City of Long Beach
Working Together to Serve

Memorandum

Date: September 10, 2002

To: Mayor and Members of the City Council

From: Henry Taboada, City Manager

Subject: **Adoption of Fiscal Year 2003 Budget**

This week, you have several budget presentations. Thereafter, you are scheduled to begin making decisions and taking the actions required to adopt the budget. The schedule calls for adoption on September 10 or September 17, since there will not be a full Council seated for the offsite City Council meeting of September 24.

Regardless of all the media attention, you have been presented a budget that is balanced and that maintains services at prior year levels. There is no deficit in the FY 03 budget to deal with.

There are several fee increases proposed that are necessary to keep pace with the costs of the related services and/or to pay for needed service improvement and expansion. The most notable is the Refuse rate increase. That increase comes out to about $1.15 per month for the average residential customer, and is the first increase since 1995. If the City Council does not adopt the Refuse rate increase, the Refuse operation has sufficient resources to remain solvent for one more year. However, an even larger rate increase would then be required during FY 04, since resources by then will not be sufficient to maintain current service levels in the Refuse program.

My recommendation is that you adopt the budget as scheduled and as proposed. The current hiring freeze should be extended for at least the duration of the FY 03 budget year, to include elected and appointed "non-City Manager" departments in the General Fund. In addition, staff should be directed to return to you in January 2003, in cooperation with the Mayor's Budget Advisory Committee, with a strategy to bring General Fund expenditures in line with revenues. That strategy must address the fundamental budget problem: **the City's revenues are not keeping pace with its expenditures.**

That being the case, there are only three ways to solve the problem:

1. Raise revenues,
2. Reduce expenditures, or
3. A combination of the two.

Using reserves, as has been noted, does not solve the problem; it simply delays the inevitable. However, since the magnitude of the gap between revenues and expenditures is so large, a prudent use of available, <u>non-emergency reserves</u> will be required.

Further, in spite of the excitement over the numerous new developments recently completed or under construction, in truth, their combined financial impact on City revenues will not be sufficient over the next two to three years to close the budget gap. Let's also not forget that we have three more years of Utility Users Tax rate reductions to look forward to (FY 03, 04, and 05). Each percentage point reduction represents a loss of approximately $7 million. As a result, net revenue growth will be relatively minor in the next three years. I assure you, however, that staff throughout the City have been working diligently to identify ways to expand the City's revenue base without increasing tax rates.

With regard to expenditures, if only budget cuts were employed to close the estimated $56 million General Fund gap for FY 04, that would require a 16 percent reduction of each department's budget, including Police and Fire. If Police and Fire were excluded, then the non-safety departments would have to take a 42 percent cut; nearly one-half of their budgets and services would have to be eliminated.

Obviously, the solution will have to include some tax and fee increases combined with judicious expenditure reductions, over a period of several years, so as not to unreasonably impact services to the public. This can only be done in conjunction with use of non-emergency reserves. Use of non-emergency reserves will temper the impact of budget cuts on service levels while allowing for revenues to begin catching up to expenditures.

I must caution you, however, that non-emergency reserves, such as those held in the Insurance Fund, <u>must not</u> be used to increase the budget. To do so defeats the purpose of any budget strategy which seeks to bring City General Fund expenditures in line with revenues. As background, using the example of the Insurance Fund, the City is self insured meaning that when we lose a claim or lawsuit, we must pay with City cash reserved for that purpose in the Insurance Fund. Several settlements during the 1990s exceeded $10 million each. Therefore, the risk of fully depleting Insurance Fund reserves is that the City would not have sufficient money in the bank to make significant payouts should that be required.

The same holds true for reserves held in other funds. They are there for a purpose and fully depleting those reserves places those operations in fiscal jeopardy. Nonetheless, a judicious use of non-emergency reserves, while not without risk, may need to be part of a multi-year strategy.

Much effort by all departments went into preparing a balanced budget proposal. The budget <u>is</u> balanced. Adopting the budget, whether this week or next week, does not prevent you from reopening and amending it at any time. We have highly competent staff. I urge you to give them the opportunity to present to you a budget strategy, in January, that will close the budget gap in a way that is not damaging to community services.

A multi-year strategy utilizing the three components I have discussed in this memo was employed during the mid-1990s, with success. However, just like the City Councils of the 1990s, the current City Council, and City staff, will have to exercise great self-control to ultimately achieve fiscal stability for the City.

HT:BT:le
Adoption of FY 03 Budget

cc: Gerald R. Miller, Assistant City Manager
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All Department Heads