CITY OF YUBA CITY
STAFF REPORT

Date: February 19, 2019

To: Honorable Mayor & Members of the City Council

From: Finance/IT Department

Presentation By: Robin Bertagna, C.P.A., Finance Director

Summary

Subject: Financial Report for the Six Months Ended December 31, 2018

Recommendation: Note and File the December 31, 2018 Financial Report

Fiscal Impact: Informational item only

Purpose:

To provide City Council with a summary of the first six months of FY 2018-19 revenue and expenditures of the City's major operating funds.

Background:

Finance provides periodic Financial Reports to City Council to keep you apprised of the City's financial activities along with trends in revenues and expenditures.

Analysis:

The attached December 31, 2018 Financial Report has been prepared for City Council review.

Fiscal Impact:

Informational item only

Alternatives:

Not applicable

Recommendation:

Staff recommends that the City Council note and file the December 31, 2018 Financial Report.

Attachments:

1. **Financial Report**

Prepared By:

/s/ Robin Bertagna
Robin Bertagna, C.P.A.
Finance Director

Submitted By:

/s/ Diana Langley
Diana Langley
Interim City Manager

Reviewed By:

City Attorney

SLC by email

ATTACHMENT 1

FINANCE DEPARTMENT

FY 2018-19 Financial Report

For the Six Months Ending 12/31/18

February 19, 2018

OVERVIEW

As of July 1, 2018, the general fund had an unassigned fund balance of $6,209,409 as stated in the City's annual independent audit, the Comprehensive Annual Financial Report (also known as the CAFR). This amount meets the City's Fiscal Policy requirement of a 15% general fund reserve. The 15% Fiscal Policy minimum reserve level is a recommended best practice and is supported by the Government Finance Officer's Association of the United States and Canada (GFOA). GFOA recommends that cities maintain a general fund reserve equal to 2 to 4 months of operating expenses. Yuba City has 1.9 months of operating expenses in reserve as of June 30, 2018.

The business cycle has been in an expansion phase for the past 115 months. The longest expansion cycle in history has been 120 months for the United States economy. The average expansion cycle from 1945 to 2009 (11 cycles) has been 58.4 months. We are well beyond that. It is difficult to determine when the next downturn in the economy will occur, the only certainty is that it will. With this in mind, it is important for the City to maintain it's 15% general fund reserve; ensure that both the water and wastewater enterprise fund revenues are sufficient to cover operating, debt service and infrastructure replacement costs; plan for infrastructure renewal and replacement; and to continue monitoring fiscal performance regularly.

Rather than lowering it further, the CalPERS Board voted in December, 2017, to maintain the lowered discount rate from 7.5% to 7.0% with the three year phase-in over a period of several years beginning in FY 18/19 for public agencies. The CalPERS Board had been evaluating the possibility of lowering it even further. This would have had severe fiscal impacts on the City. As it is, the fiscal impact of a 7.0% discount rate will be <u>significant</u>. The most recent projections based upon the June 30, 2017 CalPERS actuarial reports project that retirement costs will grow from $6.8 million in FY 16/17 to $11.5 million by FY 22/23. It will be a challenge for revenues to grow sufficiently to keep pace with this mandatory expenditure. This doesn't take into consideration growth in other expenditure categories or needs of the community such as infrastructure renewal and replacement, employee cost of living increases, or any other budget priorities. The City Council will be carefully prioritizing allocation of resources to cover increases in employee compensation and benefit costs, allocate funding towards unfunded pension liabilities, fund unmet facility and infrastructure needs related to parks and roads, cover the cost of providing police services to all City residents, and address deferred maintenance and improvements throughout the City. On a positive note, the City has a Pension Stabilization Trust Fund with $2.6 million dollars available that can be utilized to buy down a portion of future pension cost increases.

The City's financial model projects a balanced budget in the five year financial forecast. Notably, the assumptions included in this model include positive revenue growth and very conservative expenditure growth. Staff has retained the services of an independent financial consultant to, in essence, evaluate inputs of an economic downturn on the City's fiscal projections. This information will be provided to City Council at the goal setting session in March.

Finance evaluates employee vacancies on a quarterly basis to monitor the anticipated savings to the budget based on those vacancies. During the past year the vacancy ratio has ranged from a high of 11.0% in November, 2017, to a low of 6.2% in October, 2018. Finance anticipates that the City will end the fiscal year with a surplus larger than the $0.3 million contained in the original adopted budget due to normal employee turnover throughout the year. Notably, vacancy savings are usually partially offset by increased overtime for shift coverage in both the Police and Fire departments.

This report is prepared on a cash basis; therefore it describes the timing of cash flows as it relates to the City's revenues and expenditures.

Beginning Balances. The beginning fund and working capital balances presented in this report are final year end amounts from the previous year audit report and will not change.

Adjusted Budgets. The revenue projections and expenditure budgets shown in this report include adjustments for encumbrances, carryovers, and any supplemental revenue and expenditure appropriations made by the Council as of December 31, 2018.

GENERAL FUND

General Fund Financial Condition. With 50% of the year complete, General Fund revenues are at 29.8% of projections and expenditures are at exactly 50.1%.

General Fund

		Budget		YTD Actual	Percent
Balance, Start of Year	$	6,209,409	$	6,209,409	-
Revenues		44,091,104		13,159,439	29.8%
Expenditures		(44,439,515)		(22,256,149)	50.1%
Balance	**$**	**5,860,997**	**$**	**(2,887,300)**	**-**

The budgeted expenditures shown above include encumbrance carryovers from FY 17/18 of $462,200. Encumbrance carryovers are outstanding purchase orders as of June 30th. Encumbrances are liquidated and paid from the beginning fund balance as prior year budget monies are used to pay for them (as opposed to current year revenues). In addition, budgeted expenditures include $1,196,100 added for public safety grant funded programs, $454,300 for the supplemental unfunded accrued liability (UAL) payment to CalPERS, and $19,100 for staffing changes in the Police department.

In the YTD Actual shown above, the ending fund balance is negative as of the end of the second quarter. The negative balance is an indication of the typical cash flow pattern for the general fund. This happens because general fund expenditures for payroll and vendor payments are incurred evenly throughout the fiscal year whereas our largest revenue sources of sales tax and property tax lag in receipt compared to the timing of when they are earned. Property tax is received in two large payments in February and May when property taxes are received from Sutter County. This is the City's second largest revenue source for the general fund and when they are received only two times per year, it causes the cash flows (and therefore fund balance) to go deficit until the first installment is received. The City receives two advance payments and a true-up payment for each quarter of sales tax revenue. However, there is a lag in time as to the end of the quarter of revenues and when the cash is received. For example, the advance payments for the Christmas quarter (October through December revenues) are received by the City in January and February with the true-up payment in mid-March. When additional sales tax is received from the State and property taxes are received from Sutter County, the negative fund balance will reverse and fund balance will end the fiscal year with a positive balance. The negative fund balance as of December 31, 2018, was compared to that of December 31, 2017, and the City is approximately $656,700 better off (a smaller negative) in 2018. Upon analyzing this change, it is mostly related to an increase in sales tax receipts compared to the same months of the previous year. A large portion of the increase is likely related to the catch-up payments from the California Department of Tax and Fee Administration (CDTFA) where receipts were delayed from the first and second quarter of 2018 due to their computer software conversion.

Revenues.

The City's top ten revenues account for approximately 95% of total General Fund revenues. As such, they provide a very good summary of our revenue position. Key revenues are performing as projected based on payment schedules and past trends for half way through the fiscal year. More detailed information is noted below.

Top Ten Revenues		Budget		YTD Actual	% Received
Property Taxes	$	13,078,100	$	51,892	0.4%
Sales Tax		13,951,100		6,821,888	48.9%
Business Licenses		986,800		131,152	13.3%
Franchise Fees		1,828,400		302,000	16.5%
Hotel/Motel Surcharge		1,103,300		309,588	28.1%
Building Permits		998,000		502,767	50.4%
Police Special Services		220,000		71,391	32.5%
CSA "G" Fire Contract		775,700		0	0.0%
Recreation Fees		891,100		315,967	35.5%
Operating Transfers		7,675,401		3,988,571	52.0%
Total	**$**	**41,507,901**	**$**	**12,495,216**	**30.1%**

- **Property Tax.** The first apportionment of FY 18/19 taxes will not occur until February, 2019. The FY 18/19 adopted budget projected a 4.3% increase in property taxes. Based upon the final assessed valuation reports from the Sutter County Auditor-Controller's Office, general fund secured and unsecured assessed values increased by 4.89%. Property tax revenues are expected to exceed budget projections by approximately $48,000 at the end of the fiscal year.

Five of the largest components of the change in assessed values are as follows:

- o Properties were adjusted by a CPI factor of 2.0% between FY 17/18 and FY 18/19 (an increase of $70.2 million in assessed valuations), this accounted for 35% of all growth experienced in the City.

- Residential increased by 5.3% ($190.8 million).
- Unsecured decreased by 18.1% ($55.5 million) in assessed valuations. $36 million of the decrease in values is attributable to revaluation of certain power plants.
- Industrial increased by 3.3% ($7.0 million).
- Commercial values increased 5.4% ($49.2 million) largely due to sales which added $27 million.

The City received the benefit of $77.7 million in assessed value increases during FY 18/19 attributable to an increase in market value compared to prior years when there had been decreases in assessed values pursuant to Proposition 8. The increase in Proposition 8 values included $51.7 million in residential (affecting a total of 2,264 residential parcels) and $25.9 million in non-residential. An additional 2,195 parcels remain under Proposition 8 status, with a total potential recapture of $128.4 million. The City will see these increases in assessed value translate to increases in property tax revenues if real estate sales prices continue to escalate. The potential recapture is eliminated when and if a home under Proposition 8 status is sold for less than the recapture value.

- **Sales Tax.** When the FY 18/19 revenue projections were developed, sales tax was projected to increase 3.0%. The most recent quarterly sales tax results increased 15.9% on a cash basis and increased 1.9% on an adjusted basis (July - September, 2018 sales) and decreased 10.0% on a cash basis and increased 0.1% on an adjusted basis (April - June, 2018). Sales tax continues to be unpredictable and volatile, but has shown overall increases until the CDTFA upgraded their software system and fell behind in processing incoming taxpayer returns in the third and fourth quarters of FY 17/18. The average quarterly increase was 1.65% for FY 16/17 and 1.0% for FY 17/18. The first quarter FY 18/19 increase of 15.9% is abnormally high because CDTFA was distributing collections from the previous two quarters where they had fallen behind due to the computer software conversion. Finance doesn't expect sales tax revenues from new automobile sales to continue at this inflated level indefinitely and anticipate that at some point in the future these revenues will first level off and subsequently decline.

There is a lengthy lag time between the time that sales occur and when the City receives the information regarding the sales tax revenues in order to compare the data to the same quarter of the previous year. As of the date of this report, Finance staff is still waiting for the Christmas quarter results which will be available in mid-March, 2019. Finance continues to be cautiously optimistic because overall sales tax revenues have increased in 11 of the past 14 quarters on a cash basis (all 14 quarters have been positive on an adjusted basis).

As stated, the revenue data for the October through December quarter sales has not yet been released by the Board of Equalization. The revenue shown here represents the first quarter payments received from the State and advance payments received towards the second quarter revenues.

- **Business Licenses**. Business licenses are renewed in January of each year; therefore most of the revenues from business licenses are received during the third quarter of the fiscal year.

- **Franchise Fees**. The City receives franchise fees from PG&E, Recology, AT&T and Comcast; the fees are based upon a percentage of their revenues. The receipts for the second quarter of the fiscal year are not received until the end of January and PG&E pays theirs annually in April. Therefore, we would not expect franchise fees to be near the 50% mark during the first two quarters of the fiscal year.

- **Hotel/Motel Surcharge.** Surcharge revenues for the first quarter are included in the amount shown, but second quarter receipts are not due or paid until the end of January and are therefore not included here.

- **Construction Permit Fees.** Building Permits are right on track with budget expectations with 50.4% received half way through the fiscal year. This is an indication of the continued activity in construction and development.

- **CSA "G" Fire Contract.** The City receives these funds for fire services to the unincorporated area that was formerly served by the Walton Fire Protection District. Since revenues are property tax based, the first apportionment will be received in February, 2019.

- **Recreation Fees.** At 35.5% of budgeted revenues, service fees from recreation programs appear to be lower than anticipated halfway through the year. This is typical due to the seasonal nature of the programs offered.

- **Operating Transfers.** The General Fund receives reimbursement for operating costs associated with support services provided to the water and wastewater utilities as well as other fund transfers. Transfers are on track with budgetary expectations.

Expenditures. Operating costs are all within budgetary expectations with the exception of the Fire Department as summarized below. It appears that some departments exceed the 50% of budget expended half-way through the year, but this overage is attributable to the pre-payment of the City's unfunded actuarial liability for CalPERS that was made in July for the entire fiscal year in order to save interest charges from CalPERS. Additionally, the Fire Department appears to have the largest percent in excess of 50% of their budget expended. In their case, it is due to increased overtime costs related to strike teams due to all of the fires in California last fall. The Fire Department's budget will be increased to account for the increase in overtime costs when the strike team revenue reimbursements are received from the State of California.

Expenditures	Budget	YTD Actual	% Expended
City Council	$ 154,584	$ 69,838	45.2%
City Attorney	250,000	149,777	59.9%
City Manager	654,779	326,123	49.8%
Finance/IT	2,841,830	1,457,803	51.3%
City Treasurer/City Clerk	91,901	18,976	20.6%
Human Resources	972,782	402,382	41.4%
Development Services	1,591,463	661,594	41.6%
Public Works	5,097,719	2,407,252	47.2%
Police	15,486,634	7,972,696	51.5%
Fire	11,707,472	6,305,061	53.9%
Animal Control Services	855,160	355,496	41.6%
Economic Development	383,839	122,437	31.9%
Contingency	119,118	1,147	1.0%
Non-Departmental Misc.	424,228	154,645	36.5%
Community Services	3,808,007	1,850,922	48.6%
Total General Fund	**$ 44,439,515**	**$ 22,256,149**	**50.1%**

ENTERPRISE FUNDS

The following summarizes year-to-date revenues, expenditures, and changes in current assets net of current liabilities for the enterprise funds. Depreciation is included as a footnote in the budget and is therefore not included below.

Water Fund

	Budget	YTD Actual	Percent
Balance, Start of Year	$ 18,794,935	$ 18,794,935	-
Revenues			
Operating	15,934,200	8,356,523	52.4%
Capital	450,000	207,510	46.1%
SRF Surcharge	679,700	324,123	47.7%
Sub-Total Revenues	17,063,900	8,888,155	52.1%
Expenditures			
Operating Programs	(10,176,610)	(4,896,283)	48.1%
Capital Equipment	(46,678)	(12,485)	26.7%
CIP Contributions	(207,500)	(207,500)	100.0%
Debt Service	(3,248,414)	(1,108,676)	34.1%
Sub-Total Expenditures	(13,679,201)	(6,224,944)	45.5%
Balance	**$ 22,179,634**	**$ 21,458,146**	**-**
CIP Projects	**$ 11,330,650**	**$ 749,966**	**6.6%**

Water service revenue increases of ten percent (10.0%) were approved by City Council in June, 2018, in order to cover the operating cost of the Water utility, debt service costs and infrastructure renewal and replacement projects. For FY 18/19, the increased rates went into effect on July 1, 2018. In reviewing revenues billed for July through December, 2018, it is clear that the revenue increases are being generated as planned but that conservation has, in some months, kept the increase in revenues below ten percent. Below is a summary of the total service revenues billed from July to September and then from October to December, comparing the total revenues billed, the consumption and the percentage of revenues billed changes from 2017 to 2018:

July 2017	*July 2018*	*August 2017*	*August 2018*	*September 2017*	*September 2018*
$ 1,407,189	$ 1,553,002	$ 1,544,439	$ 1,666,133	$ 1,499,123	$ 1,610,081
645,006	655,564	739,255	719,866	710,190	687,488
% change	10.4%	% change	7.9%	% change	7.4%

October 2017	*October 2018*	*November 2017*	*November 2018*	*December 2017*	*December 2018*
$ 1,373,217	$ 1,452,307	$ 1,311,919	$ 1,365,482	$ 1,042,508	$ 1,177,385
628,240	585,922	556,244	487,741	340,050	396,516
% change	5.8%	% change	4.1%	% change	12.9%

Operating revenues in the water fund are at 52.1% of the amount budgeted and are on track to meet budget projections at the end of the fiscal year. At first glance halfway through the year, it would appear that we should have only approximately 50.0% of budgeted revenues as of December, 2018. However, this is somewhat misleading because the highest billing months occur in July, August and September. For comparison, last fiscal year, as of December 31st, operating revenues were at 58.6% of the amount budgeted, and at year end were at 110.4% of the total amount budgeted was received. Therefore, since operating revenues are at 52.1% mid-way through the year, it is likely that by the end of the fiscal year, operating revenues may be less than budgeted. Water consumption is heavily weather dependent. If we see an early and warm spring, customer consumption and therefore water revenues tend to increase. The reverse is also true.

Achieving targeted revenues is a fiscal priority as the City's bond covenants require the City to raise rates in order to continue meeting a 1.2% debt coverage ratio. Capital connection fee revenues are at 46.1% of the amount budgeted mid-way through the fiscal year.

Operating expenditures are at 48.1% at the mid-point of the fiscal year. There is savings in salaries and benefits due to 4.75 full-time equivalent vacant positions in the water utility, in addition to budgetary savings to date in operation and maintenance accounts.

Debt service expenditures are less than half for the first two quarters for both Water and Wastewater as they include only an interest payment because the payment that includes both principal and interest is not due until June 1st of each year.

Wastewater Fund

	Budget	YTD Actual	Percent
Balance, Start of Year	$ 22,901,949	$ 22,901,949	-
Revenues			
Operating	16,298,000	8,031,166	49.3%
Capital	634,000	156,210	24.6%
Sub-Total Revenues	16,932,000	8,187,376	48.4%
Expenditures			
Operating Programs	(11,309,230)	(4,945,394)	43.7%
Capital Equipment	(276,939)	(16,570)	6.0%
Debt Service	(2,154,437)	(605,636)	28.1%
Sub-Total Expenditures	(13,740,605)	(5,567,600)	40.5%
Balance	**$ 26,093,343**	**$ 25,521,724**	**-**

CIP Projects	**$ 9,915,600**	**$ 296,636**	**3.0%**

Wastewater operating revenues are at 49.3% of the amount budgeted and capital revenues are at 24.6%. Revenues through December 31st are closely on track with expectations. As of July 1, 2018, the City implemented an eight percent (8.0%) increase in wastewater service charges.

Wastewater operating expenses are slightly lower than anticipated halfway through the year at only 43.7% of budget. There is savings in salaries and benefits due to 3.75 full-time equivalent vacant positions in the wastewater utility, in addition to budgetary savings to date in operation and maintenance accounts. The most significant area where there are budgetary savings are in professional services. However, a significant amount of the unspent budget is encumbered (purchase orders have been issued but the actual expense has not yet been incurred).

Finance staff tracks and accounts for the operating funds and capital connection fee funds for both the Water and Wastewater operations separately. Debt service payments are allocated to the capital connection fee funds based upon how the debt proceeds were used to finance projects at the time the debt was issued. Repayments for bond principal and interest are charged accordingly. Public Works/Utilities advises Finance when a Water or Wastewater project is approved how much should be paid from operating funds vs. capital connection fee funds. In recent years with the decline in development activities, City Council has been advised that at some point Finance staff will draw the connection fee fund reserves into a negative position in order to meet our bond covenant commitments and make debt service payments. Council concurred that this was an acceptable practice as long as Finance kept track of the funds separately, and replenished the cash flows as development activities increased. As of December 31, 2018, Finance reviewed the available cash balance in both the Water and Wastewater connection fee/capital funds and provides the following update:

	Water	Wastewater
Cash available @ 12/31/18	$ (2,003,792)	$ 893,492
Annual D/S from connection fees	$ 1,498,786	$ 816,294
# of years of coverage available	-1.34	1.09

This table indicates that the Water connection fee fund cash balance is deficit as of December 31, 2018. This table compares the amount of cash reserves available in each of the capital connection fee accounts to the total annual debt service currently being allocated to and paid from capital connection fees. Those two amounts are then compared to calculate a ratio of how long, in terms of years, the City will be able to pay debt service without drawing capital connection fee funds into a deficit position. In this case, it shows that the Water capital connection fee fund is approximately 15 months in a deficit (negative) position. Measured in terms of shortage in dollars, the operating funds would need to provide the following amounts of cash to meet the 1.2 requirement for debt coverage:

	Water	Wastewater
Required Ratio	1.2	1.2
Cash Reqd. to be at 1.2 Coverage	$ 1,798,543	$ 979,553
Cash Short @ 12/31/18	$ 3,802,335	$ 86,062

This calculation does not consider amounts used from capital connection fees for future capital projects or future revenues received; it is a snapshot in time of where the funds stand as of December 31, 2018. The Wastewater fund is in a better position to cover debt service than the Water fund, but without additional development to increase revenues, both will need to cover debt service from the operating funds as has been anticipated.