

**City of Modesto Office of the Mayor  
Mayor's FY 2008-09 Proposed Budget Message**

**Recommendation**

I recommend that the City Council adopt the Mayor's Proposed Budget for Fiscal Year 2008-09. This proposed budget is guided by the policy direction and framework of priorities outlined in this Message.

**Introduction**

For the third time in four years, Modesto is facing a significant budget shortfall in the General Fund. This shortfall – over \$13 million for FY 2008-09 – will prevent the City from maintaining the eight percent (8%) reserve as directed by prior Council policy if services are not cut and revenues improved.

We are not alone in this situation. Cities throughout California and the nation are faced with difficult economic times largely fueled by the foreclosure crisis. In the past few months, the city of Vallejo made headlines for considering bankruptcy, while Sacramento, San Jose, and others have made headlines with proposed budget reductions across their General Funds. Could Vallejo's experience happen in other cities? Regrettably, the answer is yes. Fortunately, we have the opportunity to learn from the lessons of Vallejo and others. We must understand our budget challenges now and take immediate action to solve our structural deficit to limit further impacts on the services most important to our community.

**The Economic Climate**

Modesto, like cities across the nation, has been significantly impacted by the foreclosure crisis. The tri-county area of San Joaquin, Stanislaus, and Merced has been hit harder than most areas with over 2,000 foreclosures in March 2008 alone. On an individual basis, many of our neighbors face the challenge of dealing with abandoned homes next door. Left untended these homes become targets of vandalism and property theft. They also devalue the homes in the surrounding area.

On a larger scale, the foreclosure crisis has driven consumer spending in key economic areas such as big ticket sales, home improvements, and car sales to a standstill. Quite simply, homeownership stimulates the economy. When people buy a house, they then purchase washers, dryers, furniture, landscaping, and all those other things that make our homes livable. And, as we have found, they often – when home values are rising – use the equity in their homes for big ticket purchases such as cars and recreational vehicles.

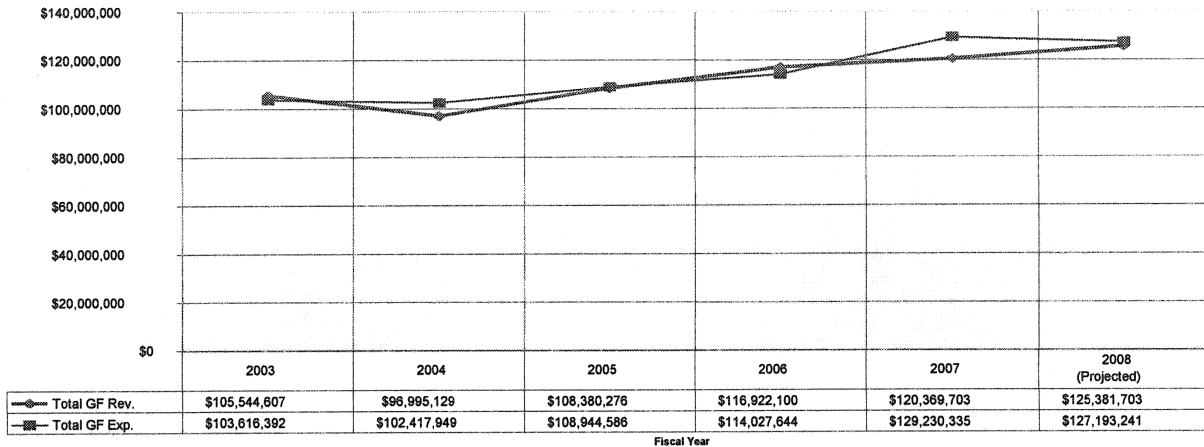
In FY 2007-08, the impact of the housing crisis hit hard. Just two years ago, in FY 2005-06, the City recognized over \$29.6 million in sales tax revenue and projected steady increases of 4-5% in outgoing years. For this current fiscal year, we adopted a budget that estimated sales tax at \$29.4 million. Over the year, that figure has been revised downward four times and we are now estimating we will end the year with slightly less than \$27 million. In FY 2008-09, staff projects sales tax revenue at \$26.7 million.

Property tax revenue has followed a similar path. Homeowners unable to pay their mortgage are also understandably unable, and sometimes unwilling, to pay their property taxes and, with declining property values (about 30% county-wide in the past year), requests for property re-evaluations are coming in at staggering levels. The County of Stanislaus Assessor's Office is anticipating a county-wide drop in property tax valuations of four to eight percent. Given Modesto's strong commercial sector property values, we anticipate the decrease will not be as substantial, but it is clear we can no longer anticipate the steady revenue increases once enjoyed. For next fiscal year, property tax revenue is expected to remain flat with no growth

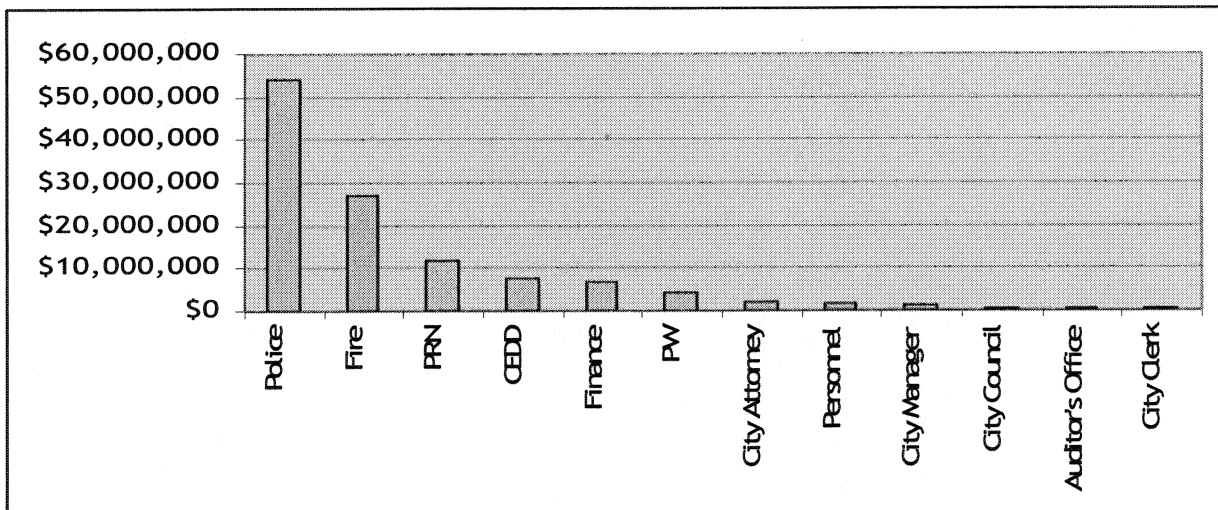
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projected. This is an area we must monitor closely and be prepared to react quickly to as needed. We anticipate more information from the Assessor's Office in September – October.

As the chart below shows, we face significant challenges in the years ahead. Even with the significant budget deficits of the past, spending has increased faster than growth in revenues as illustrated in the chart below detailing revenues and expenses (including fund transfers) from FY 2003 through 2008. Bluntly, we have a spending problem.



Historically, this Council and Councils before it have focused the vast majority of General Fund resources on core municipal services, most specifically public safety. In the upcoming budget year, 69% of department operating expenditures will be spent in the Police and Fire Department budgets. The remaining 31% must then be spread thinly to provide other vital community services such as park maintenance, growth planning, and personnel and financial services. The chart below graphically illustrates the allocation of General Fund operating dollars in FY 2008-09.



When expenditure trends are broken out and evaluated by category, the analysis indicates that personnel costs, which account for approximately 75% of the General Fund budget, is the largest factor driving spending beyond growth in revenue. Factors that drive personnel costs

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include scheduled step increases, negotiated salary and benefit adjustments, and retirement costs.

Historically, we have balanced our budget by using a combination of one-time and on-going revenue and expenditures solutions with the expectation that the economy would improve. Now is the time to be realistic – the economy is stagnant or declining and will likely be that way for the foreseeable future. But even if the economy were to improve tomorrow, the lesson remains the same – we must protect the services which are most vital to this community and to do so, we must fix our spending problem. This is a challenge that will not be remedied in one year, but making the tough decisions now will equip us with the tools for a more financially stable future.

**Background**

In February, Modesto voters overwhelmingly approved amendments to the City Charter through Measures M and N. Measure M charges the Mayor with the development and delivery of a recommended budget. The FY 2008-09 marks the first implementation of this change.

It was only fitting that this year, the Mayor's State of the City Address focused on the subject of "*Keeping our Fiscal House in Order.*" Doing so requires discipline. We cannot continue to spend more than we take in. We cannot continue to provide every service residents want. We must set priorities and we must, when we are able to do so, fully recover the cost of doing business.

This message intentionally does not outline new spending proposals. This is not the time for such things. Instead, this message focuses on the things we can and must do to make progress to control spending while meeting the expectations of our citizens in the delivery of vital community services.

To achieve this we must ask the hard questions about City programs and services:

- ✓ Is the service needed and who does it serve?
- ✓ Does it serve Modesto residents' greatest needs?
- ✓ Can we do it better and at less cost?
- ✓ Are there others who provide the service with whom we can partner to reduce costs and improve effectiveness?
- ✓ What are the long-term benefits of continuing the program or spending level?

Despite the challenges ahead, I remain confident that we can make the tough decisions required of us as the City Council and as an organization. This confidence is not misplaced. This Council has shown great leadership in many areas, most notably in the utility funds. As I've said before, we must be in a position to fully recover our cost of doing business. In the Water Fund, the capital improvement program reflects the downstream projects that are vital to the expansion of the surface water treatment plant paid for by bond proceeds. The plan to provide water meters with automated reading devices at each customer location is on track and should be completed by the target completion date in 2016. Revenues in the current year are tracking well compared to the revised forecast established in the Rudnansky Water Rate Study Report. Plans are also being made for the next water rate study that is needed to support the costs of the proposed surface water treatment plant project being constructed by the Turlock Irrigation

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District and the higher costs associated with the construction and operation of the expanded surface water treatment plant operated by the Modesto Irrigation District.

In the Sewer Fund, the recently adopted fee structure is generating the levels of income forecast in the rate study. The proforma reflects that both the operating costs and capital project costs are adequately funded. Bond debt service coverage is adequate and provides an indication that the plan to finance future capital spending with long-term debt can be accomplished. Cash reserves in the sewer fund are adequate to provide a contingency reserve and pay for a significant amount of the capital improvement program. The ability to pay cash for these multi-million dollar projects will save the ratepayers millions of dollars in future costs.

By contrast, the Storm Drain Fund is not self-sustaining. Each year, the General Fund must loan money to this enterprise fund just to keep basic operations going. In FY 2007-08, the General Fund subsidy amounted to over \$800,000. In FY 2008-09, the General Fund contribution is limited to \$326,000. Because of this, the Storm Drain Fund proforma currently reflects a deficit of approximately \$2 million including the cost of the pruned refuse program which is estimated at \$1.2 million. There are no monies budgeted for new capital programs or for reinvestment in stormwater infrastructure. **I encourage my colleagues to seriously consider the implementation of regulatory fees for those programs and services in the Storm Drain Fund mandated for certain customer classes. I also have directed the City Manager to return to the City Council with a proposal to again consider eliminating the pruned refuse program.** This is a program that is frequently provided by other communities in a different form and without the significant financial investment by the City. Earlier I asked the question – “Does the service meet our residents’ greatest needs?” For pruned refuse collection, I believe it is a service that we can no longer afford when priority services such as public safety are being reduced.

The final area of major budget expenditure is in our traffic and transportation related programs. This year, we once again face significant challenges. Proposition 42 funds were withheld by the State as they dealt with their own budget challenges. This reduced our budget for road maintenance and projects by approximately \$1 million. Earlier this year, we were also notified of the State’s intent to withhold the City’s Gas Tax funding for 5 months (April – August). And, although the City is being allowed to utilize Proposition 1B funds to replace this loss, it yet again points out the precarious position the City is in due to our dependence on State funding. If a transportation sales tax measure was ever needed, the time is now. One final note on road maintenance – as part of this year’s budget presentation, Council will receive a copy of the City’s first annual Roads Report. This report will highlight the accomplishments of the prior year, funding, and upcoming challenges. I hope you find it useful. In the near future, you will see similar reports prepared for the utility funds as well.

The Mayor’s Proposed Budget for FY 2008-09, as presented to you, strives to minimize reductions in core service areas and focuses on key fiscal priorities: public safety, programs for the less fortunate, clean drinking water, safe waste disposal, preservation of our developed assets like our park system, and maintaining economic competitiveness. Nonetheless, I am recommending the Council’s consideration of over \$13 million in combined revenue enhancements and expenditure reductions to bring the General Fund expenditures in line with proposed revenues. Of this total, there is approximately \$3 million in new revenue and \$10 million in reduced spending across all departments. **Additionally, to avoid crippling vital public services, I am also recommending reducing the General Fund reserve level to 7% for FY 08-09.** This should, however, be considered a one-time action that will be re-evaluated on an annual basis.

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The recommendation for expenditure reductions results in the reduction to or elimination of key programs, such as:

- Reduces the Building Inspection program by a total of 3 Building Inspectors in acknowledgement of the reduced activity in this area (\$234,810);
- Reduced all travel and training accounts by 50% with emphasis on training needed to maintain professional standards and certifications (\$500,000);
- Eliminates fire staffing at the Airport Fire Station (#8) which will require other apparatus to respond to this location during flight operations (\$775,000);
- Eliminates the formal Beat Health program requiring this work to continue in a less formal manner through inter-department teams (\$100,000);
- Leaves 21 sworn positions in the Police Department vacant for the entire year – five positions less than what has been held vacant in FY 2007-08 (est. \$1.8 million);
- Eliminates the neighborhood-based pool program demolishing seven pools with corresponding staffing reductions (\$256,037);
- Reduces the Tree Preservation program by two Tree Trimmer positions impacting service levels for tree preservation activities and cycle pruning (\$112,752).

In focusing the City's budget on these priorities, it is obvious that the City cannot be all things to all people. Now is the time for support of and expanding upon community involvement and partnerships. We must recommit ourselves to this community's long-held tradition of neighbors-helping-neighbors through programs such as Neighborhood Watch, the West Modesto King-Kennedy Collaborative, and La Loma Neighborhood Association; volunteers working for a better community through efforts like Park Partners; and, neighborhood-business-government partnerships like the Weed and Seed Program as well as the recent foreclosure workshop at the Centre Plaza attended by over 1,000 homeowners who came to work out new loans with their mortgage company in order to stay in their homes.

I encourage you, my colleagues, to formally adopt these budget goals:

- ✓ Focus resources on vital public services. In keeping with this goal, **I will be convening a special workshop of the City Council later this summer to develop an organization vision and mission statement.** This is in keeping with the Charter amendments approved by voters in February and will provide direction for future budget decisions. Additionally, **I am seeking the Council's commitment to place a measure on the November 2009 ballot that will provide a long-term stable source of funding for public safety which will include youth programs designed to catch our youth before they have chosen a life with gangs, crime, and drug usage.**
- ✓ Begin efforts which will result in long-term structural budget changes. We need to change the current dynamic of making service cuts each year only to turn around and do it again the following year. **To that end I am calling for a community-wide budget survey and a series of "Town Hall Meetings" this fall to assure we elicit community participation in the budget process and that we understand the community's priorities.**

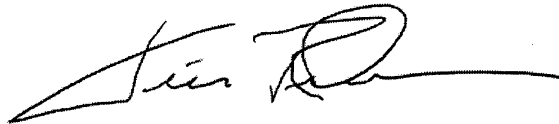
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- ✓ **Reduce deferred maintenance.** Master Plans are now in place for the water and wastewater utilities. The Stormwater Master Plan is moving toward completion. We must fund these utilities at adequate levels to ensure not only appropriate operations and maintenance efforts, but also a commitment to infrastructure improvements. Likewise, we must focus our efforts on rebuilding our roads, parks, and public facilities. The City of Modesto, and our neighboring communities, has a tremendous opportunity later this fall as voters consider the half-cent sales tax for transportation. We can no longer rely on financial crumbs coming from the state and federal government. We need to take more control of our own financial destiny and to do that we must have control of our financial resources.
  
- ✓ **Increase the City's economic opportunities. We must find a way to complete the comprehensive update of the General Plan.** I know this is a controversial item, but the General Plan is the City's fiscal planning tool. Proper land use planning including transportation and utilities, positions the City to respond appropriately and effectively to development opportunities when they arise. In order for this community to retain its economic competitiveness we must ensure that the backbone infrastructure is there when economic opportunities are presented. We must plan for a successful future. We do that through comprehensive planning efforts. We do that through ensuring funding is available when it is needed.

**Finally, as I have thought about this budget and researched the budgets of various cities, I ran across the City of San Jose's Budget Principles. They mirror many of the policy statements we have discussed as a Council over the years. I seek your discussion and consideration of these Budget Principles and encourage your approval of them as part of the budget adoption process.**

This is a complex budget with many difficult and unpopular choices. It is unlikely that this budget recommendation or any recommendation that deals with the tough expenditure and revenue challenges we face will satisfy all Modesto citizens and Council members. As Mayor, I commit to working openly and tirelessly with my colleagues and the community to deliver an annual budget that responsibly addresses the fiscal challenges of the current economy while preserving to the extent possible critical core services and the long-term vitality of our wonderful city.

In closing, I would be remiss if I did not take this opportunity to thank the Interim City Manager, Deputy City Manager, Finance Director, other Department Directors, and city staff for their assistance in the development of this budget. Without their efforts, this work could not have been completed.



Jim Ridenour  
Mayor, City of Modesto

## **Recommended Budget Principles**

### **1. Annually Adopt a Structurally Balanced Budget**

A structurally balanced budget means on-going revenues and on-going expenditures are in balance with on-going revenues meeting or exceeding expenditures during the same time period. If a structural imbalance occurs, a plan must be developed and implemented to bring the budget back into balance.

### **2. Use of One-Time Resources**

Once brought into balance, one-time revenues (excess reserves about reasonable risk calculations, revenue spikes, prior year budget savings, sale of property, etc) shall not be used for current or new on-going operating costs. Examples of appropriate uses of one-time revenues include early retirement of debt, capital expenditures without significant operating or maintenance costs, and other non-reoccurring expenditures.

### **3. Budget Revisions**

New programs, services, or staffing requests are considered in light of the Council's priorities and shall include a spending offset at the time of the request so that the request has a net-zero impact on the budget.

### **4. Reserves**

All City funds must maintain an adequate reserve level and/or ending fund balance as determined annually as appropriate for each fund. For the General Fund, the contingency reserve amount, which a minimum of 8% of the operating budget shall be maintained. Any use of the General Fund contingency reserve will require a majority vote of the Council.

### **5. Debt Issuance**

Long-term General Fund debt will not be incurred to support on-going operating costs (other than debt service) unless such issuance achieves net operating cost savings and such savings can be independently verified. All General Fund debt issuances shall identify a method of repayment or have a dedicated revenue source.

### **6. Employee Compensation**

Recognizing that employees are the City's major resource, negotiations for employee compensation shall focus on the total compensation costs (e.g. increases in salary, steps, and benefit costs) while considering the City's fiscal condition, revenue growth, and changes in the cost of living.

### **7. Capital Improvement Projects**

Capital Improvement Projects shall not proceed for projects with annual operating and maintenance costs in the General Fund without City Council certification that funding will be available in the applicable year of the cost impact. Certification shall demonstrate that the entire cost of the project, including operating and maintenance costs, will not require a decrease in the City's core services.

### **8. Fees and Charges**

The development of fees and fee increases shall be utilized where appropriate to assure fee program costs are fully recovered by fee revenue.

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**9. Grants**

Staff will seek out, apply for, and effectively administer grants that address the City's priorities, policy objectives, and provide an overall positive benefit to the City. Before a grant is pursued, staff shall provide a detailed fiscal analysis addressing both the immediate and long-term costs and benefits of the grant. With the exception of pilot projects, one-time grant revenues shall not be used to begin or support the costs of on-going programs.

**10. General Plan**

The General Plan is the primary long-term fiscal planning tool. Recommendations to create new development capacity beyond the existing General Plan shall be analyzed to ensure that capital improvements and operating/maintenance costs are within the City's financial capabilities.

**11. Performance Measurement**

All requests for funding shall include performance measure data so funding requests can be reviewed and approved in light of anticipated service level outcomes.