

Policies & Issues

INTRODUCTION

The *Policies & Issues* section of the Proposed Budget outlines the most important “big picture” budget issues faced by the City of Modesto, and highlights aspects of the budget with the most immediate significance to the public.

This year, this section expands upon the “Policy Questions” format used in previous budgets, to include:

- Policy Direction: policy direction which the Finance Committee and the City Council have given to staff and which have guided the development of the Proposed Budget
- Budget Highlights: key proposals included in the Proposed Budget which would modify existing City policies and practices, or which could have a significant effect on the general public
- Policy Questions: major open policy questions for the City Council to discuss in its budget deliberations
- Long Term Issues: unmet service needs and areas which may require future investments, along with the general outlook for the City’s financial future
- Strategic Directions: four alternative directions the City of Modesto could follow in the upcoming three to five years, to help frame the overall budget discussion

In addition, this year we have asked City department directors to prepare staff papers on selected policy issues. These staff papers are collected in Appendix A, and the discussion in the following pages cross-references the staff papers where appropriate.

We look forward to feedback from the Council and the public on the usefulness of this new format.

POLICY DIRECTION

This section outlines the major Council policies that have guided the preparation of the Proposed Budget.

1. General Fund Beginning Balance Estimate

Staff identified a range of estimates for the 2004-05 beginning balance in the General Fund, based on different assumptions about revenue receipts and department spending patterns. The Committee selected the “most likely” estimate of \$14.7 million.

2. Use of Reserves to Balance the Budget

Staff originally identified a General Fund shortfall of \$9.7 million and presented a number of alternatives for balancing the budget. The Committee opted to make up one half of the shortfall by tapping the City’s reserves, with the other half to be addressed by budget cuts. The General Fund shortfall has since been revised to \$8.5 million, due to an improved revenue outlook. The Proposed Budget roughly follows the Committee’s “50% reserves + 50% cuts” policy to the updated shortfall, using \$4.1 million in reserves and \$4.4 million in cuts, revenues and one-time savings.

3. Police & Fire Departments Exempt from Across-the-Board Cuts

The Committee was asked to determine whether the Police and Fire departments should be included in the base from which the \$4.4 million needed to be cut. The Committee directed that the Police and Fire departments should be excluded from those cuts. With Police and Fire excluded, and after deducting department-specific revenues and internal payments for City services (i.e. internal service fund charges), the remaining General Fund cut base was \$16.9 million. Across-the-board cuts were assigned at approximately 15-16% of each department’s cut base.

4. General Fund Reserve

The Committee re-affirmed the existing Council policy that a minimum reserve equal to 8% of General Fund expenditures, should be retained.

5. Unfunded Liabilities

The Committee directed that sufficient funding be included in the budget to keep the City’s unfunded liability for post-retirement health benefits, estimated at \$40.8 million, from growing in the upcoming fiscal year. They also directed that funding be included for general liability and workers compensation self-insurance reserves at the “expected” cost level. This does not include a funding “cushion” for claims above the expected level. (See staff paper #13 in Appendix A for more details.)

This section describes many of the key proposals that have been incorporated into the Proposed Budget, focusing in particular on items with major policy implications or which may have a visible service impact on the community. The budget highlights are grouped under the following headings:

- Visible Service Reductions
- Reorganization
- Revisiting Formulas & Allocations
- Improved Administrative Cost Recovery
- One-Time Savings
- Areas of Increased Spending

Visible Service Reductions

Staff has made every effort to minimize the visible service impact of budget cuts on the community. Where possible, cuts have been implemented in ways that will attract little public attention – for example delaying the replacement of aging equipment, or eliminating executive and administrative positions. However, there is only so far such “belt-tightening” measures can go – and this is the third consecutive year of belt-tightening the City has faced. Some degree of community impact is inevitable.

The following summarizes some of the more visible service impacts of the 2004-05 Proposed Budget:

- City Hall at the Mall (CHATM) will close. A police presence will remain at the current CHATM site, but bill payment and other services currently offered there will no longer be available.
- Funding for local arts groups and community events will be eliminated (with the exception of \$10,000 for the Fourth of July Committee, which is covered by a two-year agreement). We hope that these organizations will be able to locate private support to replace the lost City funds, but this cannot be guaranteed.
- Community groups will be asked to pay the costs – such as police, fire, and clean-up – of local events and festivals
- The “open swim” programs at the Davis and Downey High School pools will be discontinued. This will leave three high school pools still available for recreational use.
- The use of the multi-purpose facility at Somerset Middle School for community recreation will be discontinued.
- Green fees at municipal golf courses will be increased, making the Golf Fund self-supporting, allowing the elimination of the General Fund subsidy.
- Restroom facilities in certain neighborhood parks will be closed.

- Tennis courts at Graceada, East La Loma, and Roosevelt parks will be closed, and lighting at all tennis courts will be deactivated.
- Maintenance of certain “pocket parks” will be ended, except where absolutely required for health and safety. The City will explore options for mitigating the impact of this change, such as adopt-a-park arrangements and sponsorships. It will also explore the option of selling parcels when feasible.
- Park landscape watering will be cut back by 15%, which will degrade turf conditions visibly. However, irrigation at this level is expected to keep the park trees alive. Planting of new trees will largely be limited to new subdivisions and developments which pay a fee for tree planting.
- Although the Police and Fire budgets have not been reduced, the Proposed Budget provides no funding for additional officers or firefighters. Therefore, service levels may not keep pace with growing population and demand.

Reorganization

The Proposed Budget includes a proposed reorganization affecting several City departments. While many implementation details remain to be worked out, the key points are the following:

- Parks maintenance services will be transferred from the Operations & Maintenance department to the Parks, Recreation and Neighborhoods department. This will create an integrated department responsible for all aspects of parks planning, development, acquisition and maintenance.
- The Engineering & Transportation department will be merged with the remaining functions of Operations & Maintenance, giving Modesto an integrated Public Works department.
- The roles of City Manager and Finance Director will be merged.
- Once these changes are completed, it will be possible to eliminate three executive level management positions and two executive secretary positions.
- City-wide ongoing cost savings are estimated at approximately \$600,000, with approximately \$450,000 accruing to the General Fund.
- Some transition and implementation costs, in the neighborhood of \$100,000, are also anticipated.

Revisiting Formulas & Allocations

Over the years, the City of Modesto has established policies, practices and agreements which automatically allocate funding to various purposes, departments and agencies. In some cases the allocations are formula driven, while in others they involve flat dollar amounts. However, at a time when the City is facing the need to make significant cuts, it makes sense to revisit these standing allocations.

The Proposed Budget includes reductions in several of these allocations:

- **Parks Fund**

In previous years, the Council has directed that 3.8% of property tax revenues be earmarked for parks development and be transferred to the Parks Fund for that purpose. In the current fiscal year, a portion of this funding (\$150,000) was re-allocated to parks maintenance, “back-filling” a cut which was needed to balance the 2003-04 budget.

In the current financial climate, in which parks maintenance is already being scaled back, setting aside a fixed amount of General Fund resources for future parks development appears unsustainable. The 2004-05 Proposed Budget would eliminate the fixed “earmark” percentage, and reduce the transfer to the Parks Fund to \$136,533. This amount is needed to meet existing commitments under the School Facilities Infrastructure program.

- **Modesto Redevelopment Agency (RDA)**

In previous years, funding was allocated for the RDA according to the following formula:

- (a) All sales tax produced by the Lincoln High School site (Savemart), plus
- (b) All transient occupancy tax (TOT) generated by the DoubleTree Hotel, plus
- (c) Twenty percent of the remaining TOT

This funding was deemed necessary to allow the RDA to service its existing debt, to carry out its administrative functions, and to perform planning tasks under its existing workplan. The City Council has determined that this support should be classified as a loan from the City to the RDA. An interest rate for the loan has been agreed, but no repayment schedule has been determined.

The primary funding source for the RDA is the property tax revenue associated with increased values within the redevelopment area (the “tax increment”). In recent years, the RDA’s tax increment revenues have significantly exceeded expectations. As a result, we believe that General Fund support for the RDA can be reduced by 50%, without impacting the agency’s ability to service its debt and perform its other basic functions.

The Proposed Budget reduces the General Fund support to the RDA accordingly, yielding a savings of \$479,000 per year. However, it should be kept in mind that the RDA lacks resources to undertake major new projects and planning efforts. (See staff paper # 11 in Appendix A for more information.)

- **Strategic Planning Fund**

The Strategic Planning Fund is a separate fund which was established to account for resources set aside for major planning projects conducted by the Community & Economic Development department, such as the comprehensive update to the City's General Plan.

In previous years, the City has followed a practice of contributing \$50,000 per year from the General Fund to the Strategic Planning Fund. In addition, the annual payments on the \$2 million loan from the General Fund to the Village I Community Facilities District have been directed to the Strategic Planning Fund rather than to the General Fund itself. The loan payment amounts to \$125,000 per year.

The Proposed Budget would end the annual transfer from the General Fund to the Strategic Planning Fund and re-direct the Village I loan repayments to the General Fund. This action will not impact dollars already set aside for initiating the General Plan update or other CEDD projects. However, existing funding falls short of the amount probably needed to complete the General Plan update. New projects – and additional funding for existing projects – will need to be considered and funded on a case-by-case basis.

- **Convention & Visitors Bureau (CVB)**

In previous years, the City has allocated 13.33% of revenues from the Transient Occupancy Tax (TOT) to the Convention & Visitors Bureau (up to \$330,000, and 5% of TOT once the \$330,000 level is reached), which promotes Modesto as a location for conventions, tourism, film production, and other activities.

The Proposed Budget would reduce the 2004-05 allocation by 15.7%, the same across-the-board cut factor applied to all General Fund discretionary spending. This reduction treats CVB “on par” with City departments.

- **Sidewalks, Curbs & Gutters**

In previous years, the City has transferred \$200,000 per year from the General Liability fund to the Gas Tax fund to pay for sidewalk maintenance projects. The rationale was that excess funding in the General Liability fund could be used for projects that might reduce the number of “trip-and-fall” claims against the City.

However, as a result of actions taken in the current fiscal year to eliminate the substantial unfunded liability in the Workers Compensation fund, the General Liability fund no longer has reserves in excess of expected costs. Therefore the Proposed Budget would discontinue this transfer.

Improved Administrative Cost Recovery

The General Fund pays the cost of the City's central administrative services such as personnel, accounting, and legal support, as well as department level administrative functions. Many of these costs are recoverable from specific City programs with non-General Fund sources of financing. For

example, the cost of grant accounting and administration can be charged to grant-funded programs, and the City will be reimbursed by the grantors.

In some cases, the City has chosen not to fully recover its administrative costs from non-General Fund programs. This has the effect of subsidizing those programs, which allows them to devote their resources to delivering service.

In the current budget climate, however, the City is less and less able to afford such subsidies. The Proposed Budget includes increased cost recovery efforts which are expected to yield over \$300,000 in additional annual reimbursement to the General Fund.

- The City Manager's Office will recover an additional \$40,000 to reflect the Deputy City Manager's role in the administration of Capital Improvement Program (CIP) projects, Community Facilities Districts (CFDs), the Capital Facilities Fee (CFF) program, and Transit
- Finance will recover an additional \$142,000 for its role supporting Transportation, the Modesto Redevelopment Agency (RDA), and the Tenth Street Plaza Joint Powers Authority (JPA).
- Engineering & Transportation will recover an additional \$127,000 primarily from CIP projects and Transit
- Parks, Recreation & Neighborhoods will recover an additional \$12,000, primarily from Community Development Block Grant (CDBG) and Home Investment Partnership (HOME) programs.

One-Time Savings

To help minimize the impact of the General Fund shortfall on the community, the Proposed Budget includes certain one-time savings strategies. These actions produce immediate savings to the General Fund, but may not be sustainable in the long run.

- **Equipment Replacement Deferral**

The Operations & Maintenance (O&M) department and the Parks, Recreation and Neighborhoods (PRN) department will delay setting aside funds for the replacement of certain vehicles and equipment for one year, saving \$265,000 and \$10,000, respectively. The City's Fleet Manager will work to apply these reductions to relatively new equipment, to allow the City the greatest possible time to make "make-up" payments, which would permit timely replacement of the equipment. If make-up payments do not become possible, the equipment's replacement will be delayed, with possible impacts to operational reliability and maintenance cost.

- **Street Tree Program**

The Street Tree program – which maintains the trees which line Modesto's streets – is financed almost exclusively by the City's General Fund, at a cost of approximately \$2.8 million per year. This program is legitimately eligible for gas tax funding, but ongoing gas tax revenues are largely committed to other street maintenance programs, such as pavement management, or to capital construction projects.

The Proposed Budget includes a reduction of \$486,000 in General Fund support for the Street Tree program, which will be temporarily “back-filled” with available balance in the Gas Tax fund. Of course, this means that these gas tax dollars will not be available for other street purposes. Moreover, at this rate the Gas Tax fund balance will be exhausted in two to three years, at which point the City will have to decide between restoring the full General Fund support or cutting the program.

Areas of Increased Spending

Although this is a cut-back year, spending in certain areas is increasing unavoidably. Significant examples include the following:

- **CalPERS Rate Hike**

City employees receive retirement pensions through the California Public Employees Retirement System (CalPERS). Every year, the City is required to contribute a certain percentage of each employee’s salary to the CalPERS system, just as a private employer would pay into a pension plan. The contribution rates are determined by CalPERS based on the contracted benefit levels, the value of previous payments collected and accumulated, and the historical and expected future performance of its investments.

CalPERS has notified the City of significant rate increases for 2004-05 and 2005-06. In the Proposed Budget, the General Fund impact of this rate hike is \$2.6 million (approximately \$2.0 million for public safety employees, and \$0.6 million for non-public safety). Next year, there will be an additional impact of \$1.6 million.

- **Police Grants**

The Proposed Budget includes General Fund spending increases related to a number of Police department grants. A grant received in past years from the Office of Traffic Safety (OTS) is ending, and two police officers supported by the grant will be moved into to the General Fund, at a cost of \$181,000. The SLESF grant which pays for nine non-sworn police personnel is expected to decline in the upcoming fiscal year to approximately \$200,000, leaving a balance of \$282,000 to be paid by the General Fund. (The remainder of the SLESF grant may be at risk in the State budget process, so the General Fund may be called upon to finance the entire cost of these staff.) Finally, \$360,000 is included to pay for the City’s match for the COPS grant and the Cops In Schools program. Both of these grants existed in the current fiscal year, but the positions have only recently been hired, so the matching payments are reflected as a spending increase from the prior year level.

Together, these increases total approximately \$723,000.

- **911 Communications Center Costs**

Emergency 911 communications and dispatch services are provided by a City-County Joint Powers Authority (JPA), which defines its own budget independently of the City’s budget process. In 2004-05, the City’s share of the JPA’s costs is expected to increase by \$500,000 over

the baseline level. This actually represents increases over two years, since the actual JPA costs for 2003-04 were not reflected in the current year's adopted budget.

The cost increase is shared between the Police and Fire departments, with shares of 80% and 20% respectively.

- **Position Swap in Personnel**

The Proposed Budget eliminates the vacant Equal Opportunity Officer position from the Personnel department budget and replaces it with an Employee Relations Specialist, which the department regards as a more urgent priority. Recruitment for the EOO position has been suspended. The Employee Relations Specialist will allow the Personnel department to provide timely advice to department managers on time-sensitive personnel issues. With complex contract negotiations on the immediate horizon, this capacity will be urgently needed. It is expected that this position will cost approximately \$11,000 more per year than the one it replaces, although delayed hiring will offset this impact in the first year.

POLICY QUESTIONS

This section highlights a number of open policy questions for Council discussion. In general, they are questions about how budget decisions should be made, rather than specific budget decisions. We raise these questions to help frame the Council’s deliberative process.

This section is limited to “open” questions – i.e. questions on which the Finance Committee and the Council have not yet provided specific guidance to staff. The *Policy Direction* section, above, recaps the existing Council policy guidelines which have shaped the development of the Proposed Budget.

1. Financing for New Positions

Question: Should the City add permanent staff positions when only temporary or short-term financing for the positions has been identified?

Discussion: Adding a permanent position with temporary financing effectively “places a bet” that City revenues will grow to the extent that when the identified financing runs out, the City will have the means to continue the position in existence. If the position is added in within a high-priority service area, it effectively commits the City to making cuts in other services to continue the position if revenue growth has not been sufficient to pay for the position.

At the same time, adding a position with temporary financing delivers immediate service benefits to the public.

Recommendation: Staff recommends that adding permanent positions with only temporary financing be approached with extreme caution. Council should give consideration to the balance between immediate service needs and long term risk, and should be mindful of the long term impacts that certain short term funding approaches (such as equipment replacement deferral) may have.

2. Budget Under-Expenditures

Question: How should the budget account for unplanned under-expenditure of departmental budgets in the General Fund?

Discussion: In recent years, under-expenditure of department budgets has contributed to the growth of the fund balance in the General Fund. These under-expenditures have had several sources, including long term staff vacancies, short term vacancies (i.e. normal turn-over), and contingency “cushions” built into department budgets. Many staff vacancies have been held open intentionally, partly to create a healthier reserve and partly due to the expectation of budget cuts. The Proposed Budget eliminates a number of vacant positions and reduces or eliminates many departmental contingency cushions. In addition, many long-vacant positions have been filled in the last twelve months. As a result, we expect to see a reduction in under-expenditures.

It is also important to define which departments will be expected to “participate,” particularly whether under-expenditures are to be expected from public safety departments.

Recommendation: Staff recommends that the Council consider incorporating under-expenditures into the budget on a trial basis. We suggest setting a conservative, achievable savings target, such as \$1.5 million over the entire General Fund. We recommend that the City Manager be given the discretion to assign targets at the department level and to re-assign them depending on where vacancies and other savings opportunities occur. We also recommend that the proceeds of the savings be budgeted for expenditures which the City can delay, in case the savings fails to materialize, such as funding for the liability and workers compensation reserves.

3. Long Term Vacancies

Question: How should the City's budget process address long term vacancies in budgeted permanent positions?

Discussion: Long term vacancies (positions which have been vacant 18 months or longer) come to exist in three main ways. First, it may be difficult or impossible to recruit a suitable employee at the offered salary range. Second, the City Manager may direct that the position be left unfilled or that recruitment be delayed – the “hiring chill.” This is done to generate salary savings which enhance the City's cash reserves. Third, a department may choose not to fill a position in anticipation of upcoming budget cuts. In effect, the department deprives itself of the position “preemptively.” This avoids the need to lay off a recently hired employee, which could significantly disrupt the individual's life.

Recommendation: Staff recommends that a review of vacant positions be incorporated into each year's budget process. As part of the review, the reason for each long term vacancy should be identified, and the relevant department director should have an opportunity to explain the rationale for retaining the position. This information should be reported to the Finance Committee and the full Council.

4. City Responses to State Financial Situation

Question: What additional steps, if any, should the City take to protect its financial condition from the immediate – and the long term – effects of the State's financial situation? (See staff paper # 1 in Appendix A for more information.)

Discussion: The Proposed Budget incorporates a reasonable estimate of the impact of the State's budget negotiations upon the City's revenues. It also protects the 8% General Fund reserve, and leaves \$1.8 million in General Fund balance over and above the 8% level. The policy question is whether the City should take additional steps such as (a) raising the 8% minimum reserve to reflect the unusual volatility of the City's “State-impacted” revenues, and (b) negotiating automatic adjustments in its collective bargaining agreements triggered by State budget actions.

UPDATE: As this document goes to press, new information regarding the likely State impacts has become available. The latest proposal increases the proportion of the \$1.3 billion statewide impact which will be borne by cities. As a result, a component of the state impact originally estimated at \$900,000 in fiscal 2005 now appears to be closer to \$2.1 million for each of the next two years.

Recommendation: Staff recommends that Council consider creating an additional 2% “State impact layer” in the General Fund reserve policy (bringing the total reserve to 10%). This layer would be available to offset the effects of State budget actions in future budget processes. Staff also recommends that the feasibility of recognizing State impacts automatically in collective bargaining agreements be explored.

This section outlines a number of issues which are not addressed – or addressed only partially – in the Proposed Budget. These are presented primarily to frame the Council’s deliberations, rather than to elicit immediate decisions.

Many of the long term issues identified here represent unmet service needs and service levels that fall short of desired targets. Naturally, we would like to meet each of these needs, and to hit every target, and the fact that we have limited financial resources does not make any of these goals unworthy. It may, however, force us to make difficult choices.

1. General Fund Financial Outlook

The outlook for the General Fund even as little as one year ahead is murky. Key variables, such as the outcomes of the State’s 2004-05 and 2005-06 budget processes, as well as the results of upcoming labor contract negotiations, are essentially unpredictable – and any projection which ignores such factors would be meaningless.

However, based on our current expectations for State action, and moderate assumptions about the growth of revenues and costs, it appears that next year’s General Fund budget will face a shortfall in the neighborhood of \$4 million. This is not surprising: it corresponds closely to the portion of the 2004-05 shortfall that is addressed by tapping our reserves.

Of course, those reserves will be largely expended in the upcoming fiscal year, and, if the Council opts to budget the prospective department under-expenditures for self-insurance or other needs (see *Policy Questions* above), there may be no easy way to replenish them.

In any event, barring unexpectedly strong revenue growth in the upcoming year, it is possible that the City may need to make up to \$4 million in additional spending reductions next year.

Beyond 2005-06, the picture becomes even less clear. The key question is whether City revenues will grow faster than its cost levels (chiefly wage and benefit rates) and population. If so, shortfalls will eventually give way to surpluses, which may allow the City to rebuild or even enhance service levels. If not, the City may face a number of difficult years.

2. City Utilities

The City of Modesto delivers three major utility services to its residents and businesses: water, sewer, and storm drainage. Today, each of these utilities faces pressing needs – with corresponding financial requirements. The following paragraphs summarize the situation in the utilities. (See staff paper # 12 in Appendix A for additional details.)

Water Fund: The City of Modesto provides water to residential, commercial and industrial customers throughout its service area. Residential customers pay a flat fee for water based on the square footage of their homes, while commercial and industrial customers pay a metered rate, based on their actual water consumption. Modesto’s water supply comes from two principal

sources: ground water pumped from wells, and surface (i.e. river) water treated by a plant owned by the Modesto Irrigation District (MID).

The main challenge facing the water fund is the declining availability of Modesto's ground water. To keep the water safe for the community, the City has undertaken expensive additional treatment at some wells, and shut down others entirely. The result is that the City is increasingly dependent upon surface water from the MID plant – and the plant is nearing its full capacity.

When originally constructed, the MID plant was designed to be expanded: it is engineered so that its capacity can be doubled cost-effectively. Even so, doubling the plant's capacity (from 30 million gallons per day to 60 mgd) will be an expensive capital project, and the cost of connections, new distribution pipelines, and storage tanks will only increase the total price tag. And there are additional projects needed to maintain the system in good working condition.

Unfortunately, current water rates are inadequate to finance these projects or to pay for ongoing maintenance and operations costs. The City is in the process of developing a new Water Master Plan which will address these needs and quantify the level of rate increases which will be necessary to keep Modesto's water supply safe and reliable. The City is also exploring the option of setting metered rates for all customers, in which case users would pay only for their actual water consumption.

Sewer Fund: The City's sewer system suffers from a significant backlog of deferred maintenance and postponed capital investment. As in the case of the Water Fund, current sewer rates are inadequate to finance the projects needed to ensure that Modesto's sewer system is safe and reliable. The City has undertaken a rate study to determine the level rate increases which would be necessary to meet the needs in this fund, and the study is expected to run through the summer of 2004.

Storm Drain Fund: The storm drainage utility is responsible for managing runoff due to rainfall – which can lead to flooding and can carry chemicals from streets and farms into the region's creeks and rivers. Like the water and sewer utilities, the Storm Drain fund has a sizeable backlog of maintenance and capital projects for which it has no funding. Raising rates for storm drainage requires an affirmative public vote. In 2002, a ballot measure to increase these rates passed, but was invalidated on technical grounds. At some point in the near future, the City may place the question before the voters again.

3. Police & Fire Service Levels

The City has identified desirable service level targets for the Police and Fire departments. (See staff papers # 8 and #9 in Appendix A for more information.) Modesto currently falls short of these targets, and significant new resources would need to be allocated to meet them.

The Police department, for example, highlights the standard identified in the City's Capital Facilities Fee (CFF) program, and in the report of the Ad Hoc Committee on Public Safety: 1.85 sworn officers per 1,000 population. At current salary and benefit levels, and with today's population, it would cost approximately \$16 million (per year) to meet this standard. Similarly, the Fire department highlights targets which could cost \$5 to \$6 million to attain.

4. Street Maintenance Backlog

Street maintenance encompasses a wide range of activities, including street lights & signals; sidewalks, curbs & gutters; traffic operations; and maintaining the trees which line Modesto's streets. But the most widely noticed aspect of street maintenance is pavement management: maintaining the surfaces underneath our tires.

Currently, the pavement of over one-quarter of Modesto's streets is in "poor" or "very poor" condition, as defined by traffic engineers. An additional 23% is graded "fair." Only 49% of the City's streets are in "good" condition, a fact which our residents have certainly noticed. (For more details on this topic, see the Street Report, which appears as staff paper #3 in Appendix A.)

It is estimated that reconstructing all streets in very poor condition would cost \$57 million, and resurfacing the streets in poor condition would cost \$38 million. Combined, the maintenance backlog totals \$104 million.

5. Parks & Recreation Needs

The City's capital facilities fee program includes over \$100 million in parks and recreation capital needs to serve the existing population. In addition, the parks system suffers from a considerable maintenance backlog. (For more information on this topic, see staff paper #4 in Appendix A.)

6. Technology Replacement & Upgrades

Currently, the City has no mechanism in place to accumulate funding to pay for large "enterprise-wide" systems upgrades or replacements. Such systems can cost millions of dollars to license and implement, so long-term planning for their acquisition can be essential. (See staff paper #14 in the Appendix for more information on this issue.)

7. General Plan Update & RDA Projects

The Proposed Budget reduces General Fund support to both the Redevelopment Authority and the Strategic Planning Fund. In the long run, this could leave both the RDA and City planners without the resources to initiate or complete major economic development projects, which could be vital to the community's future. (See staff paper #11 for more on this topic.)

8. Self-Insurance Fund "Cushions" & Post-Retirement Health Benefits

Actions taken in the current fiscal year and in the Proposed Budget will eliminate the unfunded liability in the City's Workers Compensation self-insurance reserve, and keep both the Workers Compensation fund and the General Liability fund at a funding level commensurate with the actuarially determined "expected value" of future costs. However, the current budget includes no resources to provide a funding "cushion" for the prospect that costs could exceed the "expected" level. Approximately \$3.8 million would be needed to provide 75% confidence that actual cost would not exceed the funding level in these funds.

In addition, the City expects to hold its unfunded liability for post-retirement health benefits steady in the upcoming fiscal year, at approximately \$40.8 million. While arresting the growth of this liability is a major accomplishment, the City will eventually need to take steps to shrink it to more manageable proportions. (See staff paper #13 for more on this topic.)

STRATEGIC DIRECTIONS

As every business knows, if you try to do everything at once, you wind up doing nothing well. “Strategic direction” is just a fancy term for a simple idea: if you select a few goals and focus your attention and energy on accomplishing them, your chance of success improves dramatically.

While the idea is simple, choosing a strategic direction is not. Setting priorities is partly a process of deciding what *not* to do, placing some worthy objectives on hold or abandoning them altogether. The upside, of course, is the greater likelihood of actually achieving the goals that *are* pursued.

Elsewhere in this section (see *Long Term Issues*, above), we describe a number of service areas which could benefit from significant new investment. Substantially raising service levels in one or more of these areas is the sort of goal that requires strategic focus. The key questions are:

- Which service area or areas should be addressed?
- What level of service is the goal?
- How – and how quickly – should the City move to meet the goal?

This section focuses on the third question: how and how quickly?

To help frame Council discussion of this topic, we present four broad outlines for strategic directions the City may pursue over the next three to five years. While we include “evaluations,” commenting on the pros and cons of each alternative, we present no staff recommendation. Each direction is potentially valid, depending upon the values and priorities of our citizens and their elected representatives.

***Alternative #1:
Significantly Re-Deploy General Fund Dollars to Different Service Areas***

In broad terms, the City’s discretionary General Fund resources pay for four basic services:

- | | |
|---|------|
| • Public Safety (Police & Fire) | 71 % |
| • Parks & Recreation (including park maintenance) | 11 % |
| • Community & Economic Development (with E&T) | 4 % |
| • Street Maintenance | 3 % |

Debt service accounts for another 3%.

The remaining 8% provides basic administrative and governance functions (such as City Council, the City Manager’s Office, City Clerk, City Attorney, Finance and Personnel).

One option for increasing service levels in one area is to partially or fully de-fund another, reallocating those resources to the higher priority service. For example, the Council could decide that the City should withdraw half of its general fund support from street maintenance and re-allocate those resources to parks & recreation. Alternatively, the Council could decide to move the City “out

of the business” of delivering one service altogether, and use those resources for another. Many other combinations are possible.

When thinking in these terms, it is important to keep in mind that the percentages above fluctuate slightly over time, due to factors like changing wage and benefit costs and CalPERS policies. As a “strategic direction,” re-deployment must go beyond moving a percentage point or two between services. To have a long term effect which will be visible to the public, re-deployment of the General Fund would probably involve a conscious shift of four to eight percentage points on an ongoing basis (perhaps more if the receiving service is already large).

Currently, each percentage point of General Fund discretionary resources is valued at about \$900,000.

Evaluation: The re-deployment option has the advantage of allowing the City to deliver a significant service enhancement without additional tax revenues, at the cost of significantly reducing or abandoning other lower-priority services. If carried out to the extreme, we could become essentially a single-service city. A shift of this nature would probably require a one to three year transition period, from the time the Council committed the City to move in this direction.

Alternative #2: Major New Revenues

The City of Modesto has available to it a number of potential major new revenue sources, such as the following:

- Sales Tax (up to 1% of sales)
- Parcel Tax (flat amount per parcel)
- 911 System Access Fee (flat amount per phone line)
- Special Districts (various)

Most revenue options are subject to a public vote, and would require a 2/3 super-majority if legally dedicated to a specific service, such as public safety. (More details on the City’s revenue options are provided in staff paper # 2 in Appendix A.)

With voter approval, one of these, or several in combination, could be implemented to generate financing for major improvements in certain service areas, without requiring corresponding reductions in other services.

Evaluation: The outcome of this alternative depends first and foremost on the will of the voters, and this may be a point in its favor. Placing a revenue option on the ballot would provide direct and unambiguous feedback regarding the public’s willingness to pay more for higher service levels. To improve the chance of a “yes” vote, the City could undertake a one to two year effort to build the community’s understanding of the need and its confidence in our ability to be responsible stewards of the added resources.

***Alternative #3:
Doing More With Less***

In the decade of the 1990's, corporate America undertook a number of massive efforts to raise productivity, under the rubric of "re-engineering." The basic concept of re-engineering was to take a "clean-sheet" look at an organization's processes and re-design them from scratch, leveraging new technology wherever possible. The results of these projects were decidedly mixed, but some organizations were successful, and some part of the rise in national productivity over the last ten years may be attributable to re-engineering.

A third alternative for raising service levels would be to undertake such a re-engineering effort here in Modesto. In considering this option, it is important to keep in mind that it would go beyond the City's usual efforts to become more efficient on a day-to-day basis. It would involve setting ambitious, explicit productivity improvement goals and a willingness to risk serious disruption in an effort to meet them.

A re-engineering approach would also require the City to focus on "outputs and outcomes" rather than resource-based service level concepts. For example, we would have to identify what tangible results we expect from a resource level of 1.85 sworn police officers per 1,000 population, and the focus on how to achieve those results – without necessarily employing (and paying for) the full 1.85.

It is worth keeping in mind that there is no automatic guarantee that ambitious productivity improvement goals are actually achievable. In any organization, some improvement is surely possible, and Modesto city government is no exception. But how far that goes is unknown.

Evaluation: Re-engineering is probably the most difficult of the four alternatives discussed here, both in terms of the potential for disruption and conflict and in the demands it makes on management. Even in the private sector, re-engineering projects have often been costly failures. On the other hand, if successful, it offers our community the best possible deal: better services with no higher cost. This alternative would be expected to require three to five years of concentrated effort to show major positive results.

***Alternative #4:
Status-Quo Plus***

The fourth major alternative path for the City focuses on gradual incremental improvement in service delivery without major changes in the mix of services delivered or in the revenue base that finances them. We call this "Status-Quo Plus."

The "Plus" may include incremental efficiency improvements, modest changes in the allocation of discretionary resources, and possibly certain relatively small revenue options. But the overall thrust of this alternative is holding the line on current services. This alternative also preserves the City's full range of options for future directions.

Evaluation: The principal drawback to this alternative is that it is highly unlikely to achieve major service level enhancements in any service areas. If this alternative is selected as a long term direction for the City, the Council should re-visit any policy documents (such as the Community Facilities Fee plan) which may commit the City to major service improvements.

Strategic Direction & the Proposed Budget

The Proposed Budget for 2004-05 does not commit the City to any of these four paths. As presented, it is broadly consistent with the “Status-Quo Plus” alternative – it proposes no major re-deployment of General Fund resources, it includes no major new revenues, and it does not assume major productivity increases.

The proposed re-organization, which will create a fully integrated Parks Department and Public Works Department, will streamline our management structure and position the City to pursue any of the strategic alternatives that have been described.