



City Manager's Budget Message
Martín Bernal

May 12, 2015

To the Honorable Mayor and Members of the City Council

As we prepare to enter the City's 150th year, it is my pleasure to present the Fiscal Year (FY) 2016 Adopted Budget for the City of Santa Cruz. This budget represents the City's financial plan for the coming fiscal year. The budget defines how we operate as a city and sets our expenditure priorities based on the City Council's adopted goals and priorities. The budget provides the means to fund the ongoing maintenance and improvements to the City's infrastructure, including our streets, bridges, parks, and utilities. Moreover, this budget funds the program and services to keep Santa Cruz a vibrant place to live, work and visit.

The Adopted FY 2016 budget totals \$212.8 million. This figure includes an operating budget of \$182.6 million and capital project appropriations of \$30.1 million. Included in the operating budget is the City's General Fund of \$86.2 million, which supports our day-to-day public safety, roads, traffic, and parks operations and enterprise funds of \$87.1 million (the largest of which are the Water Fund of \$35.6 million, Wastewater Fund of \$24.4 million, and Refuse Fund of \$18.9 million). At present, our General Fund contains a modest budgetary *gap* of 1.1% that would be *funded from* existing reserves at year end.

Budget Considerations

The City continues to emerge from the Great Recession, allowing us to slowly shift from a reactive to a proactive mode. We are no longer in a position to have to make significant reductions in programs and services or to ask for concessions from our employees. We have even been able to make modest one-time investments in infrastructure and employee compensation, and to address unfunded liabilities. The recovery has been incremental and as a result so has our approach to budgetary growth. As such, we are fortunate to be in a position to recommend some ongoing, operational investments. Nevertheless, despite the hopeful economic conditions, there are important factors that need to be considered as we look ahead at the long-term fiscal health of our City and sustainability of operations.

Key Fiscal Actions

June 24, 2014. Adopted on-time budget that meets reserve requirements

September 23, 2014. Approved new water rates to create interim drought funding and long-term resources for infrastructure projects

September 9, 2014. Adopted a General Fund surplus policy to prioritize available resources towards reduction of unfunded capital projects and debt obligations

September 9, 2014. Created the Economic Development Trust to support economic projects and initiatives

January 27, 2015. Approved new refuse rates to support capital and infrastructure needs.

April 2015. Finalized issuance of \$14.3 Million, low-interest (1.97%) debt to accelerate road improvement projects

May 5, 2015. Held a public Budget 101 Study Session

May 12, 2015. Released the Adopted FY 2016 Budget

The City's fiscal status is largely determined by four major factors: (1) the condition of the overall economy; (2) the City's tax base; (3) built-in cost increases (i.e., retirement, health and capital and service demands); and (4) the City's fiscal policies and practices.

The economy continues to improve (although it lags behind the Bay Area economy) as reflected by reduced unemployment; an improving housing market; increased development activity; and sustainable increases in sales and hotel tax revenues. The City's tax base is also growing, emphasized by the addition of new hotels, some of which have opened for business while others are under construction and several are entitled and expected to be built over the next several years. We are also seeing increased development activity in the Downtown and major business corridors and growth in overall economic activity citywide.

These improvements on the revenue side of the equation are tempered by mandatory, built-in cost increases that are largely out of the City's control. Most significant are employee benefit costs for pensions and healthcare. Healthcare costs and PERS pension rates are expected to grow into the foreseeable future. PERS will take many years to recover from the investment losses of the Great Recession, with this recovery borne by its member entities, such as the City. Moreover, PERS is expected to make policy changes that are likely to result in rates above the already projected increases. The impact will be that pension costs in particular are expected to continue to escalate beyond historical norms through the end of the next decade and could peak at 60% for safety (Fire and Police) and 25% for all non-safety positions (as a percent of salary). It is also important to note that all of the City's employment contracts are either under negotiation in the current year or will be in the coming fiscal year. We will also need to implement ways to reduce our unfunded pension obligations. Service demand and aging infrastructure and facilities also put significant pressure to increase allocations of resources to meet new community expectations and to keep pace with the ever increasing rate of capital and construction costs.

Given these considerations, what we face then is a situation whereby much of the economic and revenue gains are absorbed by the built-in cost increases, leaving little room for new/expanded programs and services, deferred maintenance, and infrastructure investments.

This economic reality will weigh heavily on the City's ability to make improvements in the coming years. Alternate funding strategies must be explored to meet community demands.

The City continues to adhere to and develop fiscal best practices. Our General Fund balance meets our minimum 2-month operating criteria; we have set aside modest funding for future retirement obligations; we have created policies to prioritize reduction of unfunded obligations; and, we have created a dedicated funding source to support Economic Development initiatives. These policies have served us well, allowing the City to maintain an enviable AA+ bond rating. This bond rating is important because it allows the City to secure low interest rates for any debt issued.

During the past several months, the City Council has committed to refining its three-year Strategic Plan, which focuses our collective efforts to address community needs and

improve the quality of life in Santa Cruz. The plan includes six goals that cover virtually all of the City's activities. These broad goals are:

- Environmental Sustainability and Well-Managed Resources
- Community Safety and Well-Being
- Economic Vitality
- Organizational Health and Sustainability
- Reliable and Forward Thinking Infrastructure
- Engaged and Informed Community

While we have an extensive list of projects to meet the City Council's adopted goals and priorities, an area that has become critical and is worthy of special attention is infrastructure and facilities.

Infrastructure and Facilities

A renewed focus on infrastructure and facilities is required. Infrastructure is a core function and responsibility of a municipality. We have aging infrastructure and facilities. The City will celebrate its 150 anniversary next year. While City's enterprise funds have the ability to set rates in order to fund capital projects, this is not the case for the General Fund. The current unfunded capital and facility projects list totals over \$200 million. Moreover, the City has lost a significant source of infrastructure funding with the elimination of redevelopment. It is very clear then that if we are to make progress, a new funding strategy needs to be deployed.

We have been fortunate to issue \$14.3 million in low-interest (1.97%) Measure H debt to fund much needed road improvements throughout the City. The City will enjoy these improvements in the next several years. We also remain hopeful that the California State Legislature will allow the City to access an additional \$35 million in bonds frozen in the Redevelopment dissolution process for which we are making debt payments but not receiving any benefit. Access to these funds will make significant progress on improving sections of the City like Ocean Street and the Beach Area, as well as support projects like the Highway 1 bridge replacement, which are essential for economic development and job creation opportunities. Additionally, the bonds include funding for much needed affordable housing.

The most significant infrastructure needs are highlighted below.

Water Utility

In the coming months, the Water Supply Advisory Committee (WSAC) is poised to bring forward recommendations to address the City's ongoing drought water supply problem. This will likely require a multi-year, multi-million dollar investment. Moreover, it is important to remember that the City's water system is over 100 years old and requires major infrastructure investments to keep it operating in a safe and effective manner. Among the items that need attention are pipelines, Loch Lomond Reservoir, and treatment facilities.

Roads and Intersections

While we are fortunate to have a designated source of funds for road paving (2006 Measure H sales tax), there is a growing need to improve certain roads, intersections, and bridges to address vehicular congestion and safety, and to make them safer and more usable for pedestrians and bicycles.

Broadband

In addition to existing infrastructure, the City must develop the infrastructure of the future that will support ongoing economic vitality. Specifically, the City needs a high-speed broadband network as detailed in the City Council-approved Broadband Master Plan policies.

Lighting and Landscaping

The lighting and landscaping in a number of the City's major thoroughfares is now close to end-of-life and needs to be updated, such as Ocean Street, Beach Street, and Riverside Avenue.

Sidewalks/Curbs

We have miles of sidewalks that need replacement and areas where they need to be installed to make Santa Cruz a more walkable city.

Storm Drains

There are several areas of the City where existing storm drains are inadequate and cannot prevent flooding during storm events.

Community Facilities

The City is fortunate to have a wealth of community facilities. As the City Council recently learned, we have done a very good job maintaining most facilities. However, many have become outdated and need improvements to make them more accessible, safe, and to continue to be functional into the future. Among those major facilities needing modernization are libraries, golf lodge, community centers, and the corporation yard.

Wharf Master Plan

A vital economic engine for our community, the Santa Cruz Municipal Wharf turned 100 years old during the FY 2015 budget year. Staff is now working on implementation steps for the City Council-approved Wharf Master Plan. This plan focuses on how to usher the half-mile long landmark into the next century of its existence. The plan lays out a comprehensive vision for increasing public access and recreational uses on the Wharf, business and economic development opportunities, integration of scientific, educational, and research initiatives, parking and vehicular movement improvements, and the preparation of design and development standards for buildings and public spaces. In addition, the Engineering Report component identifies repairs and upgrades to the Wharf necessary to see it through to its next major anniversary.

Civic Auditorium Master Plan

Similarly, for our 75 year old Civic Auditorium, city staff and the community are focused on the Civic Auditorium Master Plan to consider options to how best invest now in the Civic to renew its life for the next 75 years.

Permanent Arena/Events Center

In their third year the NBA Development League team, the Santa Cruz Warriors have already made a significant positive impression with their community involvement and in enhancing the vibrancy of the downtown. City staff is currently working on a feasibility study to consider a permanent state-of-the-art arena/multiple-use facility.

Adopted Budget Highlights

The FY 2016 adopted budget builds on last year's approach to focus on reinvesting in core services that were stretched tight by the Great Recession. Departments were invited to submit modest budget enhancement proposals, as opposed to status quo or reduced budgets with an aim to rebuild and strengthen our core City services while advancing the Council's Strategic Plan.

Following is a summary of the modest areas recommended for additional investment, as presented in the FY 2016 Adopted Budget.

Capital Improvement Program (CIP)

The initial CIP budget contained \$31.7 million in total FY 2016 projects, including \$5.9 million in requested funding from the General Fund. However, after review of available General Fund dollars, only \$1.23 million in funding exists. Many of the projects proposed for funding and those that went unfunded would address deferred maintenance needs in our parks, facilities, and streets. As discussed in the previous pages, a comprehensive alternate funding strategy is required to realistically address the City's great demand for capital investment.

Parks and Recreation

In the last two years, the Parks and Recreation Department budget provided for additional temporary park rangers to address public safety concerns as well as enhance the maintenance, parks planning, and recreational program functions of the department. The adopted budget builds on these staffing investments by supporting the Parks Master Plan development, ranger, and maintenance services. The CIP includes modest funding to improve some parks and community facilities, and to beautify key street medians.

Planning and Community Development

As the local business and residential economy has improved, we are seeing increased demand for development services. While this is a good sign for our local economy, the department service levels require additional investments to support and bring in-house planning and plans examiner services that were formally contracted out and to streamline and simplify the development review process.

Public Works

Within all of Public Works (roads, resource recovery, wastewater, refuse, parking, landfill, maintenance, etc.), moderate staffing reallocation and changes are contained in the Adopted Budget. However, within the CIP, the infusion of \$14.3 million over 3-years from the issuance of Measure H sales tax-supported debt and grant funded projects has increased the FY 2016 CIP program to \$16.2 million.

Information Technology

The adopted budget continues recognition of the need to be innovative and creative with limited resources to support required, critical IT systems and infrastructure in our operating departments. To help address this critical service gap is the creation of a new position class, Business Systems Analyst. This class will help maximize existing technological resources within the City while also keeping current systems and processes compliant with external requirements.

Conclusion

The City continues to make significant progress consistent with the adopted Strategic Plan. We are seeing revenue gains in the General Fund but are also experiencing uncontrollable pension and health benefit expenditures as well as urgent demand for interim funding of infrastructure and capital costs. Accordingly, we have little room to add new programs and services or to invest any significant dollars in capital projects. Therefore, we must continue our efforts to build the City's tax base, increase efficiency, and implement best fiscal practices.

Our limited resources will continue to be directed at maintaining and rebuilding core functions and services. We are also facing a tremendous and growing backlog of deferred maintenance and infrastructure needs. These needs cannot be addressed within the operating budget and so we must develop and implement an infrastructure strategic plan which sets out a vision and funding plan. My hope is that we will begin this work in the coming months.

Acknowledgments

I want to thank the City Councilmembers for your ongoing leadership and support. I also want to express my sincere appreciation to the City's employees for their hard work and dedication. The development of this budget is a collaborative effort led by the City's executive team who also deserve recognition. We deployed a much more rigorous process this year necessitating double the meetings and review than in past years, and at the same time reduced the timeline to prepare, present, and adopt the budget.

Finally, our finance professionals who together crafted this budget deserve much praise. More specifically, I want to acknowledge our Finance Director Marcus Pimentel and Assistant Finance Director Cheryl Fyfe for their leadership, resilience, and quality work. Finance Manager Raymond Chin, Senior Accountant Beth Cabell, and Accountant IIs, Ralph Reader, Tracy Cole, and Nick Gong provided critical support in the direct development of this financial plan with support by Administrative Assistant III Natalia Duarte and the rest of the Finance Department staff to manage an even more condensed timeline than the prior year.

The City continues to be fortunate to have such a high, professional level of commitment and talent throughout our entire City.

Sincerely,

A handwritten signature in blue ink that reads "Martín Bernal". The signature is fluid and cursive, with a large loop at the end of the last name.

Martín Bernal
City Manager

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