



# CITY MANAGER'S BUDGET MESSAGE

**Martín Bernal**

May 12, 2017

---

## To the Honorable Mayor and Members of the City Council:

It is my honor to present you with the Fiscal Year (FY) 2018 Annual Budget for the City of Santa Cruz. This budget continues to build on the City's Strategic Vision to enhance: (1) environmental sustainability and well-managed resources, (2) community safety and well-being, (3) economic vitality, (4) organizational health, (5) financial stability, (6) reliable and forward-looking infrastructure and facilities, and (7) an engaged and informed community. To achieve these multi-year goals, close to 50 different initiatives and projects are underway, in addition to day-to-day operations to serve our community.

This year, we have also embarked on developing a work plan in order to focus priority and resources on the most critical needs facing our community. By focusing on a limited number of high-priority objectives, and targeting our existing resources there, we hope to be able to improve our effectiveness and deliver outcomes faster. The City Council has agreed that our two-year work plan will focus on implementing projects and programs to address three critical areas:

**Increasing Housing Availability and Affordability**

**Enhancing Community Safety and Well-Being**

**Delivering 21st Century Infrastructure**

These priorities, discussed in more detail later in this message, will be supported through the FY 2018 Budget, largely with the dedication of staff focus and time.

# Budget Overview

The Annual FY 2018 Budget totals \$263.2 million. This includes an operating budget of \$211.3 million and capital project appropriations of \$47.1 million. The major operations included in the FY 2018 operating budget are the City's General Fund of \$106.1 million, which supports our day-to-day public safety, roads, traffic, and parks operations; the Water Fund of \$55.2 million; the Wastewater Fund of \$26.3 million; and the Refuse Fund of \$21.5 million.

The budget is largely a status quo budget in that functions, programs, and services are proposed to remain at the same level of funding and staffing, with marginal changes across the organization to respond to service needs. The organization's operating budgets have grown due to natural escalation in costs, predominantly in the employee health care and pension categories. More information about the FY 2018 Budget, and these operations, are presented in the Finance Director's Budget Overview and in the Department Summaries.

---

## The Financial Big Picture

### **At the State and National Level**

The national economic climate was modestly positive in 2016. Economic growth (GDP) was 1.6% and the forecast is for growth to continue in this same range. However, this is a slow down from 2015, where we saw growth of 2.6%. While regional economic growth (Bay Area) has been higher than the U.S. as a whole and the State of California, job growth there fell from 3.8% in 2015 to 2.7% in 2016. The overall trend is a slowing down of the economy. Further, considering the historic national recession-and-growth cycles, the economy is overdue for a recession. We are watching our revenues and models closely to track indicators of an economic downturn.

The Governor released his proposed budget on January 10, 2017 for the 2018 fiscal year. Governor Brown warns that 2018 will be the most difficult year faced by the State since 2012. Revenue growth has declined and a budget deficit of \$2 billion was forecasted. But with his May Revise, the Governor updated the projected budget deficit to \$500 Million.

When faced with deficits, the State has historically balanced its budget at the expense of local government. And while cities have successfully adopted measures to limit any further raids on local revenues, it is possible that the State, faced with a massive budget deficit, may once again look to cities to help solve its budget problem. We will have to remain vigilant to continue to protect local revenue.

## At Home

While we have incrementally recovered from the Great Recession and slowly recuperated programs and services, including employee compensation, a financial hurdle looms for public sector agencies in California. Our financial projections estimate that the City will face budget deficits in the General Fund over the next several fiscal years. The reason is that revenue growth is expected to slow down, while costs will continue to climb at a higher rate, particularly employee pension and health care costs. After Fiscal Year 2022, we anticipate some modest recovery based on reduced expenditures (largely from the payoff of pension obligation bonds and the leveling off of pension rates) and the expectation of increased tax base.

For this reason, we need to be restrained in adding to the City's ongoing operating budget. The overall fiscal trend is simply not sustainable as expenditures are outpacing economic and tax base growth. Bridging this gap, while maintaining services and responding to emerging needs, is our challenge, particularly over the next five years.

Thus far we have employed a multi-pronged approach. On the revenue side, the growth in transient occupancy tax (TOT) has been our saving grace. The City has been able to increase the tax rate to its current level of 11 percent. More significantly, we added to our hotel stock with the approval of major hotel projects, some of which are completed, and others which are currently under construction, or will be in the next several years. The modestly improving economy has also helped to improve general revenues. We have also been working on keeping fees at the closest cost recovery level possible. The expenditure side, however, has been much more difficult to manage as a significant portion of our costs (health care and pension) are largely out of our control.

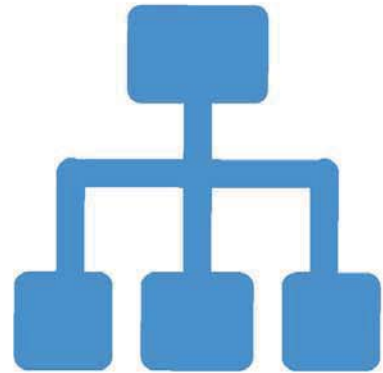
Moreover, we have been forced to redirect general revenues into the operating budget that we previously set aside for capital projects. For the second straight year, we are in a position where zero General Fund revenues are set-aside for the General Capital Improvement Program, a situation that is unsustainable, particularly if we are to continue to maintain and improve our facilities (storm drain system, community centers, corporation yards, fire stations, and cultural and parks facilities).

Looking ahead at what else we will need to do in the coming fiscal years, there is no way to avoid expenditure reductions in order to reduce the size of projected future operating deficits. It is best to look at making expenditure reductions proactively and strategically, as opposed to waiting until we face massive deficits and help pay for badly needed capital projects. Accordingly, in fiscal year 2018, I anticipate that we will need to direct departments to identify potential cost reductions, including accessing whether services are no longer priorities for the community and whether these resources could be better applied elsewhere. We will need to start this process early on and incorporate it into the strategic planning and work plan update process.

We must also continue to look at increasing the City's tax base and may have to ask our residents to adopt a general revenue measure for operating and capital needs. As noted above, maintaining fiscal stability is a strategic goal of the City. Given Santa Cruz's long history of sound financial management, there is every reason to believe that the City will continue to successfully address budgetary issues, while continuing to provide needed and emerging services to the community.

# Our Fiscal Years 2018-2019 Work Plan

Santa Cruz is an ambitious community. Our residents have high expectations and there is never a shortage of worthwhile endeavors. The City's Strategic Plan and Goals reflect this ambition. However, with close to 50 priorities, it is no surprise that we have struggled to balance our workload with our available resources. At the same time, over the last several years, we have seen several significant issues becoming more pressing, arguably becoming crisis situations. That is why this year's City Council annual strategic planning process focused on developing a two-year work plan that takes into account available resources, as well as on projects and objectives that are achievable and require action within the work plan timeline.



As highlighted at the top of this message, it should not come as a surprise that the priority areas identified by the City Council fall into three critical areas: (1) housing, (2) community safety and well-being, and (3) infrastructure.

## Housing

Santa Cruz is one of the nation's least affordable communities with regards to housing. There are multiple variables that affect the supply and demand for housing including: (1) the fact that the City is largely built out, (2) our proximity to Silicon Valley, (3) university growth, (4) our coastal location (desirability and tourism), (5) the cost of land, and (6) the significantly reduced level of financial resources to augment and sustain the subsidized affordable housing stock.

The impact is profound and is changing the face of our community. More and more members of our community are no longer able to afford to buy or rent in Santa Cruz. This includes individuals in low, medium, and high wage professions; from restaurant and hotel workers to nurses, teachers, police officers, tech workers, and other professionals. It is particularly impacting millennials who are in the formative years in their careers and beginning to start their families, as well as our service workers who are forced to move farther and farther away and commute into the City.

While the City does not exist in an isolated or independent housing market and cannot alone manipulate the market, there are actions that the City Council can take to affect both the supply and demand for housing. In the coming two years, the City Council will consider policies related to (1) short-term and vacation rentals, (2) higher density, especially Santa Cruz appropriate density in the Downtown, (3) affordable housing incentives, and (4) university growth. We also need to identify a revenue source to assist in the development of housing, including affordable and workforce housing.

## **Community Safety and Well-Being**

Community safety and well-being in Santa Cruz has, in recent years, largely been defined by the increasing levels of nuisance crime and anti-social behavior in our community. There are many reasons for this. First, the criminal justice system reforms that have occurred in the last several years to reduce prison overcrowding, while perhaps necessary and for good cause, have been made without providing the appropriate level of support services (shelters, rehabilitation, drug treatment, etc.). Crimes that used to result in jail time now result in citations. These criminal justice reforms were made by the state legislature and voter propositions, not by cities, yet cities are bearing the impacts. Second, drug use has increased and the types of drugs that are used now make it very difficult to get sober through rehabilitation; and these drugs spur individuals to commit theft crimes in order to feed their addiction. Third, the state and federal governments do not provide sufficient mental health facilities and outreach services. In summary, as a society we have chosen to deal with many of our mentally ill and drug addicted by relegating them to the streets, where they do not get the help they need and cause the problems that the community is experiencing.

We are experiencing a larger societal issue, and Santa Cruz is not alone in seeing increases in homelessness, drug addiction, and nuisance crimes. Many cities across California, and the United States, are facing the same situation. This is particularly true for county seats like Santa Cruz, which host jails, courts, and county public health facilities (Los Angeles, San Francisco, San Jose, Salinas, and Santa Ana are also county seats). Communities such as ours are more heavily impacted.

The City of Santa Cruz has not, and cannot, ignore this significant issue. We have taken measures to address this continually increasing problem. Amongst those are increased enforcement staffing (police and rangers), upholding community standards, and funding prevention (rehabilitation, mental health) and housing programs. We have also established an interdepartmental Neighborhood Safety Team whose priority is to address problem areas by combining the resources of all of the City's departments to more holistically address neighborhood issues.

The City of Santa Cruz, however, cannot solve this problem alone. Cities are not principally charged with responding to public health issues. This is a responsibility of the state and, being arms of the state, counties. Nonetheless, the City has to be a partner in solutions. The City allocates significant funds every year to address a variety of social service needs from our General Fund including: homelessness, mental health, substance use disorder, and shelter programs. The City Council also adopted the recommendations of its Homelessness Coordinating Committee, a 20-pronged plan that in partnership with other agencies, and service providers, will reduce the suffering and community impacts of homelessness. We must also advocate strongly at the state and federal level, to provide the tools and resources to address homelessness, drug addiction, and mental illness.

## **Infrastructure**

The lack of infrastructure funding for General Fund operations is a major problem. This includes funding to improve aging facilities (like the Civic Auditorium, storm drain system, community centers, corporation yards, fire stations, and cultural and parks facilities) or to build new facilities like soccer fields and a sports arena. The only viable way to address this in a meaningful way, is to invest additional funds that are only likely to come by way of a voter-approved revenue ballot measure.

Despite the doom and gloom of future infrastructure funding, we do have several bright spots. First, the voters approved funding to modernize the library branches within the City, although there will be a funding gap that will have to be filled. The Downtown Branch is in particularly bad shape. With the appointment of the Downtown Library Advisory Committee, the process has started to develop the vision and programming for this critical regional branch. Second, funding for infrastructure has increased at the regional and state level. In November of 2016, voters approved a regional transportation funding measure (Measure D) that will increase City funding by approximately \$1 million in this proposed budget. The state legislature also recently approved infrastructure funding legislation (SB 1) that will provide much needed resources.

The infrastructure of the 21st Century is the telecommunications fiber network. With the City Council's recent approval of the I-Net Plan and Dig Once Policy, the City is poised to begin the process of creating the beginnings of this critical infrastructure. In the coming year, the City will also explore the feasibility of building a ubiquitous City-owned network to serve all of the residents of our community, including those that live in areas where internet service providers have no financial incentive to serve with high speed services.

My hope is that working with the community, we might be able to bring forward a Quality of Life Initiative to significantly improve our economic, cultural, recreational, and public infrastructure and facilities.

---

## **Conclusion**

Santa Cruz is an amazing place. While no doubt we are facing some major challenges, the future is filled with tremendous opportunities. Our charge is to take advantage of these opportunities to meet the needs of our community and further improve our quality of life. The Fiscal Year 2018 Adopted Budget, furthers the City's Strategic Vision and Work Plan, and will hopefully contribute to making the City of Santa Cruz an even more amazing place.

# Acknowledgements

I want to thank the Mayor and Councilmembers for your dedication, guidance, and leadership. I also want to thank the City's department heads and senior staff who provide internal leadership, wisdom, and continued flexibility, in crafting solutions to meet the community's service demands. Finally, I want to thank each and every employee of our City, for their efforts that make the City of Santa Cruz an incredible place to live, work, and conduct business.

The Finance Department deserves special recognition as well for crafting and compiling this Annual Budget. This City is very fortunate to have this caliber of dedicated, intelligent, and resourceful finance professionals.

Sincerely,

A handwritten signature in blue ink, appearing to read "Martín Bernal". The signature is fluid and cursive, with a prominent loop at the end.

Martín Bernal  
City Manager

*This page intentionally blank*