



TO: The Honorable Mayor and City Council

FROM: James G. Marshall, City Manager

SUBJECT: Proposed 2005-2006 Fiscal Year Budget

DATE: May 13, 2005

On behalf of the staff and employees of the City of Merced, I am pleased to present the fiscal year 2005-2006 budget to the City Council. This budget offers the City Council opportunities for the second consecutive year to increase manpower to grow the municipal services needed in the community. Last year, the City Council was able to add 31 positions. For 2005-06, it is recommended that the City Council add 29 positions.

The new positions are intended to deliver an array of services to the community from a number of general and special funding sources. Please refer to Chart 1 for a full description of the recommended positions and their funding sources.

The past conservative nature of the City's budgeting practices allows the more aggressive approach in 2005-06. Nonetheless, approval of the budget as recommended by the City Manager is not without risk. Forward projections demonstrate funding capability in 2005-06 and 2006-07, but shortfalls will develop in 2007-08 unless new revenue sources develop or existing revenue sources generate more than currently anticipated. This applies to the General Fund and other special and enterprise funds.

The positive outlook for 2005-06 is secured by the voters' recent passage of Proposition 1A – a constitutional amendment designed to protect local government revenues. While 2005-06 still involves a transfer of funds to the State of California (the second of two years agreed to as a condition of gubernatorial support for local government revenue protection), staff believes

that our past conservative approach of building reserves to flatten out the erratic revenue flow from prior years will sustain the City and allow growth in 2005-06.

From a general fund revenue perspective, it should be noted that sales taxes are now reflected in two separate revenue accounts – sales tax as distributed by the State Board of Equalization and an amount equal to 25 percent of the sales tax backfilled from property taxes. When Proposition 57 was approved (state debt bailout), 25 percent of local government sales tax revenues was used to guarantee and secure the debt. Therefore, only 75 percent of local sales tax revenue will be distributed by the State Board of Equalization with the remaining 25 percent coming as backfill in the form of property tax. While the backfill is distributed twice a year (sales taxes distributed monthly), the resultant cash flow should not impact the City of Merced because of the Charter-required cash basis fund. The local share of sales tax (one percent) is constitutionally guaranteed through Proposition 1A.

Another component of the revenue swap with the State of California (commonly referred to as the “triple flip”) involves the distribution of motor vehicle in-lieu fees. Motor vehicle in-lieu fees are generated from the annual registration fee paid on motor vehicles. In recent years, registration fees have been reduced by 66.67 percent. Cities bore the brunt of this revenue loss. However, Proposition 1A guarantees 100 percent of the motor vehicle in-lieu fees to cities. Therefore, you will note that 33.33 percent of the motor vehicle in-lieu fee revenue is identified in revenue account number 001-0701-325.01-00. The remaining 66.67 percent is now backfilled from property taxes. A small amount of motor vehicle in-lieu fees designated as the “little roundabout” is fixed at \$58,500 and is distributed annually from the State. The “little roundabout” is a payback from the State of California as a result of property taxes that were shifted in 1992-93.

In fiscal year 2003-04, cities did not receive their full amount of motor vehicle in-lieu backfill. The State retained the funds in order to meet its own obligations. However, the State did promise to repay the funds in August 2006. During fiscal year 2004-05, many cities and counties in the State, including the City of Merced, sold this account receivable to public investors. Although the City received approximately 93 cents for each dollar retained by the State, the security of having cash in hand in 2004-05 for appropriation in fiscal year 2005-06 was far superior to taking a chance that the State would not have sufficient cash to meet the August 2006 promise. The receipt of the funds in fiscal year 2004-05 adds to the positive outlook for 2005-06.

In fiscal year 2004-05, the voters in the City of Merced considered a one-half cent sales tax measure for public safety. The sales tax measure was for a special tax requiring a two-thirds majority vote. Unfortunately, the tax received about 62 percent of the vote – insufficient to meet the 66.67 percent requirement. As this budget is being prepared, a City Council-appointed citizens committee is

considering a recommendation for the placement of another sales tax measure on the ballot in November 2005. Because this would be coincidental with the City Council general election, the City Council has the opportunity to place a general tax before the voters. In comparison, a general tax only requires a simple majority to be successful. Currently, a polling research company retained by the City Council is conducting studies in the community to help the committee ascertain what the community's needs are and what the community feels would be an appropriate revenue source and amount to meet this need.

Another sales tax measure that may be placed before the voters in 2005-06 is a countywide transportation tax. The Merced County Association of Governments (MCAG) is currently considering the reintroduction of a tax measure similar to "Measure M" that appeared on the ballot in 2002. As a special tax, 66.67 percent of the vote is needed to adopt a countywide sales tax increase for transportation purposes. Measure M received approximately 62 percent countywide in 2002.

One of the significant cost increases in prior years has been contribution requirements to the California Public Employee Retirement System (PERS). Contribution rates are based on certain actuarial assumptions that are adjusted annually. Investment losses in prior years have resulted in increased contributions to meet retirement obligations. In 2005-06, PERS will be implementing a rate stabilization program. The initial implementation will be for employees of the State of California. Local government members will participate the following year. The current rate stabilization program in effect uses a three-year time horizon to stabilize contribution costs. The new rate stabilization program will use a 15-year time horizon. While there will certainly be long-term benefit to such a rate stabilization program, there will likely be negative short-term impacts. A new account will need to be established by PERS for rate stabilization purposes. The initial account will need to be funded from an increase in contribution rates until such time as an adequate fund balance is established. Once established, the incremental increase will be discontinued. However, until adequate funds are developed in the stabilization account, member agencies will likely see a slight increase in PERS contributions. The proposed General Fund Budget uses 96 percent of revenue to provide police and fire services.

Administrative Reimbursement, Interdepartmental Direct Service Charges, Transfers In and Carryover will fund Parks Maintenance, Economic Development, City Council, City Manager, City Attorney, Finance, Purchasing and operating Transfers Out for Street Trees, Street Maintenance, Recreation and Park Programs, Airport and Maintenance Districts.

Two appropriations have not been recommended but require City Council consideration – visitor services and graffiti abatement. The recommended

budget contains no appropriation for visitor services. If the City Council wishes to fund some level of visitor services, General Fund appropriation will be required.

Video services have been funded at the 2004-05 level in the City Council professional services line. Graffiti abatement has been budgeted with revenue from two Redevelopment Project Areas -- \$3,000 from Gateways and \$8,000 from Project Area Two. No General Fund revenues have been appropriated, and no budget request has been received from the current provider – Merced Community Action Network (MCAN). The vendor will submit a written proposal and scope of work before June 30, 2005, and staff will make a recommendation to Council at that time.

This year it is recommended that all of the Unrestricted Program Income (Housing) be transferred to the Youth Endowment Fund. Further, that 50 percent of the Youth Endowment fund be allocated to youth recreation programs. With this transfer, the General fund contribution to Fund 024 will exceed \$2 million.

To relieve pressure on the General Fund, it is recommended that funds be advanced via a loan from the General Fund to the Mello-Roos District-Services for Police (\$178,000) and Parks Maintenance (\$77,300). As funds develop over time in the CDF-Services, the General Fund can be repaid.

2004-05: A RETROSPECTIVE

During fiscal year 2004-05, a number of significant projects were completed and several more are in progress.

A new Parks and Open Space Master Plan was adopted by the City Council. Two new parks were developed and are now serving the community – Stephan Gray Park and Davenport Park. Flanagan Park was annexed into the City. Funds continue to be accumulated towards the rehabilitation of this park site.

The bike path system throughout the City was extended by various developments. A Congestion Mitigation Air Quality (CMAQ) grant will complete portions of the Fahrens-Cottonwood bike path.

New affordable housing was provided throughout the community. Two projects specifically designed to meet affordable housing needs that were completed and occupied during this fiscal year were The Grove and The Sunnyside Apartments. The financial success of these projects depends significantly upon the continuation of the Federal Department of Housing and Urban Development Section 8 rent assistance program. Unfortunately, the Merced County Housing Authority (administrator of the Section 8 program) has advised the City that they will lose 25 percent of their voucher eligibility as a result of cuts in the federal program. The Housing Authority is sensitive to the financing arrangements with

the affordable housing projects and will take every precaution to ensure that affordable housing is available in the Merced community.

During 2004-05, significant infrastructure projects to service the campus of the University of California at Merced were completed. Water and sewer lines were extended from the vicinity of G Street and Cottonwood Creek northerly along the G Street alignment to its intersection with Bellevue, and easterly along Bellevue terminating at the UC Merced campus. Capacity in the lines has been designed to meet projected campus needs at buildout; however, capacity has only been provided to the campus for phase one development. A new production water well was also installed on the campus to meet the needs of both the campus and the municipal water system in North Merced.

Water wells 15 and 16 were drilled. Well 15 is located near the intersection of G Street and Cardella; and, Well 16 is located near the intersection of North Highway 59 and Buena Vista. The City is currently out to bid for the installation of the pump, motor, diesel standby, chlorine and fluoride injection systems, etc. Both wells will be fully on line in fiscal year 2005-06.

Significant commercial development also occurred during 2004-05. The Mondo Building was designated as a National Historical Site and the rehabilitation/restoration of the building was completed. The University of California at Merced is occupying the top two floors. County Bank is occupying the ground level. The Redeveloper, Jonathan Tolkin, has done an excellent job in returning a building of historic significance to the City of Merced.

Next door to the Mondo Building, the Merced Lofts project is nearing completion. This project provides retail space at ground level with 13 loft-style apartments on the second and third floors. The Merced Redevelopment Agency assisted in both the Mondo Building rehabilitation/restoration and construction of the Merced Lofts project.

The City also benefited from the completion of the Promenade commercial complex at Yosemite Avenue and Paulson Road, the first tenants moved into buildings at El Portal Plaza, office buildings were completed at both Greystone and Yosemite Gateway on Yosemite Avenue, and new tenants occupied space at the Merced Marketplace. Retail commercial and office space construction continues to keep pace with the residential growth in Merced.

A significant traffic signal timing project was also completed in 2004-05. Traffic flow along the major north-south arterials has improved significantly. Some minor delays have been noted in east-west cross traffic; however, a conscious decision was made by the City Council to give priority to the north-south traffic due to the limited number of north-south arterials serving the Merced community. While significant improvement has occurred, the City Council should not lose

sight of the traffic volume/traffic capacity problem. A road system initially designed more than 50 years ago was not projected to carry the traffic loads present today. The City Council will face very expensive road widening or new north-south arterial construction in the future. While the General Plan has forecasted the need for a Parsons Avenue thoroughfare for many years, care must be given not to incrementalize the project in such a way that existing neighborhoods with older deficient street designs will be required to absorb increased traffic flows.

While much has been accomplished in 2004-05, next fiscal year will see the completion of many more items; and, the ongoing implementation of several projects and programs.

The City Council has identified the update of the Merced Vision 2015 General Plan as its highest priority. Any general plan update requires an intensive public involvement component. That, coupled with the environmental review, will cause the General Plan Update to be an active project throughout fiscal year 2005-06 with completion anticipated in fiscal year 2006-07. The City Council will be asked to select a consultant for this project at its second meeting in May 2005.

Coupled with the General Plan Update are two significant land use proposals that are currently outside of the City's Sphere of Influence. The City Council has authorized the inclusion of four square miles at the northwest corner of North Highway 59 and Bellevue Road currently under development consideration by Brookfield-Natomas. Another project south of Dickenson-Ferry Road containing approximately three square miles is under development consideration by Ranchwood Homes. Coupled with development pressure on properties within the Sphere of Influence, the City Council will need to carefully evaluate all future land use development against the ability of the City to provide adequate services.

The City Council has philosophically been in agreement that growth should pay for growth. Immediately prior to fiscal year 2004-05, the City Council established Mello-Roos community facility districts for services. All future annexations and developments are conditioned upon their participation in the community facilities district for services. In fiscal year 2003-04, eight units were constructed inside the community facilities district-services. In fiscal year 2004-05, approximately 415 units will be constructed within the community facilities district-services. As more building development occurs, more units will be obligated under the CFD-Services tax.

The City Council has had several study sessions regarding the wastewater treatment plant. The study sessions have focused on two separate issues. The first issue concerns enhanced treatment quality requirements anticipated under the NPDES permit scheduled for renewal by the State Regional Water Quality Control Board in October 2005. A report of waste discharge has been submitted

in April 2004 in anticipation of the NPDES permit requirements. The second issue is the expansion of the wastewater treatment plant from its current 10 million gallons per day capacity (mgd) to 11.5 mgd, 15 mgd, and 20 mgd over time.

Financing such major capital investments requires deliberate financial strategies. If growth must pay for growth, then existing wastewater treatment plant facility users should not pay for growth. However, existing wastewater treatment plant users will benefit from the increased treatment processes. Therefore, two financing vehicles will be created to address the different needs. A team of consultants (financial advisor, disclosure counsel, bond counsel, underwriter, rate consultant, etc.) is currently being formed to develop the financing mechanisms.

The City will continue and hopefully complete its water reliability program in fiscal year 2005-06. This program replaces the Polybutylene and Polyethylene service connections with copper. After a 10- to 15-year life span, it has been found that the Polybutylene and Polyethylene services do not tolerate the expansive soil conditions in Merced. Water department personnel are spending an inordinate amount of time making repairs. The overall maintenance of the system is lacking as a result of time spent making repairs. Therefore, the water reliability service program was developed to allow Polybutylene and Polyethylene services to be replaced as a capital project using a portion of the proceeds from an \$8.7 million water revenue bond sold in fiscal year 2004-05. The proceeds of the water revenue bond are being used to refinance existing debt at a lower interest rate and make repairs to existing deficiencies within the system, including the Polybutylene and Polyethylene replacement water service reliability program.

During fiscal year 2005-06, the municipal water production well infrastructure projects at well sites 15 and 16 will be completed. In combination, both wells will add approximately 6,500 gallons per minute into the City's water delivery system.

The City continues to monitor groundwater contaminants very closely. The City and the Regional Water Quality Control Board are continuing the federal mediation process over PCE. Late in fiscal year 2004-05, the City Council authorized retaining specialized legal counsel to protect the groundwater supply and the ratepayers from the high costs anticipated in the cleanup of MTBE – a gasoline additive to improve air quality – from the groundwater.

In fiscal year 2005-06, the first homes will be occupied in Bellevue Ranch. The Bellevue Ranch project was originally approved in 1995. An absorption study prepared for Bellevue Ranch East south of Bellevue Road anticipates (given current market conditions) that all new homes will be constructed and sold within a 41-month window. Bellevue Ranch West and Bellevue Ranch north of Bellevue Road are also scheduled for development. It is anticipated that fiscal

year 2005-06 will add another approximately 1,000 single-family homes to the community.

Fire station 55 is currently under construction. It is anticipated that construction will be completed in October 2005.

With new growth comes the need for new schools. While school construction and financing are not the responsibility of the City Council, coordination with the various school districts is needed to ensure that all community services are available to new residents. Currently, the school districts and development community are in negotiations to establish capital fees for schools in excess of the state-mandated SB 50 mitigation.

Fiscal year 2005-06 will see the arrival of the first on-campus students for UC Merced. In preparation, the City Council has held workshops with the University to discuss "town-gown" issues. To date, discussions have included standardized residential leasing requirements, property maintenance requirements, alcohol sales, use, and abuse issues, and transportation. UC Merced has hired its first police chief. On-campus police services will be in place when the campus opens. The Merced Police Department has agreed to coordinate closely with the UC Merced police to ensure a safe environment for all of the students both on and off campus.

In addition to the Flanagan Park rehabilitation, it is anticipated that four new neighborhood parks will come on line in fiscal year 2005-06. Improvements are currently under construction for additional soccer fields at the west end of Joe Herb Park adjacent to Parsons Avenue. An agreement has been signed with the developer of the Willowbrook Apartments project to develop Willowbrook-Gabriault Park. Other park sites anticipated to be completed are in the Sandcastle development near Weaver School, and the Horizon Gateway development north of Yosemite Avenue, west of R Street.

During 2005-06, a new commercial shopping center is anticipated at the southwest corner of State Route 140-Yosemite Parkway and Parsons Avenue. This neighborhood shopping center will meet the needs of many of the new and existing households in Southeast Merced.

Redevelopment will continue to be active in fiscal year 2005-06. The Gateways Martin Luther King Jr. project will be constructed. This will improve both the appearance and traffic circulation safety on Martin Luther King Jr. Way from 14th Street to the UP railroad tracks. The Merced Center project will recommence with a new hotel developer on property immediately across the street from the Civic Center. The Agency will take responsibility for building the parking structure to support the hotel and an office classroom building for Merced

College. A vacant parcel facing West 19th Street will remain. Merced County has again expressed an interest and may pursue a facility at this location.

Operationally, five Memoranda of Understanding expire in December 2005. City staff will begin to meet and confer early in the fiscal year with the bargaining units. It is hoped that a redesign of the employee benefits delivery program can be accomplished to allow employees to take advantage of a Section 125 pretax contribution.

In closing, the staff and employees of the City of Merced remain committed to meeting the stated goals of this organization:

1. Serve our citizens by delivering superior service exceeding expectations in cost, safety, and quality.
2. Serve the City Council by providing clear, concise, accurate, unbiased professional staff work.
3. Serve our employees by establishing goals, objectives, measurable standards for performance; and, to compensate them accordingly.
4. Model our shared values.

Sincerely,

James G. Marshall
City Manager

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