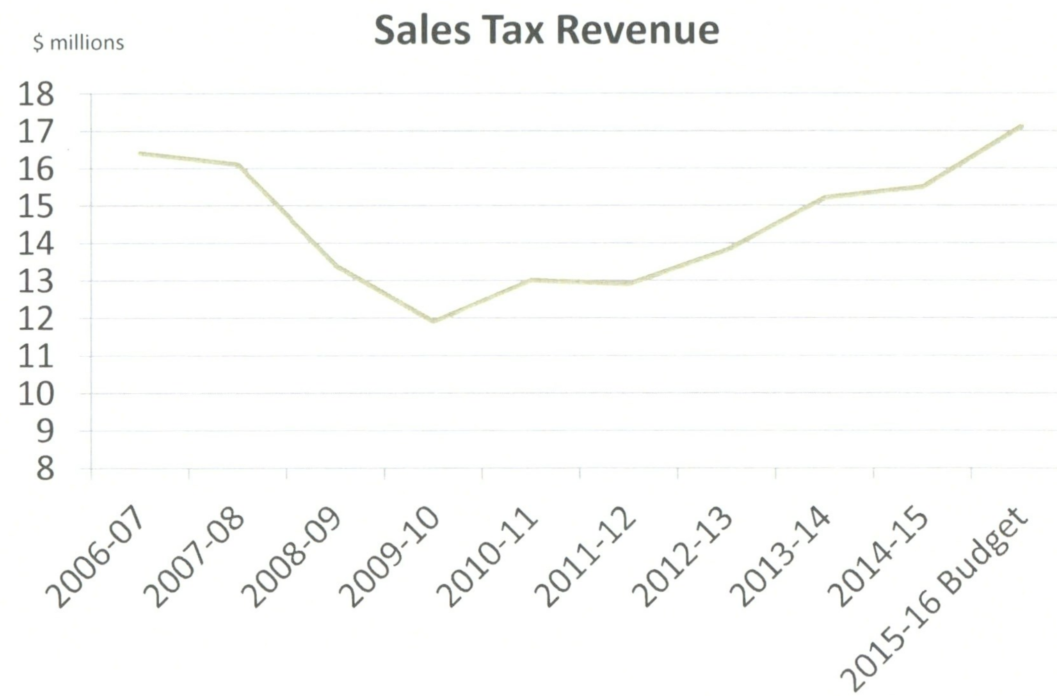
Westminster's Weak Revenue Base

- Low property tax and transient occupancy tax revenues translate to over $14 million less revenue annually for Westminster, compared to our neighbors

	Property Tax	Transient Occupancy Tax
Average of 5 cities (per capita)	$ 164	$ 32
Westminster (per capita)	37	6
Shortfall	127	26
X Population	92,106	92,106
Total revenue shortfall, compared to neighboring cities	$11,697,462	$ 2,394,756

Sales Tax Revenue Lost From The "Great Recession"

- The Great Recession resulted in a seven-year "trough" in sales tax revenue
- FY 15-16 should finally surpass FY 07-08 sales tax revenue
- "Trough" represents a total revenue loss of $ 17 million over the past seven years
  - Even assuming zero growth over FY 07-08 levels

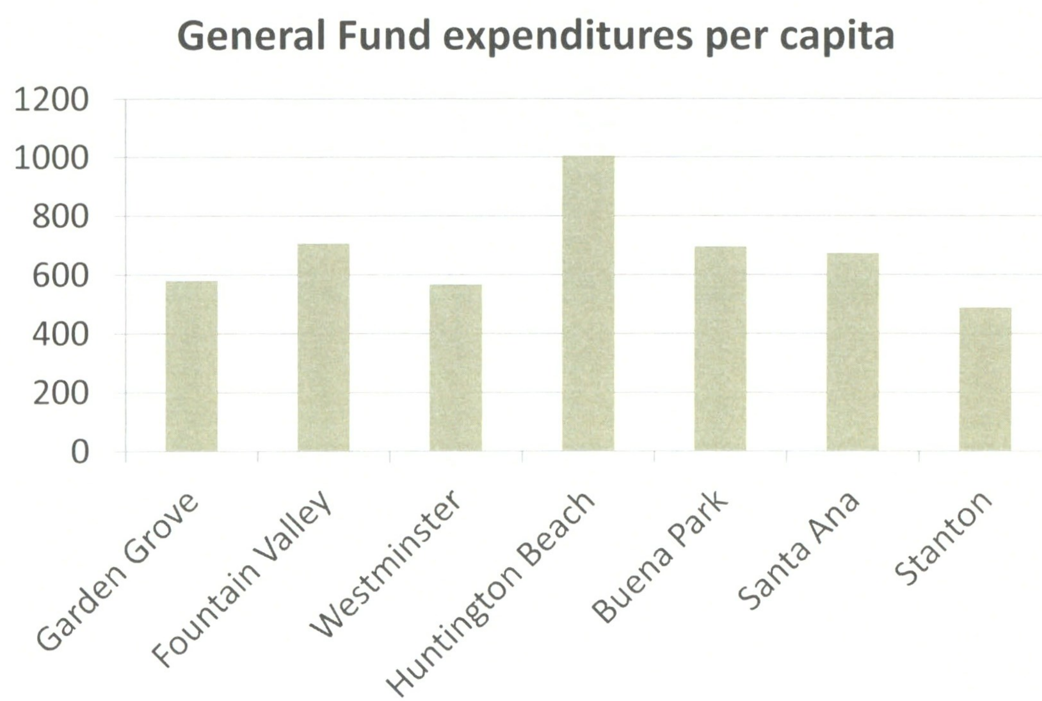


Loss of Redevelopment in 2012

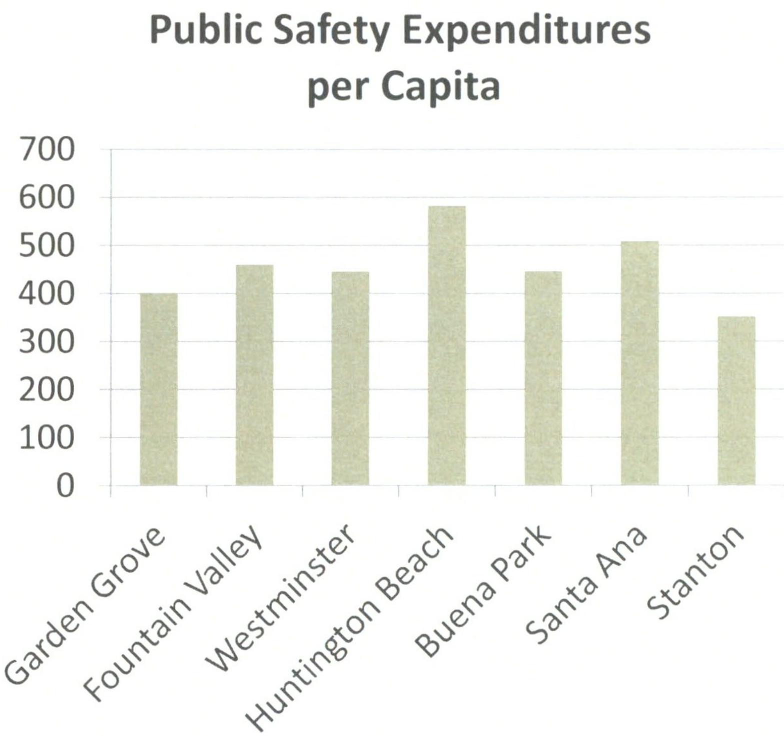
- Redevelopment project areas encompassed the entire City
- Loss of redevelopment hit the City's General Fund as well as economic development efforts
- Redevelopment used to provide significant funding to offset the cost of basic City services
  - FY 2010-11 – approximately $6 million
- Infrastructure Revitalization Program (IRP) component of redevelopment previously generated $5 million per year for street maintenance
- City General Fund receives back just 7.8 cents of every redevelopment property tax dollar lost

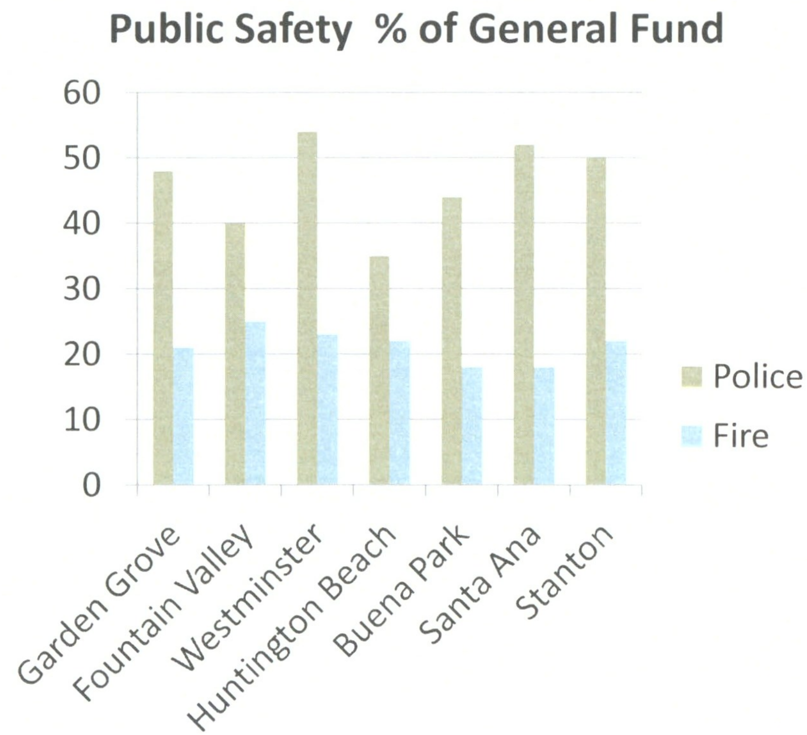
Comparable Service Levels

- Westminster spends comparable amounts to our neighbors
  - Based on FY 15-16 budgets (FY 14-15 for Garden Grove)



Public Safety Spending Comparisons

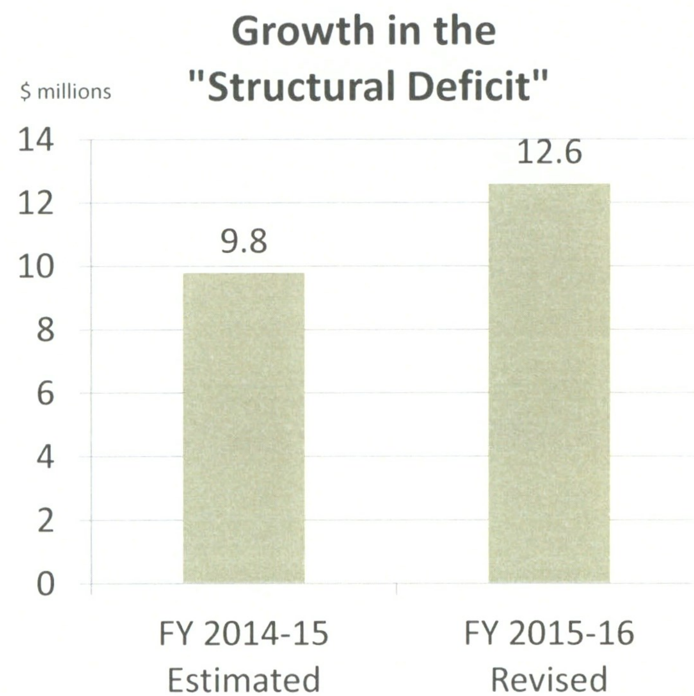




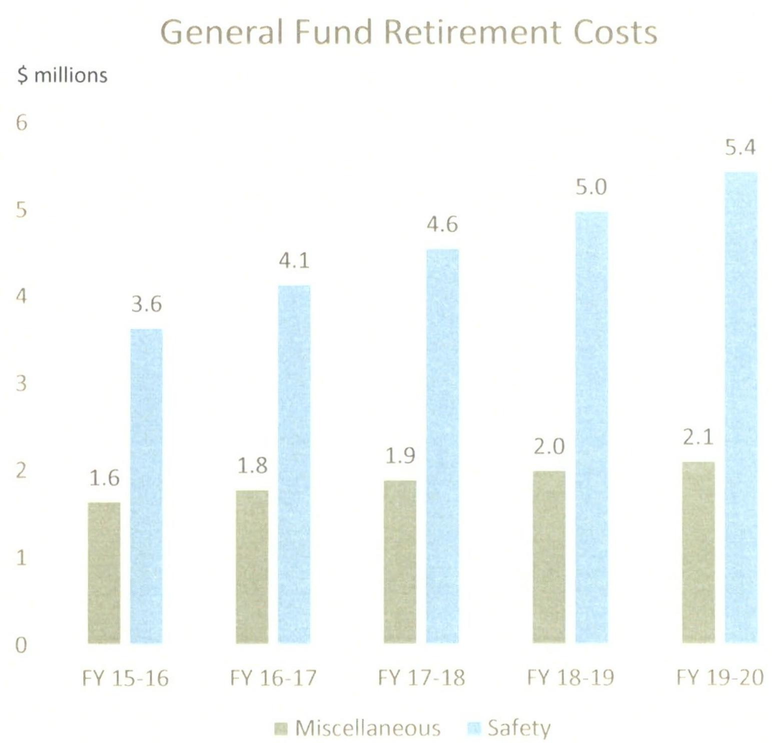
Based on FY 15-16 budgets (FY 14-15 for Garden Grove)

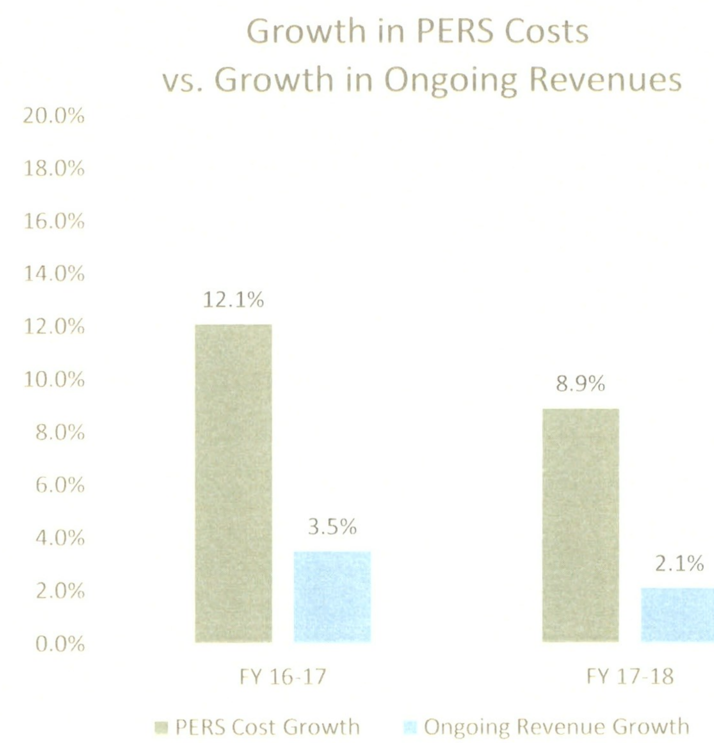
Structural Deficit Growth in FY 2015-16

- Significant progress had been made in shrinking the "Structural Deficit" through FY 2014-15
- Primary causes for $2.8 million growth in the "structural deficit" from FY 2014-15 to FY 2015-16
  - Safety retirement cost increase ($1.2 million)
  - Miscellaneous retirement cost increase ($0.3 million)
  - Stabilization of Internal Service Funds ($0.6 million)
  - OCFA contract costs ($0.4 million)



Projected PERS Retirement Costs





Estimates based on October 2014 CalPERS actuarial valuation information

Part IV. Possible Solutions

- Solutions should focus on eliminating the "Structural Deficit"
- There are multiple solutions involving expenditure cuts and/or revenue enhancements
- Expenditure cuts and/or revenue enhancements can be phased in over a period of a few years
- Revenue enhancements may involve ballot measures

Possible Solution – Expenditure Cuts

- FY 15-16 "Structural Deficit," allocated proportionately by department, based on General Fund net operating expenditures (excluding OCFA contract- assumed to be fixed)
- Would result in a 30% cut in expenditures:

Department	Net Operating Expenditures (revised)	%	Proportionate Share of FY 2015-16 "Structural Deficit"
General Government	$ 3,052,813	7.3	$ 920,000
Police	27,996,989	67.0	8,440,000
Fire (excluding OCFA)	1,757,844	4.2	530,000
Public Works	4,440,164	10.6	1,338,000
Community Development	2,100,000	5.0	633,000
Community Services	2,451,000	5.9	739,000
Totals	$ 41,798,810	100.0	$ 12,600,000

Proportionate Allocations of a 30% Staffing Reduction

By Employee Group	Total # of General Funded Positions	30% Reduction
Admin	38.3	11.5
Municipal	15.5	4.6
Sworn	86.0	25.8
Non-Sworn	34.0	10.2
Contract	1.9	0.6
Total	**175.7**	**52.7**
Temporary $	**$ 1,385,000**	**$ 415,500**

By Department	Total # of General Funded Positions	30% Reduction
General Government	14.7	4.5
Police	127.7	38.3
Public Works	17.3	5.1
Community Development	10.0	3.0
Community Services	6.0	1.8
Total	**175.7**	**52.7**

Possible Solution – Revenue Enhancements

Revenue Source	Current Rate	FY 2015-16 Estimated Revenue	Estimated Revenue per 1% Rate Change
Utility Users Tax	4%	$ 5,000,000	$ 1,250,000
Transient Occupancy Tax	8%	$ 700,000	$ 87,500
Sales Tax	1%	$ 16,925,000	$13,774,000 *

* Transaction Tax (Major items sold in Westminster but delivered outside the City are not taxed)

Conclusions

- Projected annual General Fund "budget deficits" are less than originally estimated
- The General Fund "structural deficit" -- the difference between ongoing revenues and ongoing expenditures in the General Fund, stands around $12.6 million
- Action must be taken to address the deficits <u>before the end of FY 2017-18</u>
- Deficits are not new and are caused by several underlying factors, the most significant of which is a relatively weak general revenue base
- Budget solutions should focus on the "structural deficit"
- The goal should be to eliminate the current "structural deficit," and control the growth of ongoing expenditures going forward
  - The growth in ongoing expenditures should be kept in line with the growth in ongoing revenues