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AGENDA REPORT

TO: DEANNA J. SANTANA
CITY ADMINISTRATOR

FROM: Sabrina Landreth

SUBJECT: Proposed Midcycle Budget

DATE: May 31, 2012

City Administrator
Approval

Deanna Santana

Date

5/31/12

COUNCIL DISTRICT: City-Wide

REASON FOR SUPPLEMENTAL REPORT

The purpose of this supplemental report is to transmit to the full City Council responses to several questions that have been raised in regard to the Proposed FY 2012-13 Midcycle Budget. In addition, this supplemental transmits revisions and clarification regarding a couple of technical errata, as well as an update on a couple of the referrals from the January 31, 2012 Budget Motion.

DISCUSSION

Summary of Proposed Position Amendments

Clarification has been sought on the number of the positions being proposed to be added to the FY 2012-13 Budget. The Administration has proposed several cost-neutral Add/Deletes of existing vacant positions, the majority of which are clean-up items to align the positions with the action taken by Council in January as part of the post-redevelopment and reorganization efforts.

In addition, there are approximately 10 Full-Time Equivalents (PTEs) proposed as net-adds, as well as 3 FTEs that are proposed to be unfrozen (previously defunded but not eliminated). The proposed additions are for the newly proposed Office of Inspector General (OIG), Economic Development, Worker's Compensation, Fire, Equipment and Meter Repair; the positions proposed to be unfrozen are for the Director of the Administrative Services Department and two additional Equipment Repair positions.

Negative Funds and Repayment Plans

Several questions have been raised recently about the status of the City's Negative Funds and the Adopted Repayment Plans.

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Over the past decade, many Non-General Purpose Funds (GPF) have been depleted, creating financial pressures on the GPF. They are largely attributable to historical overspending and/or under-recovery and transfers to the GPF for budget balancing measures. Other contributing factors include the more recent operational shortfalls. At the close of FY 2010-11, over \$121 million remained in negative fund balances (down from \$138 million at the close of FY 2009-10), with approximately \$42 million in Internal Service Funds (ISFs). The FY 2011-13 Adopted Policy Budget included a repayment plan for the City to repay itself for the use of pooled cash for both Program Funds and ISFs. The repayment plan has been monitored closely by staff and to date over \$17 million has been repaid, reducing the negative balances and mitigating the accumulation of negative interest. Continued commitment to repayment, especially while interest rates are low, is strongly encouraged to ensure the necessary financial progress as a commitment to external auditors. While acknowledging the City's recent efforts, the external auditors stressed it is critical that "the City monitor the progress over its restructured rebalancing plan very closely to ensure its feasibility. If it is determined that the plan is not feasible and that the City does not intend to or cannot recover the full cost of providing goods or services, then the use of internal service funds is no longer appropriate and should not be used." The Proposed FY 2012-13 Midcycle Budget continues to include these repayment plans.

Why continue to provide services from negative funds?

Negative funds with current programs require current appropriations or FTEs for management and operations of the current funds. Of note, the funds are operationally balanced. For example, the proposed budget for the Equipment Fund is balanced in the Proposed Midcycle Budget from an operating standpoint – in other words, the anticipated expenditures do not exceed the anticipated revenues for the year – however, the Equipment Fund does have a negative fund balance from previous years. The City has been monitoring the expenditures and revenues in the Equipment Fund ensuring that we do not exceed the budgeted expenditures, as well as maintain the Fund's repayment schedule. The result has been under spending in the Fund and an improvement in the negative fund balance.

Positive efforts in managing the negative funds

Fiscal staff in the Administrative Services Department, as well as the City Administrator's Office, in collaboration with departmental fiscal officers, have undertaken proactive steps to reduce and eliminate negative fund balances over the last several years, including the implementation of strict internal controls and guidelines in processing payment requests that are being paid out of funds with negative balances. According to the external auditors' required communications and recommendations to Council, for fiscal year 2011, the City was able to achieve a positive change in fund balance for each of the internal service funds that had a negative beginning fund balance. In addition, the positive change in fund balance for each of these funds was greater than the change projected in the restructured rebalancing plan. The other funds have also realized reduced negative accruals which are mainly attributable to more frequent drawdowns of grant funds, and increased oversight and management of expenditures for funds with negative balances.

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In the FY 2011-13 Proposed Budget, the Mayor proposed using some of the proceeds from the sale of property to the Redevelopment Agency (namely the HJK Convention Center sale proceeds) to reduce the negative fund balances. In addition to the above efforts, staff has looked at other options for repaying the negative fund balances. Options such as issuing debt and using the proceeds to reduce the negative balances were considered. However, it would not only be costly, but also viewed negatively by our bond rating agencies. Of note, the City's third-party financial advisors have endorsed the City's current repayment efforts and the proposed use of land sale proceeds in the manner being recommended. This effort has been put on-hold pending further legal and risk analysis regarding the State Controller's clawback order; however, the Administration will be bringing forward more detailed plans and recommendations in fall 2012 as part of its Five-Year Financial Plan.

Unfunded Liabilities: OPEB

As noted in the Proposed FY 12-13 Midcycle Budget, the City continues to face some large structural fiscal challenges related to pensions, retiree healthcare, and capital/equipment needs. Specifically related to retiree healthcare, or OPEB (Other Post-Employment Benefits), the City's unfunded liability is approximately \$500 million. The City has employed a pay-as-you-go strategy and has always made the necessary payment each year; however, it has not set-aside funds for the future payment of this liability. On May 24, 2012, the City received approval of its Recognized Obligation Payment Schedule (ROPS) from the State Department of Finance. Included in the ROPS is a total payment of approximately \$0.7 million for OPEB liabilities in FY 2012-13. Staff will be bringing forward a recommendation to Council as part of the Five-Year Financial Plan to establish a Trust Fund utilizing these funds as the initial deposit, perhaps as part of the CalPERS program, that will prefund health and other post-employment benefit costs for retirees and their beneficiaries.

Technical Errata

The Proposed FY 2012-13 Midcycle Budget contained three technical errors in Attachment B that should be corrected as follows:

- Page 3 of 5: Fire: "*Inspectors*" should be changed to "*Investigators*"
- Page 5 of 5: Public Works: Remove "*Delete Program Analyst/Add Management Intern-in Equipment Fund*";
- Page 5 of 5: Public Works: Remove funding for the *West Oakland Teen Center*, as the Center will not be open until July 2013 and this adjustment will occur as part of the FY 2013-15 Budget.

January 31, 2012 Referrals

On January 31, 2012, City Council's Adopted Budget Motion contained several referrals to the City Administration. Specifically: 1) Each Council District should have at minimum one

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permanent NSC assigned; 2) Neighborhood Services should be redesigned to integrate support of NCPCs and Neighborhood Watch and provide more equitable support of both; and 3) Contracting limits to be established at \$5,000 for City Auditor and at \$25,000 for City Attorney for outside contracts, with higher expenditures needing to return to Council for approval. The first two referrals related to the Neighborhood Services Division are being incorporated into the reorganizational work being conducted for the Community Services Department. These changes will take effect in FY 2012-13. For the third referral, in response to City Council's direction, staff has drafted a preliminary resolution to establish contract limits for the Office of the City Auditor and Office of the City Attorney with the intent of establishing thresholds such that the purchase of services exceeding established contract limits must be brought forward through the Council Agenda Management process to the City Council for approval. This draft resolution will be coming to the Council for consideration upon further collaboration with the City Auditor and City Attorney – with a goal of September 2012.

Respectfully submitted,



SABRINA LANDRETH
Deputy City Administrator/Budget Director