General Fund Five Year Forecast: 2006-10

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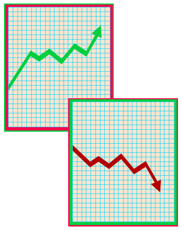

City of Agoura Hills

SUMMARY OF FORECAST FINDINGS

The purpose of this forecast is to identify the General Fund's ability over the next five years—on an "order of magnitude" basis—to continue current services, maintain our **existing** assets and fund new initiatives such as enhanced operating programs or the acquisition of *new* facilities, equipment and infrastructure.

The forecast does this by projecting ongoing revenues and subtracting from them operating costs, debt service and maintenance of existing assets (equipment, facilities and infrastructure). If positive, the balance remaining is available to fund "new initiatives;" if negative, it shows the likely "budget gap" to continue current service levels.

FORECAST PURPOSE

***It is important to stress that this forecast is not a budget*.**

It doesn't make expenditure decisions; it doesn't make revenue decisions. Its sole purpose is to provide an "order of magnitude" feel for our ability to continue current services, maintain our existing assets and fund new initiatives.

Ultimately, this forecast cannot answer the question: "can we afford new initiatives?" This is a basic question of priorities, not of our financial capacity. However, funding major initiatives within existing resources will require significant reductions—beyond those that will already be needed—in existing services or asset maintenance levels in order to do so. However, making trade-offs is what the budget process is all about: determining the highest priority uses of the City's limited resources.

Can we afford new initiatives? This is a basic question of priorities, not of our financial capacity.

Nonetheless, this forecast can help us assess how difficult making these priority decisions will be, and underscore the need for significant new revenue sources if we want to achieve our CIP goals while at the same time preserving our service levels and adequately maintaining the assets we already have.

GENERAL FISCAL OUTLOOK

California's economic recession has ended and the economic expansion is expected to continue at a moderate pace. Local governments continue confronting significant challenges to making sound fiscal policy. Among the factors increasing the strain on the local bottom line are sluggish economic growth leading to disappointing tax revenues, large federal budget deficits resulting in a lack of adequate funding, an ongoing multibillion dollar gap between spending and taxes in the California state budget, and added responsibilities for homeland security.

The recent passage of Proposition 1A on November 2, 2004 significantly improves our fiscal situation by shielding us from more State budget raids, and thus provides us with greater certainty and stability on this front than we've experienced in many years. However, it is important to stress that it only helps prevent added State budget cuts to cities in the future: it doesn't return any past takeaways.

It is also important to note that Proposition 1A does not stop State takeaways: they are still possible, but they are much harder to do. The Ground Rules: If two-thirds of the legislature declares a fiscal emergency, then funds can be taken away from local government, but only as a loan that must be repaid within three years; the amount cannot be more than 1.3 billion; it cannot occur more than twice in a ten-year period; and no new takeaways can be made if a past takeaway has not been repaid. This is a high hurdle to overcome, certainly, but not an impossible one.

In exchange for this reasonable assurance (but not guarantee) of no more raids in the future, local government agreed to give the State $1.3 billion per year for two years (in 2004-05 and 2005-06), for a total of $2.6 billion. The City's share of this is $232,904 per year, $465,808 over two years. After this, we should return to our prior situation.

In short, while passage of Proposition 1A was essential for our future fiscal health and stability, it does not improve our current fiscal situation: it simply deters the State from making it worse.

The good news is with the passage of Prop 1A there will be a constitutional protection for cities:

1. Against takeaways.
2. Against un-reimbursed mandated costs.
3. For repayment in 2006-07 of 2003-04 loan.

Cities will now be able to predict what revenues they have to work with, but predicting revenue streams and projecting cash flow estimates with the VLF-property tax swap and the triple flip will certainly be more challenging this year.

Our 2005-07 Fiscal Story. The challenges facing us today can be attributed to three key factors:

1. The effects of the Triple Flip and VLF Swap.

2. New infrastructure responsibilities, most notably Kanan Interchange and Reyes Adobe Interchange construction that will come on-line during 2006-07.

3. New service responsibilities of meeting National Pollution Discharge Elimination System (NPDES) requirements for storm water.

While each of these is described in more detail below, the following highlights the three most serious threats to our long-term fiscal health: Dealing with the “Triple Flip” and “VLF Swap”, the Kanan Interchange, the Reyes Adobe Interchange, and NPDES costs.

❶ Triple Flip and Vehicle License Fee Swap

The “Triple Flip” was signed into law last year to become effective July 1, 2004. On March 2, 2004, the voters approved a statewide ballot measure to issue $15 billion in deficit reduction bonds. These bonds will be paid off over seven to ten years based on the revenue stream that will fund them from the “Triple Flip.” As summarized below, the following three “flips” will occur:

First Flip. One-quarter cent of the local one-cent sales tax enacted by cities and counties throughout the State will be repealed.

Second Flip. The State will enact a new, dedicated one-quarter cent sales tax to repaying the deficit reduction bonds. At this point in the “flip” sequence, the State has grabbed locally-enacted revenues and used them to finance $15 billion of its budget deficit. Overall, the taxes paid by Californians will be unchanged.

Third Flip. This final flip is a promise by the State to backfill the lost local revenues. This will be funded by a re-allocation of property tax revenues from the Educational Revenue Augmentation Fund (ERAF). Cities, counties and special districts are already the sole funding source of ERAF—in the amount of $4 billion annually.

The City will establish a new General Fund account entitled Property tax in-lieu of Sales Tax and Property tax in-lieu of VLF to account for the “Triple Flips” and “VLF Swaps.”

VLF Background: Just a few short years ago, the State had a significant budget surplus, and it flirted briefly with the notion of a State tax cut. Instead, it decided to reduce city and county revenues by reducing vehicle license fees (VLF) by two-thirds (2/3). However, the State agreed to “backfill” these lost revenues, thus keeping cities and counties “whole.” In the fiscal year 2003-04 the VLF Backfill Gap was the result of the State refusing to fulfill its promise to backfill the VLF when then Governor Gray Davis reinstated the VLF back to its original fee level. That step was taken June 2003. A lag occurred between the time that action was taken and the actual increase in fees could be implemented. This created the VLF Backfill Gap for the City’s General Fund in the amount of $371,873. The State has promised that the amount they failed to “backfill” was to be categorized as a loan from local governments to the State, to be repaid in August 2006. In fiscal year 2004-05 $339,173 of these funds were recovered by action of the City Council.

With the passage of Proposition 1A in November 2004, the constitution currently guarantees all VLF revenue to cities and counties in the form of property tax in-lieu. No particular amount of revenue is guaranteed, however, because the amount depends upon the VLF rate that is set by the Legislature. Under Proposition 1A, the 2004 State budget includes a permanent reduction of the VLF rate from 2% to 0.65%. The VLF backfill is eliminated and replaced with a like amount of property taxes, dollar-for-dollar. Cities and counties will receive these funds in the form of increased allocations of property tax beginning in 2004-05 fiscal year from the countywide ERAF fund.

❷ Kanan Interchange and Reyes Adobe Interchange

Being in the works for over a decade, the US 101/Kanan Road Interchange Project will become a reality over the next two years. As a major thoroughfare for the City, the interchange between freeway US 101 and Kanan Road in its current state cannot handle the amount of traffic it receives on a daily basis. The newly approved interchange will reduce traffic congestion by eliminating all left hand turns, relocating traffic signals, increasing the number of lanes in exit ramps, and improve interchange ratings to a grade of "C" or better.

Cost Estimates

- Road Construction
- Signals/Signing/Striping
- Right-of-way
- Bridges
- Drainage
- Landscaping
- Design/Support Costs

Funding

- **$10.5 Million – MTA matching grant**
- **$13.5 Million – City Funds**
  - General Fund/Set aside funds
  - Traffic Impact Fees
  - Other State or Federal Grants
  - Local funding (Prop A or C, Gas Tax**)**
  - Developer contribution
- **Total Project Cost = $24 million**

Furthermore, the City has initiated the preliminary studies for the reconstruction and widening of the Reyes Adobe Interchange. The total project cost is estimated at $5 million and will include bridge and ramp widening, signing, striping, signals, and drainage. Construction is scheduled for 2006-07.

❸ New Responsibilities of NPDES

National Pollutant Discharge Elimination System (NPDES) Program is a Federally-mandated program administered by the State Water Resources Control Board via Regional Boards' permits to mitigate storm water pollution. We are in the third 5-year permit cycle.

Several daunting tasks are awaiting the City and our Malibu watershed members in the next 5 years. Recent court cases subject our City to greater responsibilities and liabilities.

- <u>NPDES Permit</u>
  The current permit will expire in 2006. Discussions regarding the development of the next permit will commence next year and are sure to be challenging. The economic justification of the storm water pollution control measures are always a key issue - ensuring the mandates imposed by the State make sense and provide substantive benefit to the community in comparison to their costs. The City will work with the LA County DPW, who is the principal permittee, and our watershed cities to ensure a practicable, fiscally responsible permit is developed.

- <u>Total Maximum Daily Loads (TMDLs)</u>
  The TMDLs are the most ominous regulatory threat of the storm water program. These court-ordered requirements impose specific reductions in identified pollutants upon the permittees without regard to cost. Agoura Hills is affected by two listings: 1) Santa Monica Bay and 2) Malibu Creek. Some of the listed pollutants will result in a specific TMDL requirement with a testing regimen and quantifiable limits, and specify actions for any exceedences. Ultimately, permitted cities and agencies will be required to investigate and remedy chronic exeedences. While these regulations are being developed with multiple year implementation and compliance plans, they will burden cities' budgets as they are developed.

- <u>AB 885</u>
  New rules and regulations have recently been established by the Regional Board in preparation to this bill's requirements. The requirements address storm water quality issues as related to septic tanks systems. The City is currently investigating the impacts of

this measure and how to address its impacts to those properties with septic systems.

The greatest challenge to complying with the myriad of storm water pollution rules and regulations is the lack of funding. Due to Proposition 218, establishing a storm water pollution assessment, like the cities of Los Angeles, Manhattan Beach and Santa Monica have in place (established prior to Prop 218), is not an option. Grants are scarce. Thus NPDES funding will continue to impact the City's ability to address all its needs via the General Fund.

Factors Not Included In the Forecast:

Above are immediate concerns for the next two years, but what the forecast has not included is a prudent look at identifying a contingency strategy for needs over the next five years.

- This forecast is based on the General Fund only.
- No new or enhanced programs are included in the forecast.
- No significant increase in personnel.
- The forecast expenditures will not expand or improve existing assets. It does not include the establishment of any capital projects.
- Future Capital Project Designations. The Council may designate specific fund balance levels for future development of capital projects which it has determined to be in the best long-term interests of the City. These designations reflect tentative managerial plans or intent and should be clearly distinguished from reserves. The following is a list the Council may want to consider segregating a portion of fund balance to indicate tentative plans for future financial resource use.

  1. Lindero Creek Park $2 million
  2. Recreation Center Project $8 million
  3. Cheseboro Interchange $8 million
  4. Civic Center Capital Funds $100,000
  5. Agoura Hills/Calabasas Community Center building Capital Funds $100,000.

Setting aside reserves is difficult for public policy makers. It will be important to make informed and rational decisions, so that we can build sound fiscal bridges between current challenging times and Agoura Hill's promising future.

DEMOGRAPHIC TRENDS

1. **Population and Housing.** Population grows by 1% annually throughout the forecast period.

2. **Inflation.** Grows by 3% annually throughout the forecast period.

EXPENDITURES

1. **Operating Expenditures.** Regular staffing costs, which account for about 25% of total operating costs, are based on a detailed analysis of scheduled salary and benefit increases, including projected Public Employee's Retirement System rate increases. The compensation increases is based on PERS assumptions of 3.75% annually.

   All other costs are projected to grow by population and inflation (4% annually in the forecast).

2. **CIP Expenditures.** Based on projected costs to adequately maintain or replace existing facilities, equipment and infrastructure (about $600,000 annually).

3. **Debt Service**. The last three years debt service on the new Civic Center has been paid from the sale of the "old library," the Kanan six (6) acre library parcel and the Civic Center optional parcel, west of City Hall. Beginning in fiscal year 2006-07 the forecast includes debt service obligations (about $670,000 annually) for the bond payments to be funded by the General Fund. It is recommended that we establish a one year reserve fund for this debt service.

STATE BUDGET ACTIONS

While no past cuts will be restored, the forecast assumes no further State cuts to cities after the ERAF III Shift is paid. The forecast assumes the $232,904 takeaway of ERAF III Shift for each year in 2004-05 and 2005-06.

KEY REVENUES

Sources used in developing revenue projections for the forecast include long and short-term trends in key City revenues; forecast data for California as developed by economic trends as reported in the national media; economic and fiscal information developed by the State Legislative Analyst and the State Department of Finance; and materials prepared by the League of California Cities and State Controller's Office.

Ultimately, however, the forecast revenue projections reflect the staff's best judgment about the State budget process, and the performance of the local economy during the next year and how it will affect the City's General Fund revenues.

1. **Sales Tax.** Grows by an underlying growth rate of 3.0% plus additional "net" revenues from the following new sources:

a.	Agoura Furniture Center (Wickman) -2005	$100,000
b.	Leader Carpet Store -2005	$ 40,000
c.	Agoura Design Center (Adler)-2006	$135,000
d.	Snyder – restaurants/retail -2006	$100,000
e.	Moore-restaurants/retail -2008	$100,000

2. **Property Tax.** Grows by 2.1% in 2003-04 based on the confirmed tax levy by the County and expected supplemental assessments, and by 2.8% annually thereafter based on trends for the past ten years. Fiscal years 2004-05 and 2005-06 reflect the State takeaways in the amount of $232,904 per year.

3. **Transient Occupancy Tax.** Grew by $400,000 annually in FY 2003-04 when the new Hampton Inn came on board in late FY 2002-03. Plus an additional $400,000 in 2006-07 will begin in "net" new revenues from the new Homewood Suites.

4. **Motor Vehicle in Lieu.** Grows by 8.2% on the last two year average based on year-to-date trends using the State numbers; and by 6% during the forecast period based on trends for the last ten years.

5. **Business Registration**. Fluctuates by the amount of building sub-contractors working in town. Grows by 5% throughout the forecast period based on trends for the last ten years.

6. **Franchise Fees**. Grows by population and inflation (4%) throughout the forecast period based on trends for the last ten years.

7. **Development Review Fees**. A 1% growing inflation rate was used throughout the forecast.

8. **Recreation Fees**. Grows by population and inflation (4%) throughout the forecast period.

9. **Other Fees.** Grows by population and inflation (4%) throughout the forecast period.

10. **Investments.** Based on yields ranging from 2.0% to 4.0% on investable cash balances.