

**CITY OF DANA POINT**  
**AGENDA REPORT**

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**DATE:** MARCH 9, 2005

**TO:** CITY MANAGER / HONORABLE MAYOR AND CITY COUNCIL

**FROM:** SHARIE APODACA, DIRECTOR OF ADMINISTRATIVE SERVICES  
ANDY GLASS, ACCOUNTING MANAGER  
SHANNA WOLF, MANAGEMENT ANALYST

**SUBJECT:** FISCAL YEAR 2004-05 MID-YEAR BUDGET REPORT

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**RECOMMENDED ACTION:**

That the City Council amend the General Fund operating Budget as detailed within this report.

**ISSUES:**

Shall the FY05 Budget be revised to reflect changes in estimates for certain revenues and expenditures that have occurred subsequent to the adoption of the operating Budget?

**BACKGROUND:**

On June 25, 2003, the City Council adopted a two-year Operating and Capital Improvement Budget for the City covering fiscal years 2003-04 and 2004-05. The 2004-05 Budget now comes before City Council for possible amendment as part of a "Mid-Year Budget Adjustment". This report is intended to cover the timeframe of July 1, 2004 through December 31, 2004.

**STATE BUDGET CRISIS AND REVENUE CONCERNS**

The situation in Sacramento is very bleak with regard to the State Budget. There is tremendous amount of rhetoric as to how the State is going to balance its budget and at what cost to cities. There continues to be considerable speculation as to the extent of the State's budget problems, and how these may ultimately impact local governments.

While it is certain that the City's future State-related revenues will be curtailed, the magnitude and timing will not be known until a State Budget is actually adopted. We already know that a portion of the City's Motor Vehicle In-lieu (MVIL) revenues will be cut short in fiscal years 2005 and 2006. (This is explained in detail below.) In the short term,

the City has adequate reserves to deal with any revenue losses that may occur in the current or next fiscal year.

**Motor Vehicle In-lieu (MVIL) Fees:** With the passage of Proposition 57, in fiscal year 2004 the State closed a nearly \$14 billion budget gap through a mix of cost shifting to future years, long-term borrowing and shifting of local revenues to the State treasury. Once again, there were a few major adjustments to the core revenue and expenditure issues that caused the deficit, and early indications are that the State may face a deficit of \$10 billion or more in fiscal year 2006 and beyond. As a result of its budget difficulties, in June 2003 the State ceased backfilling the legislated reduction in motor vehicle in-lieu fees which were apportioned to local governmental agencies. (As the Council will recall, the fee was reduced from 2% to .66% several years ago when the State's coffers were brimming, with the State backfilling the payments to local agencies from its General Fund, so that the local agencies continued to receive the full 2%). In June 2003 the State briefly raised the fee back to its legislated level of 2%, effective October 1, 2003. However, promptly after taking office, Governor Schwarzenegger reduced the fee back to .66% in November 2003. The Governor made a commitment to backfill the reduction so that the budgets of local governments would not be harmed. Unfortunately, the backfill did not occur for three months, costing the City approximately \$400,000 of general fund revenues in fiscal year 2004. As part of its plan to balance the fiscal year 2005 and 2006 budgets, the State has seized an additional \$405,259 per year from the City's Motor Vehicle In-lieu apportionment.

**The Triple Flip:** In the State's budget there were also equal-dollar swaps of portions of the City's MVIL and sales taxes apportionments for a new revenue called "in-lieu property taxes". In-lieu property taxes are a new revenue source and are the result of the State's implementation of the "triple flip", which exchanged most of the City's MVIL revenues and 25% of our sales tax revenues for property taxes. Although these swaps have a zero dollar impact, they do have a cash flow impact because they are substituting a substantial portion of MVIL and sales tax revenues that are currently received monthly with one that will be received only in January and May via the Orange County Assessor's office. As a result of these swaps, it will become necessary for the City to tap its investment accounts more frequently during the year to meet monthly cash flow requirements. Fortunately, the City has sufficient reserves set aside for this purpose.

**Proposition 1A:** In November 2004 the voters passed Proposition 1A by an overwhelming 83.6% of voters. This constitutional amendment is a historic bipartisan agreement supported by Governor Schwarzenegger, California State Association of Counties, the League of California Cities and Leave Our Local Community Assets Local (LOCAL). Proposition 1A restricts the State Legislature's ability to raid local government funding, including local government share of existing sales taxes, property taxes and vehicle license fee (VLF) revenues. Prop 1A provides constitutional protection of local revenues that currently go to cities and counties to provide essential services such as public safety, emergency response, parks, roads, and transportation. Prop 1A prohibits the deferral of payments for mandated programs and instead requires the State to either pay for or suspend mandates each year. It also forbids unreimbursed shifts of costs from the State

to counties. Prop 1A will allow the Legislature to *borrow* – but no longer to simply take – property tax from cities, counties and special districts. As the Council may recall, the Educational Relief Augmentation Fund (ERAF) shift of the early '90's was one of the contributing factors in the dissolution of the Capistrano Bay Park & Recreation District and was devastating to many cities.

There are provisions, however, for suspension of Prop 1A in the case of a financial emergency in the State. If this were to occur, the Governor would have to officially declare an emergency, and the Legislature would have to pass a bill to reduce local property taxes by a two-thirds vote. However, this reduction must be taken in the form of a loan and it can only be for one year. The loan must be repaid within three years, with interest. No second loan can be taken unless any outstanding loans have been fully repaid. Loans may not be taken more than twice in any ten-year period and cannot exceed 8% of the local property tax (this equates to approximately \$325,000). Prop 1A is viewed by many as a critical step for reforming the State and local fiscal system, program alignments and service delivery structures.

As the State of California continues to take City revenues (MVIL and Sales Tax) to balance its budget, we must continue to explore additional revenue sources (e.g. Transient Occupancy Tax increase and grants) to offset these revenue reductions. We have done an exhaustive and successful job of finding one-time infusions of revenue to fund our capital improvements (e.g. \$4 million to fund Salt Creek Treatment Project, and \$500,000 for the Del Obispo Storm Drain Project). We will continue our on-going efforts to seek state and federal grant funds for other capital improvements such as the community library and Sea Terrace Park project that was denied grant funding this year. Despite our efforts, and while we are not to the point of a deficit situation, the State's Budget crisis continues and its actions are unpredictable.

Jail Booking Fees: Fortunately, legislation as currently written requires the State to continue reimbursing the City for jail booking fees (\$42,400 was received in November 2004) which has resulted in a favorable budget variance in Intergovernmental revenues.

Staff will continue to monitor these developments and will continue to brief the City Council on any new developments.

The Council's history of being fiscally conservative should positively impact the City's ability to overcome the adverse affects of the State's on-going budget crisis.

### **FISCAL YEAR 2004 RECAP (JULY 2003 – JUNE 2004)**

In November 2004 the City's final audited financial statements and footnotes from fiscal year 2003-04 were issued within the Comprehensive Annual Financial Report (CAFR). It is easier to know where we are going if you start at where we've been. As FY04 is the last independently audited fiscal year, its outcome significantly shapes our current fiscal year. The following are some key financial highlights from the CAFR:

FY04	Gen Fund	CIP Fund	Other Funds	Total
Beginning Fund Balances	21,879,054	25,218,263	3,705,987	50,803,304
Revenues	22,579,895	1,495,257	1,595,104	25,670,256
Expenditures	(18,638,562)	(11,826,769)	(110,101)	(30,575,432)
Transfers In (Out)	(9,464,211)	10,963,076	(1,498,865)	
<b>Ending Fund Balances</b>	<b>16,356,176</b>	<b>25,849,827</b>	<b>3,692,125</b>	<b>45,898,128</b>

#### 2004 EXPENDITURES:

Total General Fund expenditures for FY2004 were \$18,638,562, which was \$3,207,186 less than the final budgeted amounts. Approximately \$880,000 of these savings related to projects that were in-progress at year end, and for which funds had been obligated through the issuance of purchase orders. As such, these funds were re-appropriated into the FY2005 Budget. The remaining \$2,327,186 comprises actual expenditure savings from the amounts budgeted, but of this amount the Council re-appropriated \$313,000 in FY05 for specific projects related to City facility improvements, marketing efforts, and automated Permit System that were not initiated or completed by June 30, 2004. The remaining \$2,014,186 is budgeted in the General Fund Undesignated Fund.

#### 2004 REVENUES:

Total General Fund revenues for FY2004 were \$22,579,895, which was \$680,297 more than the final budgeted amounts. The principal areas contributing to the favorable variance were Transient Occupancy Taxes and Property Taxes which both came in well ahead of plan. These were partially offset by an unfavorable variance in investment interest earnings, which were impacted by last year's plunge in interest rates. Total General Fund revenues for FY2004 decreased by \$503,311, or 2.2%, from FY2003.

#### 2004 CAPITAL IMPROVEMENT PROJECT PROGRAM:

There was a major increase in Capital Improvement Project ("CIP") Fund activity in FY2004, with many new projects being undertaken. Total expenditures increased from \$8.5 million to \$11.8 million. This is the highest single year for CIP expenditures since the City incorporated. In addition to the projects already funded and in process at the beginning of FY2004, the City Council transferred an additional \$11 million into the CIP Fund during the year for new projects and expansion of previously funded projects.

#### 2004 FUND BALANCES – ALL FUNDS:

As of June 30, 2004, the fund balances were as noted below. The \$2.7 million of General Fund balance (expenditure savings + revenue surplus) from 2004 is budgeted in the General Fund Undesignated Fund.

Fund Balances	General Fund	CIP Fund	Other Funds
Reserved:	2,105,588	6,685,845	13,182
Unreserved:			
Designated for cash flow	1,500,000		
Designated for uninsured claims	1,000,000		
Designated for veh/equip replcmnt	66,685		
Designated for emergencies	2,000,000		
Designated for open space acq.		1,440,000	
Designated for City Hall impvmnt	100,000		
Designated for utility undergrnd.		2,625,000	
Designated for art in public places	118,296		
Designated for special projects	1,664,000		
Designated for CIP/Park projects		15,098,982	1,387,619
Designated for Coastal Transit			1,048,036
Undesignated	7,801,607		1,243,288
<b>Total</b>	<b>16,356,176</b>	<b>25,849,827</b>	<b>3,692,125</b>

## FISCAL YEAR 2005 MID-YEAR SUMMARY (JULY 2004 – DECEMBER 2004)

Now let us turn our focus to 2005. Since the City of Dana Point uses a two year budget cycle, it is important that periodic adjustments be made to budgetary issues which have arisen during the fiscal year, which are addressed in the following sections.

### 2005 EXPENDITURES:

FY05 General Fund expenditures are tracking close to Budget, if not slightly under. Through December 2004 the City has spent \$9,549,052 which was \$312,991, or 3.2% less than the budgeted amount.

When compared to the first six months of last year, FY 2005 General Fund expenditures were up by \$539,967, or 6.0%. The cost centers with the major increases were the Planning Department due mainly to Town Center Specific Plan expenditures, and the Risk Management Department due to increases in liability insurance premiums and litigation-related expenditures.

### 2005 ESTIMATED SAVINGS:

Based on an analysis of each departmental budget, staff has estimated an under-expenditure of funds of approximately \$337,425 (1.5 %) to occur during this Fiscal Year through June 30, 2005. Although this figure may change up or down due to unexpected events over the next four months, this estimate should be fairly accurate. It has been an annual historical trend for expenditures to run under the budgeted amounts in this City. Staff works hard each year to minimize their spending and wisely utilize their budgets, which greatly accounts for the yearly savings.

**2005 REVENUES:**

General Fund revenues for the first six months totaled \$10,426,729, placing the City \$570,742, or 5.8%, ahead of Budget. The major components of this favorable variance are Intergovernmental Reimbursements (+\$208,020), Property Transfer Taxes (+\$91,087), Property Taxes (+\$99,470), and Sales Taxes (+\$100,085). All major revenue sources are running ahead of Budget, with the exception of Transient Occupancy Tax revenues (-\$3,284). This is attributed to several months of major renovations occurring at the Ritz Carlton (rooms and restaurant facilities) which is scheduled to be completed by this May. However, the decrease was partially offset by increases at the St. Regis, Marriott and Doubletree. If the current trends persist through the fiscal year end, we would anticipate ending the fiscal year very close to the budgeted amount.

If current Sales Tax trends persist we would anticipate a full-year favorable variance of approximately \$100,000 in Sales Tax revenues. We also anticipate a full-year favorable variance of approximately \$151,000 in Property Tax revenues.

The State's implementation of the triple flip, as described on page 2 of this report, resulted in a \$1,772,000 reduction in the original budget of MVIL (from \$2,050,000 to \$277,372) and a \$925,000 reduction in the original budget of Sales Tax revenues (from \$3,700,000 to \$2,775,000). These revenue reductions were swapped for a new In-lieu Property Tax revenue which is received twice a year from the County. Staff does not expect any significant variance from the annual budget of \$2,460,026 for this new revenue source.

At this point in time it appears that for the full fiscal year the anticipated favorable and unfavorable variances in the major revenue categories will largely offset one another such that our total revenue budget is still valid. Also, in August 2004 the Council took action to adjust revenue projections for Sales Tax, Motor Vehicle In-lieu, and In-Lieu Property Tax due to the imposition of the "triple flip" component of the State budget as described above. Therefore at this time staff is not proposing any adjustments to the General Fund revenue budget.

**2005 MID-YEAR BUDGET ADJUSTMENT:**

Fee Study: Fees currently charged by City Departments for various services, including, Engineering, Building, Community Development, Administration and Community Services, were last revised and adopted by resolution of the Council in 1998. State law requires that development fees (i.e. property approval fees and impact fees) be reviewed every five years; hence we are two years overdue. Although there is no legal requirement that other general service fees (i.e. recreation/facility use fees; building permits) be reviewed on a periodic basis, staff feels it prudent to conduct a comprehensive fee study of all City fees to determine if the cost to provide a service is being fully recovered. Therefore, it is recommended that \$50,000 from the Undesignated

General Fund Balance be utilized for a professional fee and cost recovery study in order to determine if existing fees represent the true cost of providing services, and to develop a revised fee schedule for City Council consideration. Staff recommends that this comprehensive fee study be initiated this Fiscal Year.

As noted above, General Fund operating expenditures are running under budget with an anticipated savings of approximately \$337,425. Staff is recommending an expenditure adjustment in the amount of \$50,000 for the proposed fee study as follows:

Authorize transfer of \$50,000 from Undesignated General Fund Balance to Administrative Services Budget #21-223 for professional services contract to perform Comprehensive User Fee and Cost Study.

TOTAL PROPOSED FY05 BUDGET ADJUSTMENT	\$ 50,000
Anticipated Expenditure Savings in FY05	\$337,425
Anticipated Net Impact/Favorable	\$287,425

City Attorney/Litigation: There are two components to the legal expenses budget: the City Attorney budget and the Risk Management/Litigation budget. The first account allots money to pay for the routine duties of the City Attorney and most legal expenses incurred by the City of Dana Point during general municipal business. Separately, the Risk Management budget sets aside money for unanticipated litigation and consulting/witness fees incurred by the City for specific litigation cases. The City Attorney budget is currently on target with respect to spending. However, the litigation and consulting/witness fees accounts are currently running at a deficit due to several ongoing litigation cases including the Headlands LLC, DiCarli v. Hamilton, and cases related to the Mobile Home Park Closure. The attorney fees incurred as a result of these legal intensive cases will be reimbursed to the City by the respective property owner as a result of a condition of approval assigned to the various projects. At the end of January 2005, the litigation account had a negative balance of (\$25,518) and the consulting/witness fees account carried a similar negative balance of (\$20,637). Total reimbursements due at the end of January 2005 equaled \$150,524.66. Once the City has been fully reimbursed for these expenses this fiscal year, both the litigation and consulting/ witness fees accounts will return to a positive balance. Therefore, no adjustments are recommended at this time.

#### 2005 RESERVE/CIP ADJUSTMENTS:

Other than a \$50,000 transfer from Undesignated General Fund Balance, no adjustments to the Reserve funds or the CIP are recommended at this time. Staff is continuing to aggressively pursue the City Council's CIP schedule.

## CAPITAL IMPROVEMENTS PROJECTS FUND:

CIP program expenditures have decreased this year. During the first six months of FY2005 the City spent a total of \$2,789,401 on 21 active projects (there are 35 projects total in the Budget). The total funding available for CIP projects in FY2005 is \$34,134,763. Of this amount, \$14.5 million is expected to be spent on projects, while the remainder represents projects that are budgeted but not due to commence until beyond June 30, 2005.

## 2005 GENERAL FUND BALANCES AND RESERVES – AS OF DECEMBER 31, 2004:

The following table summarizes General Fund balances and reserves as of December 31, 2004. It includes the originally budgeted amounts (from the printed Budget), the December 31 actual balances and the current projected year end balances:

## 2005 GENERAL FUND - PROJECTED:

Fund Balances	Original Budget	12/31/04 Actual	6/30/05 Proj.
Designated for cash flow	1,500,000	1,500,000	1,500,000
Designated for uninsured claims	1,000,000	1,000,000	1,000,000
Designated for veh/equip replacemnt	80,000	66,685	66,685
Designated for City Hall improvemnt	100,000	100,000	100,000
Designated for art in public places	0	118,296	118,296
Designated for special projects	0	0	0
Reserved for Real Property HFR	254,889	264,160	264,160
Reserved for Cap Lease Repayment	532,000	532,000	532,000
General Reserve	197,411	197,411	197,411
Emergency Reserve	2,000,000	2,000,000	2,000,000
Undesignated	0	4,964,813	3,987,396
<b>Total Fund Balance</b>	<b>5,664,300</b>	<b>10,743,365</b>	<b>9,765,948</b>

## 2005 FUND BALANCES – ALL FUNDS - BUDGETED:

FY05	Gen Fund	CIP Fund	Other Funds	Total
Beginning Fund Balances	16,356,176	25,849,827	3,692,125	45,898,128
Revenues	21,817,398	6,915,944	1,341,265	30,074,607
Expenditures	(22,224,690)	(34,134,763)	(333,182)	(56,692,635)
Transfers In (Out)	(6,182,936)	7,285,201	(1,102,265)	0
<b>Ending Fund Balances</b>	<b>9,765,948</b>	<b>5,916,209</b>	<b>3,597,943</b>	<b>19,280,100</b>

**Investment Portfolio**

The City remains fiscally strong with an investment portfolio totaling \$44.5 million, invested in U.S. Treasury notes and the State of California's Local Agency Investment Fund (LAIF). Although investment returns are down this year, this downward adjustment was anticipated during the development of the Budget and no adjustments are needed at this time. With recent interest rate increases by the Federal Reserve, the City investment returns have begun to grow.

**NOTIFICATION/FOLLOW-UP:** None.

**FISCAL IMPACT:**

Increase General Fund revenue budget by \$0. Authorize transfer of \$50,000 from Undesignated General Fund Balance to Administrative Services Budget #21-223 for professional services contract to perform Comprehensive User Fee and Cost Study.

**ALTERNATIVE ACTIONS:**

1. Eliminate or modify proposed adjustment, at Council's discretion.