

**Jim Ridenour**

**Mayor**

1010 Tenth Street

Suite 6200

P.O. Box 642

Modesto, CA 95353

209/577-5230 209

571-5586 Fax

email:

[jridenour@modestovov.com](mailto:jridenour@modestovov.com)

Hearing and Speech

Impaired Only

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To the Members of the Finance Committee, the City Council and the Citizens of the City of Modesto:

On behalf of the City, it is my privilege to present to you the Proposed Budget of the City of Modesto for Fiscal Year 2011-12 (FY11-12). The Proposed Budget is in response to the continued fiscal challenges faced by the City during the last several years. It reflects difficult decisions made in a coordinated effort between the City staff, City Manager and myself and is guided by the policy and priority direction of the City Council.

### **Mayor's Recommendation**

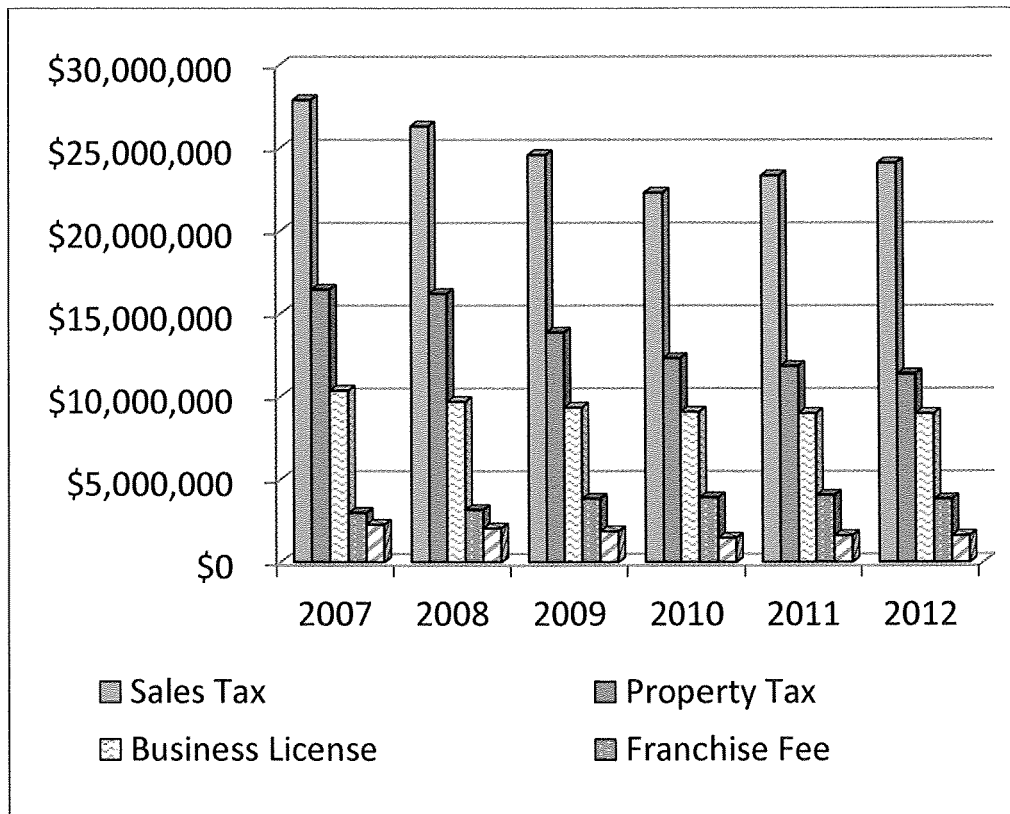
I recommend that the Finance Committee forward to the City Council for adoption the balanced Proposed Budget for Fiscal Year 2011-12.

### **Introduction and Background**

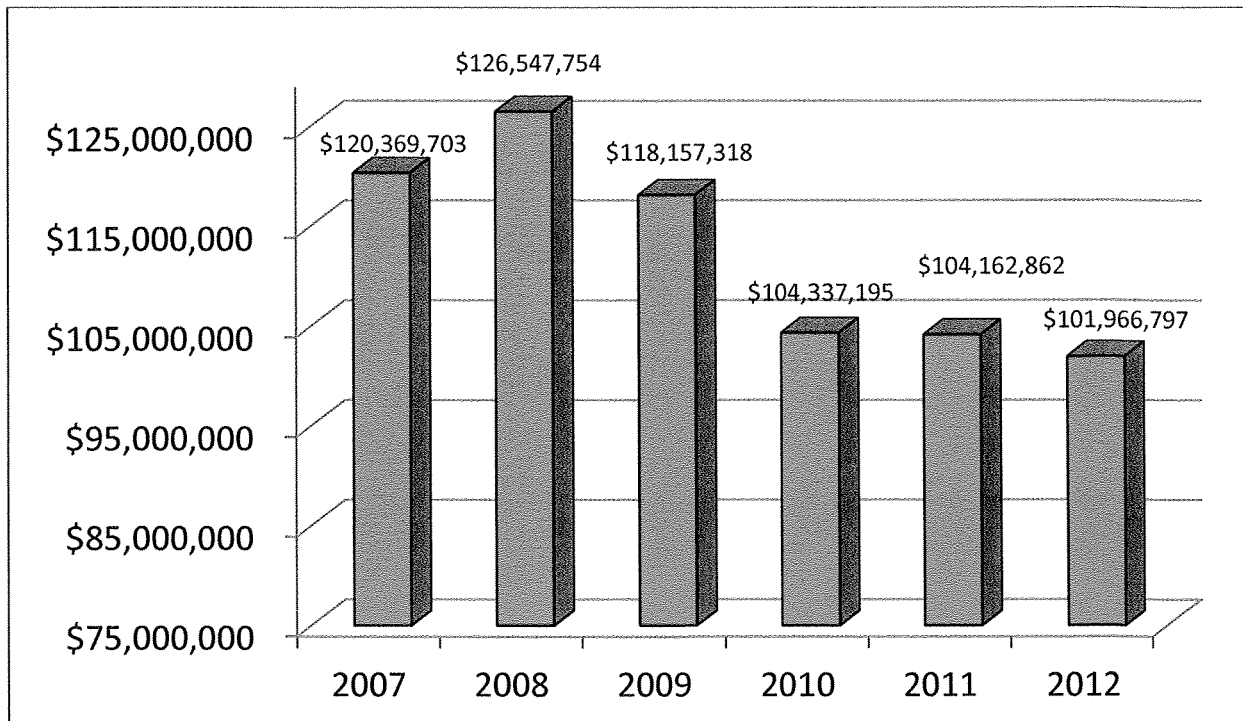
After years of stable financial growth and prosperity, the City of Modesto continues to experience impacts of the national and global financial crisis that began in 2008 and continues to unfold in 2011. Although the City has fared relatively well in comparison to some other cities in the Central Valley, we by no means have been immune to the ramifications of this recession. A decline in our major revenue sources coupled with an increase in expenditures led to a preliminary projected General Fund deficit of \$9.7 million for FY11-12. As a result, the City Manager and I established parameters for the FY11-12 budget that would address this deficit and facilitate the development of a balanced budget for the upcoming year. We worked to produce a budget which eliminates the budget shortfall minimizing impacts to City services. As a steward of Modesto's finances, this budget attempts to protect the current and future viability of our community. Our budget should reflect the values and priorities of our City and its people. This budget also successfully maintains at least \$7 million of unreserved General Fund balance.

As we've seen vividly in the last few years, financial stability requires constant and disciplined monitoring and action. We have done this over the past three years and will continue to do so as we navigate through these challenging economic times.

Sales and property tax revenues have significantly declined during the last three years and are major funding sources for the City's core operations. Other major General Fund revenue streams, such as business license and franchise fees, have been stagnant. The following graph demonstrates the impacts of this recession on the City's major General Fund revenue streams:



In FY07-08, we recognized \$126.5 million in General Fund revenues (including transfers in from other funds). This amount declined and for FY11-12, we project that General Fund revenues will be \$101.9 million. As you can see from the table below, the impact of the recession on General Fund revenues of the City has been significant:



While this recession is by no means over, we are encouraged by the beginning signs of recovery. As previously shown, revenues have stopped their dramatic decline. As a sign of stability, we are projecting sales tax revenues will begin to experience slight increases in FY11-12.

However, the City still faces significant challenges related to its budget. Just as revenues have declined in the last three years, unfortunately expenditures have and will continue to increase. Total General Fund expenditures in the Proposed Budget are \$106.2 million. As one might expect in a service delivery organization such as ours, salary and benefit costs account for 70% of these expenditures. General Fund salaries account for \$48.3 million and benefits \$25.9 million. The rising cost of employee benefits represents the greatest financial challenge we currently face. As we look to the future, the City can't sustain the cost of current retirement benefits for active and past employees.

To that end, the City is committed to reform for retiree medical and pension benefits. The City has and will continue to discuss reform with its labor bargaining groups. Just recently, the City reached a tentative agreement with the Modesto City Fire Fighters Association (MCFFA) on pension reform for new employees. New MCFFA employees will receive 3% of the average of their highest three years' salary at age 55 and will pay 9% of the employee share of the CalPERS contribution. For comparison purposes, public safety employees currently receive 3% of their single highest year salary at age 50 and the City pays 7.5% of the employee's 9% CalPERS contribution.

Last fiscal year, the City also reached agreement on retiree health benefits with its bargaining groups. New employees hired after January 1, 2011, will not be able to convert 8 hours of accrued sick leave to 1 month of medical premium contributions upon retirement. Instead, new employees receive a contribution to a health retirement account after 2 years of service. While the savings from this change will be realized in future years, I am encouraged by this action.

Modesto maintains a contingency reserve fund balance that represents money that would be used to cover emergencies or disasters, such as earthquake or flood. By the City's adopted fiscal policy, this amount is to remain at \$7 million. Some cities throughout the country have not been able to maintain their contingency reserves. Some of our neighbors have been forced to use their reserves in order to balance their budgets and have dipped into reserves to maintain existing services and wages. Others have dipped into reserves in addition to laying off staff and reducing services. I am happy to say that the Proposed Budget for FY11-12 is balanced while continuing to successfully maintaining at least a \$7 million reserve.

As I look to the future, it is exciting to watch the City implement its new Strategic Plan. I believe future budget documents will continue what was started this year, the linking of the City's budget to performance measures and our 6 Strategic Commitments. Foundations have been laid to gain vital citizen input into the budgeting process. While some input was obtained for the Proposed Budget, much work still remains in future years.

### **Overview of the Mayor's Proposed Budget**

Each of the last few years, we've asked the following questions about City programs and services as each line item was reviewed. This year is no different, and is in fact more vital than ever:

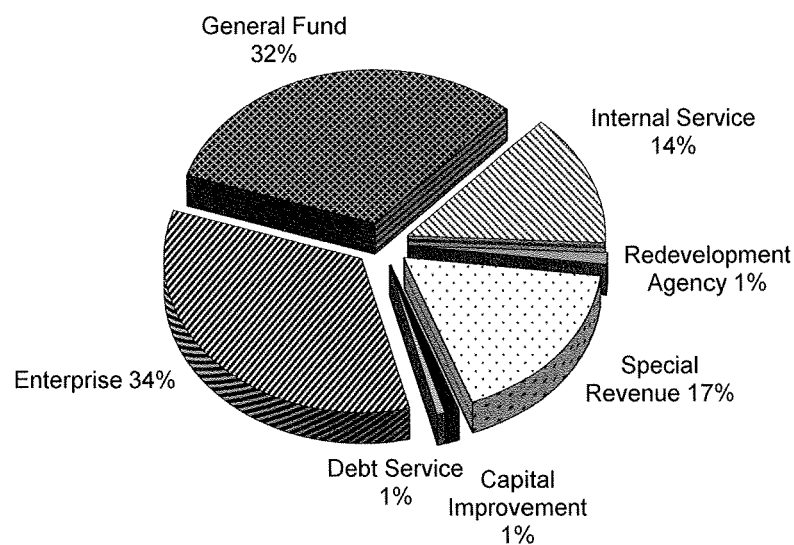
- Is the service essential and who does it serve?
- Does it serve Modesto residents' greatest needs?
- Can we do it better and at less cost?
- Are there others who provide the service with whom we can partner to reduce costs and improve effectiveness?
- What are the long-term benefits of continuing the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

The total City operating expense budget for all funds of the City for FY11-12 is \$336 million. There are three major funds within the City's budget – General, Water and Wastewater. There are also a number of smaller funds that make up the City's FY11-12 total operating expense budget. Two examples include the Storm Drainage and Airport Funds.

The General Fund has experienced the most dramatic declines while the Water and Wastewater Funds have remained relatively stable. This budget message summarizes information for these three funds. During the Finance Committee Workshops, more information will be provided on all funds.

The graph below show total operating expenses by the City's various fund types:

**FY 2011-12 Operating Expense by Fund Type**



The following information provides you with a quick summary of the City's major funds:

***Wastewater Fund***

The Wastewater Fund provides wastewater services to customers in the Cities of Modesto, Empire and a portion of Ceres. This service area equates to over 200,000 residents. The wastewater utility collection system consists of approximately 70 miles of trunk lines, 571 miles of sanitary lines and 41 wastewater lift stations. Wastewater is treated at the Sutter Primary Treatment Plant and the Jennings Secondary Treatment Plant. The operating budget of the Fund for FY11-12 is \$21.5 million plus an additional \$4 million in annual debt service payments.

The Wastewater Fund's revenues are the result of monthly service charges to residents at rates established by Council. Total revenue is estimated to be \$41.7 million for FY11-12. There is a planned rate increase of 8% that will take effect on July 1, 2011.

Wastewater capital improvement program expenses for FY11-12 are projected to be \$41 million and are in addition to the annual operating and debt service expenses. These expenses include the first of four years' construction costs for the Wastewater Tertiary Phase 2 Treatment Plant which is anticipated to cost

\$125 million and will enable the City to comply with its new National Pollutant Discharge Elimination Permit (NPDES) in FY 2016. The City is in the process of securing a State Revolving Fund low interest rate loan to fund the majority of the construction costs of this project.

### ***Water Fund***

The City provides drinking water to residents in the areas of Modesto, Empire, Salida, Waterford, Hickman, Grayson, Del Rio, parts of Ceres and Turlock, and County areas adjacent to the City system. This equates to approximately 250,000 residents. The operating budget for FY11-12 is \$48 million and includes debt service payments of \$13 million. Expenses of the Water Fund for its day-to-day operations includes employee salaries, chemicals for treating water, power for pumping water and water purchases.

The City's collects monthly service charges from the residents within our service area, which represent the primary source of revenues for the Fund. The water utility system currently has both flat rate and metered customers. For FY11-12, revenues are projected to be \$56 million and anticipate a cost-of-living rate increase of 1.8%.

The capital replacement program for the water utility system in FY11-12 is projected to be \$18 million and includes major capital projects for downstream improvements related to Modesto Regional Water Treatment Plant - Phase 2 Expansion, the strengthening and replacement of various components of the water system, water meter installation and wellhead treatment. These projects are funded through the existing revenue stream generated from monthly service charges.

### ***General Fund***

Total General Fund revenues for FY11-12 are anticipated to be \$102 million. This amount is approximately \$2.2 million less than the current budget for FY10-11 and \$2.4 million less than actual revenues in FY09-10.

In the coming fiscal year, we will spend approximately 68% of the City's General Fund on public safety – police and fire. While public safety is our top priority, we must also continue to provide other core services to Modesto citizens. As a result, the remaining 32% of the General Fund is proposed to be strategically budgeted to preserve core services in other areas such as park maintenance, planning, finance and personnel services.

I am recommending more than \$5.4 million in expense reductions and revenue increases for the coming fiscal year. Additionally, I propose a partial holiday on the payment to the Worker's Compensation Fund in the amount of \$1.8 million. This proposed budget is an effort to take the most prudent path going forward on behalf of the community. As the effect of staffing and service cuts has accumulated over the last several years, expense cuts have had to go deeper into important services.

***General Fund Community Impacts and Workforce Reductions*** – As previously mentioned, labor costs account for the majority of costs in a service driven organization such as the City. As a result, there are reductions in personnel in my proposed budget in order to meet revenue shortfalls. Including positions on my recommended reduction sheet, my proposed budget will eliminate approximately 35 positions through a combination of vacancies, layoffs, and retirements.

Despite these reductions, the City will continue to provide critical services to its residents, including:

- Response time to priority 1P (in progress) calls from the time the call is received to first officer on-scene is less than 5 minutes.

- First unit arriving at the scene of a fire is within 6 minutes, 90% of the time
- Essential development review, inspection and code enforcement services
- Special Gang-Prevention Unit specifically targeting crimes perpetrated by gangs
- Traffic and parking enforcement
- Maintenance of 75 City parks
- Volunteer partnerships with our community through neighborhood clean-ups and in the formation of neighborhood associations

However, I believe residents will be able to see a noticeable change in the delivery of some of City services. Specifically, reductions to services that will most impact our citizens include:

- Reduction in police staffing. The City will continue to redeploy officers to the most critical areas; however, response times to specific neighborhood complaints regarding quality of life issues may be delayed as a result of decreased staffing
- Reduction in fire staffing. This action will close down the full-time operation of an Engine
- Urban forestry and tree trimming activities will be reduced, resulting in a delay of pruning and removal from 7.5 years to 9 years
- Community and Economic Development will further reduce staff, increasing the turnaround time for development plan reviews and reduction of planning projects, zoning code updates and annexations
- Park restrooms will continue to be closed for about 12 weeks a year during off-peak months
- Continuation of reduced watering at certain City parks and a slower response time to park vandalism and repairs

To end on a positive note, the City has accomplished several things during the last year. Specifically, we have:

- Participated with the County of Stanislaus and Salida to form the Modesto Regional Fire Authority
- Coordinated another successful Amgen Tour event which led to another race finish for Modesto in 2011 – for which \$97,000 was raised through fund development activities
- Reduction in Part 1 crime rates of 7% in 2010
- Reached agreement with labor bargaining groups for reform of retiree medical benefits for employees hired after January 1, 2011
- Upgraded our Wastewater and Water Funds bond rating from A+ to AA and AA-, respectively
- Developed a new Strategic Plan
- Partnered with over 3,500 volunteers on volunteer community clean-up events to clear over 69 tons of trash and green waste; fill in 529 tons of sand and 360 cubic yards of bark in playgrounds; and cover more than 25,000 square feet of graffiti

### **Closing**

I would like to thank all of those responsible for the successful completion of this year's proposed budget. The proposed budget represents a tremendous amount of work by the City's department directors and key members of their staff. Special thanks go to the City's budget staff, which spent countless hours developing this budget into a single working document. Lastly, I would like to thank the City Manager, Deputy City Manager and City Council for their leadership throughout this year. Many difficult, but responsible, decisions were made that guided the City through uncertain times.

The financial crisis we faced in the past has led us into new territory this coming fiscal year. Citizens require government to be responsible in our stewardship of the City's financial resources. Our goal, as the City organization, is to provide our community with core services that emphasize public safety.

Fortunately for the City of Modesto, we are still in much better financial condition than some of our neighboring cities in the Central Valley. This is largely due to our historically conservative approach to fiscal matters and the solid financial policies adopted by this Council. We have a diverse revenue base and solid reserves that allow us to provide quality municipal programs and services to our citizens. With that in mind, I recommend that the Finance Committee forward to Council the following budget goals for FY11-12:

1. Focus resources on vital public services;
2. Continue efforts which will result in long-term structural budget changes, including permanent salary and benefit reform;
3. Reduce deferred maintenance;
4. Increase the City's economic opportunities.

This is my final proposed budget and my last year as Mayor, I am proud to serve the citizens of Modesto and represent them as the President of the League of California Cities. As my term draws to an end, I look back on the journey we have taken together over the last eight years. We have seen times of plenty and times of scarcity. We have faced some of the worst challenges seen in our lifetime. We responded with leadership and in a proactive manner to the collapse of the financial industry. We have emerged a leaner government, but I believe a more efficient one. We have a fresh perspective and strong management at City Hall. The future is bright as we begin to see signs of recovery.

In closing: "The ultimate measure of a man is not where he stands in the moments of comfort and convenience, but where he stands in times of challenge and controversy." *Martin Luther King, Jr.* It is my hope that I have withstood the trials of challenge and controversy and stood firmly as your leader during times such as these.

Thank you for allowing me to serve you,



Jim Ridenour,  
Mayor, City of Modesto