RESOLUTION NO. 2012-55

A RESOLUTION OF THE COUNCIL OF THE CITY OF FRESNO, CALIFORNIA, TO ESTABLISH A POLICY ENTITLED "FISCAL SUSTAINABILITY POLICY" TO ADDRESS SHORT- AND LONG-TERM BUDGET CHALLENGES

WHEREAS, Section 500 of the Fresno City Charter recognizes the Council as the legislative body for the City of Fresno and delegates all authority necessary for the Council to legislate on behalf of the residents of Fresno; and

WHEREAS, the City of Fresno is in severe financial distress that requires immediate action. Despite extensive and painful cuts in staffing and service delivery, the most recent short-term (5 to 10 year) financial projections demonstrate need for definitive action, starting with adoption of this Fiscal Sustainability Policy; and

WHEREAS, the Fiscal Sustainability Policy of the City of Fresno is intended as a policy framework, seeking to accomplish four outcomes: (1) to set a course to restore the City's overall financial health and credit rating; (2) to achieve spending and minimum financial reserve targets; (3) to adopt employee compensation principles to be negotiated as employee contracts are opened for negotiations; and (4) to direct immediate actions seeking to match expenditures to revenues and identify options for savings in employee compensation and other operating costs; and

WHEREAS, the City's current situation has been caused by a variety of factors, including the economic downtown, unsuccessful local investment decisions, an increase in indebtedness burdening the General Fund, and adoption of unaffordable future commitments to labor groups and others; and

WHEREAS, while not the only cause, this policy acknowledges that employee compensation constitutes such a major portion (80%) of the General Fund that meaningful cost changes necessarily require reduction in salary and employee benefit costs; and

WHEREAS, the City is subject to the Meyers-Milias-Brown Act (MMBA), which requires the City to bargain in good faith with all recognized labor organizations; and

WHEREAS, the City recognizes the need for its employees and labor organizations to be part of any long-term fiscal solution; and

WHEREAS, the City will continue to meet and confer in good faith to achieve budget concessions that ensure that essential services can be sustained. As the City moves forward, the City's administrative and legislative decisions must involve necessary reforms to ensure that all employees are fairly compensated, consistent with community standards, and on a sustainable

Adopted 3-29-12
Approved 4-9-12
Effective 4-9-12

2012-55

basis, and that the workforce is managed efficiently and according to best practices.

NOW, THEREFORE, BE IT RESOLVED by the Council of the City of Fresno as follows:

1. The Fiscal Sustainability Policy as set forth in attached Exhibit "A", as amended, is adopted as a legislative policy of the City of Fresno.

2. SEVERABILITY. The Council declares that the provisions of this Resolution are severable. If, for any reason, any sentence, paragraph, or section of this Resolution is determined by a court of competent jurisdiction to be invalid, such determination will not affect the validity of the remaining provisions of this Resolution.

3. This Resolution shall become effective and in full force upon its final passage.

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STATE OF CALIFORNIA)
COUNTY OF FRESNO) ss.
CITY OF FRESNO)

I, YVONNE SPENCE, City Clerk of the City of Fresno, certify that the foregoing resolution was adopted by the Council of the City of Fresno, at a regular meeting held on the 29th day of March, 2012.

AYES : Baines, Borgeas, Brand, Westerlund, Olivier
NOES : Quintero, Xiong
ABSENT : None
ABSTAIN : None

Mayor Approval: N/A, 2012
Mayor Approval/No Return: April 9, 2012
Mayor Veto: N/A, 2012
Council Override Vote: N/A, 2012

YVONNE SPENCE, CMC
City Clerk

BY: Yvonne Spence
Deputy

APPROVED AS TO FORM:
CITY ATTORNEY'S OFFICE

BY:
James C. Sanchez, City Attorney

No Return

March 30, 2012

Council Adoption: 3/29/2012
Mayor Approval:
Mayor Veto:
Override Request:

CITY OF FRESNO INCORPORATED OCT. 12, 1885

TO: MAYOR ASHLEY SWEARENGIN

FROM: YVONNE SPENCE, CMC YS
City Clerk

SUBJECT: TRANSMITTAL OF COUNCIL ACTION FOR APPROVAL OR VETO

At the Council meeting of 3/29/12, Council adopted the attached Resolution No. 2012-55, entitled **Implementing the Fiscal Sustainability Policy**, Item No. **9:00 A.M. A,** by the following vote:

Ayes	:	Baines, Borgeas, Brand, Olivier, Westerlund
Noes	:	Quintero, Xiong
Absent	:	None
Abstain	:	None

Please indicate either your formal approval or veto by completing the following sections and executing and dating your action. Please file the completed memo with the Clerk's office on or before April 9, 2012. In computing the ten day period required by Charter, the first day has been excluded and the tenth day has been included unless the 10th day is a Saturday, Sunday, or holiday, in which case it has also been excluded. Failure to file this memo with the Clerk's office within the required time limit shall constitute approval of the ordinance, resolution or action, and it shall take effect without the Mayor's signed approval.

Thank you.

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APPROVED:

VETOED for the following reasons: (Written objections are required by Charter; attach additional sheets if necessary.)

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____

____________________________ Date: ________________
Ashley Swearengin, Mayor

COUNCIL OVERRIDE ACTION: Date: ________________

Ayes :
Noes :
Absent :
Abstain :

City of

FRESNO

OFFICE OF THE MAYOR AND CITY MANAGER

FISCAL SUSTAINABILITY POLICY
OF THE CITY OF FRESNO

I. Purpose of the Fiscal Sustainability Policy

The City of Fresno is in severe financial distress that requires immediate action. Despite extensive and painful cuts in staffing and service delivery, the most recent short-term (5 to 10 year) financial projections demonstrate need for definitive action, starting with adoption of this Fiscal Sustainability Policy. The Fiscal Sustainability Policy of the City of Fresno is intended as a policy framework, seeking to accomplish four outcomes: (1) to set a course to restore the City's overall financial health and credit rating; (2) to achieve spending and minimum financial reserve targets; (3) to adopt employee compensation policy changes to be negotiated as employee contracts are opened for negotiations; and (4) to direct immediate actions seeking to match expenditures to revenues and identify options for savings in employee compensation and other operating costs. Consistent with this policy the City retains its legislative discretion to adjust its policy with existing economic circumstances facing the community.

The City's current situation has been caused by a variety of factors, including the economic downtown, unsuccessful local investment decisions, an increase in indebtedness burdening the General Fund, and adoption of unaffordable future commitments to labor groups and others.

While not the only cause, this policy acknowledges that employee compensation constitutes such a major portion (80%) of the General Fund that meaningful cost changes necessarily require reduction in salary and employee benefit costs.

The City is subject to the Meyers-Milias-Brown Act (MMBA), which requires the City to bargain in good faith with all recognized labor organizations. The City recognizes the need for its employees and labor organizations to be part of any long-term fiscal solution. The City will continue to meet and confer in good faith to achieve budget concessions that ensure that essential services can be sustained. As the City moves forward, the City's administrative and legislative decisions must involve necessary reforms to ensure that all employees are fairly compensated, consistent with community standards, and on a sustainable basis, and that the workforce is managed efficiently and according to best practices.

II. Background

The City of Fresno ("the City") is at an important juncture in its extensive efforts to control costs and maintain essential public services. Given the effects of the economic recession, it is increasingly difficult for the City to deliver services that are critically important to the health, safety and well-being of Fresno residents: police protection; fire protection; street and traffic system maintenance; and maintenance and operation of parks.

The City's largest General Fund costs are associated with employee salaries, fringe benefits (including health benefit costs), and pension and other post-employment benefit costs. These employee costs represent approximately 80% of the City's $214 million General Fund. They represent similar percentages of other funds, several of which are deeply stressed and will require either cost cuts or additional user rate increases.

Beginning in February 2009, the City, working with its employees and the public, has undertaken seven major rounds of budget reductions to address what has been a cumulative $100 million operating shortfall since that time. Citywide, the workforce has been reduced by attrition and layoffs from 4,171 employees in January 2009 to 3,217 employees in January 2012. The position count in the City's General Fund has been cut by 33%. An "early retirement incentive" was funded and offered in Spring 2010 to accelerate a voluntary reduction in the workforce. Furloughs affecting all unrepresented employees and all but one City bargaining unit were implemented in December 2009 and continue to this day. Two-year concessions have been agreed to by three employee bargaining units, and deferrals of compensation have been agreed to by others.

Essential City services have been reduced to the minimum level possible without jeopardizing the overall health and safety of residents. Non-essential City programs have been eliminated or severely curtailed. Examples of reductions include:

- Several City recreation centers are now being operated by volunteer community-based organizations.

- Park maintenance schedules have been extended.
- Recreation programs have been entirely eliminated in some cases and significantly reduced in others.
- Vehicle replacements have been delayed, and replacement funds have been diverted.
- Street tree trimming has been curtailed.
- Some fire inspections have been suspended, and basic police reports are conducted by phone rather than in the field.
- Building maintenance is being deferred, which will increase future costs.
- Employee training has been eliminated in some areas and significantly reduced in others.
- Four City departments have been consolidated, with management functions absorbed by already reduced management staffs.

Many of these changes are likely permanent for the foreseeable future. Other unsustainable cuts (deferred vehicle replacement, underfunded Risk/Liability Reserves) will require restoration very soon.

The City has also sought opportunities on the revenue side, including adoption of Commercial Solid Waste and Commercial Recycling franchises. The City also negotiated an increase in the PG&E gas service franchise fee, has increased Building Permit fees, and done an aggressive Business License Tax audit program. Other permit fee increases are being recommended.

III. City of Fresno Financial Position

Unfortunately, local revenues are not expected to rebound in the near term. Property taxes have declined substantially in the last year. Even the staffing reductions and deep operational cuts in recent years are not adequate to address the reality that the current costs of employee salaries and benefits cannot be sustained by the City of Fresno. **Structural changes in employee compensation are now required to address the City's dangerously weak financial position.**

The City's management has consistently disclosed this deteriorating situation, including most recently in the attached (a) Fiscal Health status report in the Mayor's Recommended FY12 Budget Message, (b) letter from the City Manager to employee bargaining groups dated February 3, 2011 seeking compensation concessions, (c) an employee-wide email dated March 21, 2011, providing information related to the February 3, 2011 letter, and (d) an employee-wide email dated November 28, 2011, reiterating concern over a deteriorating economic condition and repeating the need for employee concessions.

The City's difficult financial position is demonstrated by the following:

- **Structural Imbalance over 5-Years**: Updated 5-year projections (attached) document a serious imbalance between projected revenues and expenses. In addition to balancing the budget, the City must allocate funding to eliminate negative fund balances and restore at least minimum emergency reserve levels. Recent analyses indicate the City needs a minimum of $10-12 million per year in additional cost cuts or revenue increases, continued over a ten-year period, to structurally balance the City's operations and fiscal health, even while operating at the lower service levels caused by budget cuts.

- **Allocating Liability for Negative Fund Balances**: Compounding the City's fiscal situation, there is an immediate need to resolve the formal accounting of now long-standing negative fund balances. Typically, the General Fund is the legal backstop for negative fund balances that are not otherwise resolved in a one to two-year period. Unfortunately, the General Fund has depleted nearly all reserves.

Therefore, in addition to the obvious challenges in balancing the operating budget, the City faces a different, but equally critical challenge in allocating the liability for negative fund balances to allowable positive balances in other discretionary funds. In essence, the City must make formal loans between allowable discretionary funds to demonstrate solvency in the Comprehensive Annual Financial Reports (CAFR). While the City is able to make these allocations in the current year, the City's projections demonstrate a need to further cut expenditures or increase revenues to achieve balance in the future. Given the current fiscal condition, multi-year interfund loans should not be considered a solution.

- **Delays to Achieving Fiscal Sustainability:** The City can no longer delay addressing the underlying, structural drivers of its financial problems. The City has attempted to address the current fiscal crisis, in part, by reducing and eliminating non-essential services, by reaching agreements with labor unions to defer costs, and by spending its internal reserve funds to the point where discretionary reserves are all but depleted and, as indicated above, some funds currently carry negative balances. The City has made all the service reductions possible without endangering the health and safety of its residents. Fundamental, structural change is necessary.

- **Unsustainable Employee Health Care Costs**: The City's obligation to fund employee health care costs at the current levels is unsustainable. Costs must be contained in a responsible and fair manner. The City must re-evaluate the current system of open-ended funding of an independent Health and Welfare Trust ("Trust"). Unless there is genuine reform of the administration of employee health care benefits, the viability of the City Employees' Health and Welfare Trust is in jeopardy.

- **Unsustainable Paid Leave Balances:** A variety of City Memoranda of Understanding with labor unions contain overly generous employee paid leave accumulations and "cash out" obligations. A typical City of Fresno employee is provided paid leave (for use or cash-out) equivalent to 18% to 22% of their total workdays each year. These leave balances have become unwieldy, costly, unsustainable and inconsistent with community standards for comparable labor benefits in the Central Valley. Similar policies also exist for and are equally unsustainable for unrepresented employees.

- **Downgrade of the City's Credit Rating:** The overall poor financial health of the City has resulted in significant downgrade in the City's bond rating by all major bond rating agencies. Reports from both the City's administration and reports from the bond rating agencies concur that restoring the City's financial health will depend on the City's ability to pay back approximately $26 million in negative fund balances, restore a long-term operating balance in the General Fund, and rebuild its emergency cash reserves to levels appropriate for a city with a budget the size of Fresno's. The downgrade to the City's credit rating has restricted the City's access to certain debt markets and threatened ability to do lease-purchase acquisition of police and fire vehicle replacements and safety equipment.

- **Depletion of Emergency Reserves:** Normal accounting standards call for governments to maintain emergency reserves sufficient to cover basic services for a period of at least two to three months. The City has depleted its General Fund emergency reserves to dangerously low, and plainly, imprudent levels. The City must fund reserves to ensure that the City can sustain future economic downturns and to protect its residents from natural or man-made disasters or unforeseen future emergencies.

IV. Fiscal Management (F.M.) Policy Framework

F.M. Policy No. 1 – Fiscal Sustainability: Fiscal sustainability is defined herein as a stable operating status where (1) core services are funded, (2) all negative fund balances are properly restored, and (3) emergency and maintenance reserves have attained at least at minimally acceptable levels. In the immediate term, the City commits to establish and implement a realistic 10-year workout plan that achieves fiscal sustainability in accordance with this definition.

F.M. Policy No. 2 – Existing Legislation Mandating Responsible Financial Management Practices: Recognizing that the City has made unsustainable past decisions relating to debt, investment, labor relations and general financial management, the City Council, working with the Mayor, has proposed and adopted the following legislative policies over the last three years: (1) Debt Management Act, (2) Better Business Act, (3) Labor-Management Act, and (4) Reserve Management Act. Each of these acts sets forth criteria and process for entering into future agreements relating to significant future financial commitments. The legislation provides for public transparency and other checks against ill-advised commitments. These policies, coupled with the following additions, provide the policy framework for the City's responsible fiscal management.

F.M. Policy No. 3 – Adopt Fee Structures that Fully Cover Costs for Fee-Based Services: The City provides a variety of services that are established on the assumption that they will be paid for in total or in part by user fees. State and local policy dictate that such fees shall not exceed the fully allocated costs of the services. Over time, fee structures have tended to lag behind costs, causing operating deficits, requiring General Fund (or other fund) subsidies.

The City will take steps necessary to identify services for which fees will be adopted and the percentage of such service costs that should be covered by the fee. In the future, when the cost of services exceeds fee revenue, City staff shall identify such shortfall and when it is not possible to reduce operating costs proportionately, staff will seek fee adjustments to avoid further subsidies. In cases where the City Council wishes to subsidize fee-based services, their approval will identify the source of funding for the subsidy.

F.M. Policy No. 4 – Provide Budget Allocations for Basic Maintenance and Replacement of Equipment and Property: In recent years, in an effort to balance budgets, certain facility maintenance has been deferred and vehicle and equipment schedules have been extended. Vehicle replacement funds have been depleted. Such deferrals increase ultimate costs and cannot be extended further.

It shall be City policy that reasonable, realistic budgets be established and reviewed as necessary to operate a cost-efficient facility and equipment maintenance and replacement program.

F.M. Policy No. 5 – Notification of Cash Insufficiency: City Manager shall provide Mayor and Council prompt written notification of Manager's determination that a major government or enterprise fund is likely to have insufficient cash to cover its legal or budgetary obligations at year end.

V. Labor Relations (L.R.) Policy Framework

While the solution to Fresno's financial situation involves more than just personnel costs, employee compensation levels remain the largest component of the City General Fund budget (80%) and offer the only viable path to fiscal stability. Listed below are eight Labor Relations Policies that the City commits to implement consistently in all of its negotiations with employees. These are each critical Policies of the City. Implementation of these Policies, by the City Manager, will start immediately and be applied consistently and progressively through the meet and confer process.

L.R. Policy No. 1 – Bargain in Good Faith: The City is subject to the Meyers-Milias-Brown Act ("MMBA"), which requires the City to bargain in good faith with all recognized labor organizations. The City renews its ongoing commitment to develop strategies for long-term fiscal stability and to abide by the Meyers-Milias-Brown Act ("MMBA"). The City will continue to negotiate in good faith, seeking partnerships whenever reasonably possible, with the ultimate goal of ensuring long-term fiscal sustainability of employee salaries and benefits.

L.R. Policy No. 2 – Increase Transparency and Remove Hidden Costs: The City embraces transparency in its mission. Contracts including cost commitments should not contain embedded costs and obligations that are difficult for citizens to identify or understand, or for the City to sustain long-term. The City shall minimize "additional pay" categories that have no articulated and rational justification. Consistent with the Labor Relations Management Act, the City shall ensure that all compensation packages are fully, accurately and simply "costed out over time," with total costs displayed to the public so that all citizens can understand and evaluate the pay at issue. Unless there are exigent circumstances as determined by the City Council, tentative labor agreements shall be made available for public review at least ten calendar days prior to adoption.

L.R. Policy No. 3 – Establish Rational and Reasonable Compensation: The City greatly values the public service of its employees. However, the City serves the community, and the City's funding is from limited revenue that is subject to fluctuation. The City shall set compensation that is rational, reasonable, consistent with community standards and local labor markets, and sustainable in the long-term. Such policy should address all compensation, including base salary, salary premiums, pensions, medical coverages, paid leave programs and other compensation cost items.

L.R. Policy No. 4 – Ensure Appropriate Work Rules: Some MOUs, and informal and formal department policies, contain work rules that decrease management discretion and lower efficiencies. The City shall maintain its management rights to supervise, manage and direct its workforce. The City shall not enter into MOUs that contain unreasonable restrictions on the City's management rights.

L.R. Policy No. 5 - Simplify MOUs: In the past, the City's MOUs have included complicated provisions that are difficult to administer. These provisions have led to grievances and misunderstandings about terms in the labor agreements. The City will ensure its MOUs are simple to understand by the public, as well as City personnel. All MOUs shall be organized in a simple, clear and straightforward manner, using plain language.

L.R. Policy No. 6 – Avoid Long-Term Agreements and Unpredictable Salary Formulae: The City has been subject to long-term MOUs that schedule compensation increases that are unsustainable in light of the severe economic downturn and current budget realities. The City should avoid obligating itself to long-term agreements premised on salary formulae or other criteria that are not controlled by the City. The City shall seek to avoid MOUs that contain automatic wage adjustments that are premised on formulae that do not allow the City to predict and account for costs.

L.R. Policy No. 7 – Negotiate with Active Employees, not Retirees: The City has made past agreements that increased post-retirement compensation for retirees after they retired. The City has an obligation to negotiate (under the MMBA) with employee bargaining units regarding changes to matters involving terms and conditions of employment for active employees. Except for existing MOUs, the City is under no obligation to expand or increase benefits for employees who have already retired. The City values the service of its employees and will compensate them in keeping with community standards, but obligations for retirees should not increase after their retirement except as established at the time of their retirement.

L.R. Policy No. 8 - Limit "Premium Pay": "Premium Pay" refers to pay elements added to base pay, for "specialty" services or as "incentives." The City's MOUs and compensation plans contain a variety of "premium" pays that are in addition to base pay. These pay premiums present unsustainable compensation structures and impair the long-term fiscal health of the City. Further, the pay premiums detract from the City's policy regarding transparency because it is difficult to determine the actual pay of City employees.

VI. Immediate Actions

In addition to implementing the eight Policies set out above through the MOU negotiating process, the City must immediately take the following steps to address its fiscal crisis.

Action No. 1 – Conduct Public Review of City Financial Records and Immediate Cashflow Projections: To provide complete transparency for the public and for interested stakeholders, including employee bargaining groups, the City Manager is directed to schedule one or more workshop meetings to present the facts concerning the City's financial situation. The presentation should seek to be open, interactive and comprehensive. Employee bargaining groups are encouraged to involve their financial/accounting consultants and advisors to participate. The information should be shared equally with the public, either through direct participation or through communications utilizing available media.

Action No. 2 – Evaluate All Options to Reduce Costs of Health and Welfare Benefits: Health care costs are escalating at unpredictable and extreme rates. These costs cause pressures on the City's General Fund that jeopardize the City's overall fiscal health and its ability to deliver essential services. Employees should share in health care costs to foster accountability and responsibility. The benefit plans administered by the Fresno City Employees Health and Welfare Trust and all the City's health care related obligations must be evaluated to determine their viability and whether any alternatives exist to save costs while continuing to provide fair and sustainable benefits. These alternatives must be presented to both the City Council and the Health and Welfare Trust.

Beginning immediately, the City staff shall comprehensively scrutinize all health care obligations to ensure they are sustainable, prudent and consistent with community standards. The City will request and expects to receive full cooperation and assistance from the Trustees of the Fresno City Employees Health and Welfare

Trust to collect data (non-HIPPA protected) needed for the evaluation. It will include an analysis of the Health and Welfare Trust to determine whether alternatives exist to provide fair and sustainable benefits. The City's evaluation of health and welfare benefits will be completed by May 1, 2012 and will be presented to the City Council at a public meeting.

Action No. 3 - Evaluate All Options to Reduce Retirement Costs: The current liabilities attributable to the City's pension obligations are reported to be fully funded. Despite this, the question remains as to whether the plans are affordable and consistent with community and labor market standards. The City's pension costs are high (22% of all Personnel costs) and the pension plans include debatable features (10-year DROP, overly high post-DROP investment rates, pensionable non-salary elements, surplus sharing high post-retirement adjustment policies, etc.). The City will immediately initiate a review of all pension obligations to determine what legally may be modified in order to reduce costs. This evaluation will be completed by May 1, 2012. To the extent possible, the review will include evaluation of the actuarial assumptions of pension obligations.

Action No. 4 – Seek Opportunity to Reduce Paid Leave Liability: The City's MOUs include scheduled commitments to fund a variety of leave balances that are neither facially rational nor consistent with community standards. The accumulation of leave balances includes future cost commitments that pose a significant and unfunded burden on the City's General Fund. Overly generous leave allocations also reduce productivity of an already reduced workforce. The City shall immediately take steps to evaluate its costs associated with all leave balances. The

City shall develop a City-wide program for leaves that reduces long term liabilities and is rational, sustainable and consistent with community standards.

Action No. 5 – Direct the City Manager to Contact Labor Representatives and Request "Meet and Confer": The City Manager shall immediately contact all applicable labor representatives in writing requesting that they discuss adjustments to current employee compensation, including subjects discussed in this Fiscal Sustainability Policy. The City Manager should request labor groups to re-open their existing MOUs or, for labor groups whose MOUs will soon expire, commence negotiations now on a successor MOU. The City Manager shall report back to the Mayor and City Council within 30 days concerning bargaining groups' response to this request.

VII. Conclusion

The City of Fresno has no choice but to restructure its operations to match expenditures to available revenues. It must also restore general fund reserves and reduce negative fund balances. All fiscal health options must be considered; there can be no exceptions. The City exists to provide core services to the public. There are very few remaining service level cuts possible without adverse effects on the public health, welfare and safety.

Solutions must be structural and long-term, as opposed to merely deferring costs or incoming debt. Due to the sheer magnitude of employee compensation costs, efforts must be taken immediately to meet and confer with employee groups to study options and make meaningful cost reductions.

The evaluations must be comprehensive, and the negotiations that result from them will likely be similarly broad. Employee bargaining groups should anticipate negotiations on salaries, salary premiums, medical benefits, retirement benefits, leave accumulations and any other changes appropriate to achieve fiscal sustainability while maintaining essential City services. Not only is the City's fiscal health at issue, the long-term viability of employment with the City requires a vital City operation that earns the public's ongoing support.

ATTACHMENTS

November 28, 2011

To: **All Employees**
From: Mark Scott, City Manager
Subj.: City Economic Update

People constantly ask me if I am sorry to have come home to take the City Manager job at a time like this. The answer is no, I am not sorry. I regret that things are so tough, and it does wear on me each time employees' careers and lives are impacted negatively. However, this is my hometown, too, and I am proud to have joined a team of people who have worked through two or three years of challenges and never lost sight of our collective mission. Ultimately, we exist to serve the public and we are doing as good a job as circumstances allow. You have not given up, and neither have I.

We do have some ongoing challenges, however, and I do often regret being the bearer of unpleasant news. I am writing this global ("all employee") email to update you on the City of Fresno's economic situation. Despite the blunt reality of this message, I intend it with all the respect that is due to the dedicated group of public servants that you are. I previously wrote in one of these emails that I may not be able to provide fully satisfactory answers to all your questions, but I can tell you truth as I am able to discern it. I am doing that here again in this email. It is not a message I want to deliver, but it is the truth that I know about our situation as employees.

While I can tell you that there are cities and counties in worse shape than we are, that would represent grasping at straws to find a positive angle on my message. And please believe me when I say there is not one molecule in my body that wants to tell this organization that we need to dig deeper as employees to make things work. We just do not have resources to do otherwise.

Over the next 3 weeks, I will also set up some "employee-only" meetings in the Council Chamber to address your questions face-to-face.

Implications of the Recent Credit Downgrades

With all the talk in the news about conditions in other cities, and with the recent credit downgrade of our bond ratings, I am sure you have questions, if not concerns. I have real concerns as well. Fresno is no exception to public and private businesses around the country. To put it simply, and despite painful downsizing that has already occurred, we are not operating a sustainable enterprise. It is obvious to rating agencies, financial advisors and auditors who have studied our records. We have no choice but to do the following:

1. We have to match our Expenditures to our Revenues. Simple math.
2. We must address longer term financial health by paying off our negative fund balances and start rebuilding some emergency reserves.
3. And, we have to make fundamental changes to the 3 largest budget lines we have – salaries, retirement and employee medical expense. I am sorry, but this is our reality.

Nothing has really changed to the positive since I did my global email in March, asking our workforce to consider a 5% permanent salary cut and a change to a 70/30 premium sharing formula with the Medical Trust. Things remain very tight. For all practical purposes, except in our utility funds, we have little or no Fund Reserves, and there is little prospect for tax revenues to rise significantly anytime soon. And as you know, except for a very few cases, our bargaining groups were unwilling to do concessions.

We talk a great deal about Budgets. Budgets are tight, and we have had to make cuts to try to balance budgets. However, budgets are only one aspect of overall financial health in a city. The credit downgrades (Fitch, Standards & Poor's, and Moody's) have focused on our overall financial health. The rating agencies cite several primary concerns:

- Concern over our ability to match Expenditures to Revenues in a Central Valley economy that is not projected to grow much over the next few years.
- Lack of any General Fund Reserves and very few other funds with "borrowable cash" that could be tapped by the General Fund in an emergency.
- The existence of more than $25 Million in negative fund balances, especially in the Parking and the Development Services (Planning) Enterprise Funds. Those funds need to be made whole before we can start growing our General Fund Reserve.
- Inability to obtain voluntary concessions from our employee bargaining groups and questions about the will of city management to achieve long-term employee contracts that the City can sustain.
- The rapid growth of the balance sheet liability for "Compensated Absences" (accumulated employee leave time).
- Potential loss of Redevelopment Agency funding.

The rating agencies cite a very few bright spots. They note, with some wonder, how the City's retirement funds are so fully funded. They also applaud the City for not having entered into the expensive retiree medical liabilities of other cities. However, they do question our ability to sustain the employee benefit levels we have today. This is essentially the same in most California cities. All of the rating agencies' written comments are available to the public if you are interested.

The City's utility enterprise funds were not rated or downgraded, although our water bonds will be evaluated by one agency in December. We believe those funds (Water, Wastewater, and Sanitation) are adequately resourced, largely because they are funded by user charges.

Impacts from the Downgrade

The City was not initially affected by the rating downgrades because we do not have any immediate plans to issue more debt. However, it did not take long for the impacts to be felt. We have lost our lenders for both Tax Revenue Anticipation Notes (TRANS) and Lease-Purchase equipment replacement.

A TRANS debt is issued by many cities annually, including Fresno, to smooth out the General Fund cash flows during a fiscal year. Money is borrowed early in the fiscal year because the biggest revenues (property tax, business tax, December sales tax) do not come in until mid-year. Then the TRANS debt is paid off before the end of the year after the revenues are received. We typically issue a TRANS debt in the $50-60 million range, and repay it after receiving our tax revenues. There is an interest charge, but it allows us to keep other funds invested at the same time. It is a very common method of handling city cashflow.

This year, however, due to the downgrade, the lending world put an interest rate premium on what the TRANS would cost. We cannot afford it. Thus, we are having to manage our internal cashflows very cautiously, borrowing from among the various funds, knowing that we must be in a position to pay back those internal debts by the end of the fiscal year. There are costs incurred in maintaining this type of liquidity.

The loss of the Lease-Purchase lender is even more troubling. We drew down all of our General Fund equipment replacement funds two years ago. With all due respect to those who felt the City should deplete all its reserves before doing layoffs or service cuts, it was a wrong choice. Without replacement reserves, we have had to make increased use of lease-purchase lending (paying over time with interest) to replace patrol cars, other fleet equipment, fire safety apparatus, office equipment, etc. Since the credit downgrade, we have not been able to find a lease-purchase lender for our General Fund purchases. Some equipment manufacturers may be willing to do this, but the rates may be prohibitive. Bottomline is that we will have to buy equipment on a cash basis. If we do not have money in the budget, we will either have to do without or cut other budget lines. Police cars vs. training budgets. Breathing apparatus vs. preventive maintenance. It is a very unusual and discouraging trade-off. It is our reality.

So what does all this mean to employees?

This brings us back to where we were in March when I asked employee bargaining groups to voluntarily agree to a 5% permanent salary cut and a change to a 70/30 premium cost sharing formula for the Medical Trust. In the memo I sent at that time, I said that we needed more than that, but we hoped to make up the rest from other sources.

As you know, our effort to obtain this voluntary concession was almost completely unsuccessful. I must thank FCEA, Fire Basic, Fire Management, and our Unrepresented Employees for their support. The support is duly noted.

However, even with the support of the 4 groups, we did not get the full concession I told you that we needed. In the best case, we got a 2-year commitment to 3% and a future cut to 70/30 if other groups did the same. Where we needed about $7 million per year, we got about $1 million for just two years. I fully understand. Most bargaining groups have active contracts with the City and chose to ask us to honor those. And we are doing so. Explicitly or by inference, each group told us, "We will talk when our contracts expire."

I understand the choice. I think it was a wrong choice, but we have nonetheless moved on to what we can do.

This is what I think we all need to understand going forward:

- We have no choice but to keep making very hard decisions. Layoffs alone will not solve our problem. In fact, we are irrelevant if we do not keep service to the public as first priority. There is very little to cut other than employee costs.
- We're not about to be saved by a surging economy. The outlook for recovery is, at best, going to be gradual and modest for several years. The State of California's situation is much worse than ours, and it is likely to cause local governments to be hurt even more. We may not have seen the bottom yet.
- Acknowledging the mistakes of the past has been important to help us learn and to avoid them in the future, but it won't help us solve today's financial health issues.
- By far, the biggest costs for any city are found in salaries and employee benefits. We have little else to cut to bring expenditures in line with expenditures.

My regrettable message is that we were very serious about the larger concession and medical plan cost cut when we addressed it in March. Having failed to obtain those, our needs are greater now. Every month we delay, the greater the impact on what we finally have to do.

As bargaining agreements come due, we will negotiate in good faith (as required by law), but we will negotiate for salary and benefit levels we believe we can sustain over time. California law, and good conscience, requires that we make serious efforts to reach agreement in our collective bargaining. The law does not, however, require us to reach agreements we do not believe we can afford.

We have no choice but to look for changes in our cost structure. For that reason, I hope very much that our bargaining representatives (and all of you) will not misunderstand the proposals we will be making as contracts approach expiration. We will be sincere and serious in making proposals such as the following:

- At least 5% salary decreases, or potentially more.
- At least a cut to the Medical Trust cost share formula to 70/30, or potentially more, depending on what the Medical Trust does now to reduce costs. There is much that can be done, so we look to them to act.
- Significant reductions in the amount of compensated time off accrued by employees.
- Cuts to future retirement costs and benefit levels.
- Changes to expensive work rules that do not affect safety or increased productivity.
- Reduction of certain DROP coverages.

I fully appreciate what our workforce has already done to try to help. We have done furloughs, layoffs, demotions, salary concessions, service cuts and innovations, operational efficiencies and consolidations, increased workloads, debt refinancing – we have done everything that we can think of. Our bargaining groups have made efforts. Some bargaining groups done more than others, to be sure, but every group has helped. I fully appreciate every bit of assistance we have obtained. As a citywide workforce, you have responded both with your understanding and your ongoing commitment to mission. I feel grateful for the support you have given me since I arrived 19 months ago. I am asking you now to extend your understanding. We need to move forward with new bargaining agreements – and the sooner groups come to the table, the lesser the impact will be.

What else is being done to improve our future?

I do believe in our future. If I did not, this would not be worth the heartache. We need to position Fresno to be a vibrant, healthy community as we come out of this downturn. We have spoken of this in the past. Future economic health will be determined by a community's ability to attract new investment. Among cities, there will be winners and losers coming out of the downturn, so we are actively seeking future investment. We are all trying to build a future organization that will be as good to work for as it has been for us.

Mayor Swearengin is the best Economic Developer I have <u>ever</u> worked with. It is her background and she is tireless in promoting our community. That's a good start. We are focused on export-producing industry as first priority – both by growing existing industry and by attracting new industry. In particular, we are working on establishing Fresno's rightful place as the world center for the food processing industry. We seek jobs, we seek to add per capita income, and we seek to increase the City government's revenue base.

Economic development also means planning for the logical, sustainable development of the City. It means curbing sprawl, properly sizing and timing infrastructure, promoting density along future transportation corridors, and it means seeking infill development and revitalization of older neighborhoods. Otherwise, our older neighborhoods will become an increasing drain on future resources. We need these initiatives to succeed for the health of our citizens, and for the financial health of the City.

And we are doing much more:

- When we work on the Downtown Specific Plan and our Downtown Community Plan, we are looking for ways to rebuild the heart of our community and to attract new investment.

- When we facilitate our General Plan Update, we are seeking smart and sustainable development choices.

- When we promote the second annual Fresno Food Expo, we are reaching out to the local food processing industry and showing off to the world what can be accomplished in Fresno.

- When we streamline development application processing, we are saying to investors that this is a place that welcomes new and creative investment and will reciprocate through good service.

- When we lobby other agencies to stop approving growth in non-urban areas, we are trying to avoid the sprawl that will cost us future dollars to serve new development in areas which cannot pay their own way.

We all have a big stake in the success of our community and our employer. On many occasions this last 20 months, I have wished I could find that magic solution that would make things easier on us, but we need to be realistic about our future. There is not a single solution. It is going to be hard work. I will appreciate your ongoing support for that mission, and I ask for your understanding. Even when we have occasional differences in opinion, I know this is a team I want to be associated with.

Mark Scott

Mark Scott

From: Mark Scott
Sent: Monday, March 21, 2011 8:18 AM
To: COF-All
Subject: Message to All Employees about the City's Budget Situation

Dear City Team,

I am writing to address a number of questions I am being asked by employees concerning the budget situation and our recent request to bargaining groups to consider compensation concessions. After speaking to representatives of most of our bargaining groups, we agreed that I should address these comments to all employees directly. As such, I am sending this global email, and I will also be setting up some meetings in the City Council Chamber that any employee is welcome to attend at your convenience.

First and foremost, I want to acknowledge how much our employee team has already endured and contributed during the economic downturn. Although I am still relatively new to this organization, I have quickly learned how much you all care about the City, about public service, and about one another. We very much appreciate the many concessions our bargaining groups have already made. Unfortunately, it is clear that we are not done with cutbacks. And we know that the layoffs and bumping take a real toll on everyone in the organization. Speaking for the Mayor and myself, I can only tell you that all of us are working hard to find permanent solutions so that we can finally be done with the constant cutting and heartache. This is the hardest stretch of my career, and I am sure that is true of all of you. Through all of this, our employee team has done an exemplary job of adjusting and serving the public. I am quite sure our team has not received the full credit we all deserve for those sacrifices, but we are grateful to you for your patience and conscientiousness.

You probably know already that the City's request for a 5% concession would save us approximately $5 million annually in the General Fund and the Medical plan change (to 70/30 funding) would save another $2 million. As we look at Fiscal Year 2012 (FY12), which starts July 1, 2011, we are looking at a projected $18 million General Fund shortfall. While it's still early in the budget process, we believe we may have non-Personnel budget strategies to address approximately half that amount, leaving a $9 million shortfall. Thus, the concession would be very meaningful. We would still need to make other cuts, but they will be far less painful with the concessions. In fact, to get maximum value from the cuts, we plan to make our first cuts in the next few weeks, to minimize our deficit in FY11.

My purpose in writing today is to share as much information as I can. I have received emails and hallway comments from many employees seeking to understand the current situation. I think I can address those best in a Q&A format:

Is the City's financial situation really worse than in the past? (And as some employees have said to me, "How do we know this is real? In the past we have been told about financial crises, but City management always seems to be able to find the money when they need it.")

Answer: Yes, this is a different downturn than in the past, and we have few options. We will always look for new ideas, but we are far out of balance from a budget standpoint, and our overall financial health is poor, except in some of our highly restricted Enterprise Funds. I welcome any employee to look at our financial reports and records. In fact, two of our bargaining groups have retained financial consultants to review our records and have confirmed the validity of our financial prognosis. And furthermore, the State's situation is bound to affect us even more. Medical costs, workers compensation claims and litigation expenses are increasing when revenues are going down or remaining stagnant. We do not have a good financial situation, but we are resolved to creating a plan to return us to financial health over several years. I will be happy to share those plans with any employee or groups of employees.

When I refer to "financial health," I am talking about our lack of budgetary reserves (cash in the bank, essentially), our debt service obligations, our accumulated liabilities (pension, medical, leave balances, debt, etc.), and our prognosis of slow revenue increases. Most of this has been caused by the terrible state of the economy. Part of it relates to debt obligations for which there is no source of repayment, requiring General Fund support. And part of it relates to compensation levels that looked fine in good times, but now are essentially unaffordable. There is no one cause, but the overall economy is by far the source of the problem. Ultimately, we have to pay our debts, and we have to make payroll.

Why is the City seeking such a large concession (5% salary and approximately 2% in medical plan cost) and why a "permanent" cut rather than temporary?

Answer: This is perhaps my most common question from employees. Over the last year, we have received many suggestions from employees that we ask for a concession in order to avoid layoffs. Admirably, I think, some employees have felt that an across-the-board cut would be less painful than further layoffs and bumping. I believe that if we were able to guarantee no further cuts, this concession request would receive far more traction. Unfortunately, it would probably take a 12% cut, or more, to close our expected shortfall. We know that that is not realistic and did not ask for it.

Truly, we would be happy to take any concession we can get. However, we felt that 5% made sense and we feel it should be across-the-board. The size of the concession is directly related to the number of jobs it would protect. At 5%, employees can feel that their sacrifice did truly save many jobs. At 2%, for instance, there would still be so many layoffs that employees would probably feel like the concessions had negligible impact. Thus, we aimed for a number where the savings would justify the sacrifice, but not so high that it would be impossible for employees to handle.

I think the word "permanent" is misleading. We could look at this issue year-by-year, but it will prolong the constant uncertainty and budget traumas. In truth, the concession really lasts until the next time each bargaining group would come to the table to negotiate a new MOU. Most of our bargaining groups are negotiating their next contracts within the next 2 years. As such, the term "permanent" is really tied to those dates. Employee compensation is always tied to the next meet and confer date.

What about the medical plan concession?

Answer: At present, the City funds a very generous medical plan on a 80-20% split of total premium costs. This is a highly generous formula compared to other public and private sector employers. We think it is nearly impossible to sustain, and if necessary, we will seek this change through individual meet and confer processes. However, it will be hard for the Medical Trust to have different groups change their contribution rate in different years. We think it is better if it is done across-the-board. And, it is an opportunity to save some jobs and service levels.

We understand that this is not a desirable change for employees. We ask that your representatives study medical plan alternatives, look at what is done in other agencies and companies, and then decide how to respond. Fresno's plan is very expensive. The Trust needs to aggressively look at all options.

Does the City proposal apply to all employees – represented and unrepresented?

Answer: Yes, our request is to <u>all</u> employees.

Why is the City seeking concessions from employees who are not paid from the General Fund?

Answer: That's correct. We are asking all employees to participate. The bad economy affects all funds. Some have better cash positions than the General Fund (some do not), but all of our funds have challenges. We will be presenting a recommendation on March 31 for further rate increases in most of the Utility funds, for instance. We have an obligation to manage all of these funds with the same efficiency, and the City's credit worthiness depends on it.

And beyond that, our City employees all share equally in the upside of our employment – the strong pension program, our excellent medical plan, our leave programs, etc. We are a diverse group. We have 12 City departments and more than a dozen primary fund sources. We have 13 bargaining groups and a wide variety of labor market influences on salaries. But when it comes to seeking solutions to this economic challenge, the idea of quickly negotiating individual deals with each of the above.....it is impossible. Thus, we are asking all employees to be part of the solution on an equitable basis.

The City's proposal seems to have a negative impact on pension calculations due to the impact on "final highest salary." How does the City respond to that?

Answer: We offer to hold current employees harmless as it relates to this calculation. We will talk to the bargaining group representatives to develop language that ensures that no current employee is caused to receive a lower pension calculation as a result of the 5% reduction. The formula differs for the two retirement systems, so we will need to enter into a written commitment that is applicable to each one separately.

What if the bargaining groups do not agree to the concessions?

Answer: This is the issue of the day! We will look elsewhere for opportunities to cut our costs. Our options on the revenue side are limited, so most of our efforts will have to focus on the expense side. We proposed a franchise of the commercial solid waste service because it would have generated $2.5 million per year and offered back up employment to most of our employees. That would have helped, but it did not pass. So we have moved on to other options. In one way or another, we have to meet payroll, pay our debt service, and serve the public's core services. Our options are painful both for employees and the public, so we hope our bargaining groups will step up once again to help. And again, we are grateful for both the past and future commitments that have been made already.

As you no doubt know, we are very actively working on some deep cuts over the next few weeks. We have no choice or we could have an untenable cash flow situation by May or June. To the extent we cut ongoing costs (salaries or other recurring expenses), the cuts will reduce the FY12 deficit as well.

Is the City looking for other savings, or just savings from layoffs?

Answer: We are always looking for opportunities of all sorts, and we have received some good suggestions from employees. We hope to receive even more. As you are well aware, the budget cutting has spanned more than a year now, and the easiest solutions are long since gone. Our General Fund consists primarily of Personnel costs. As such, there are not many opportunities that do not relate to personnel. Thus, we look at things like layoffs, furloughs and salary concessions.

Yes, we also look elsewhere. We need to control liability exposures to avoid expensive litigation. We need to reduce fuel usage and eliminate purchase of unnecessary equipment. We have significantly reduced the number of take-home cars. We have cuts service levels where we can, but that also tends to affect jobs. Turning recreation centers over to community-based organizations saved us money, but also cost us some jobs. There are few significant savings that are possible without cutting staff.

On the Revenue side, we continue to do what we can to maximize our resources. We have dramatically increased Business License Tax receipts by doing aggressive auditing of businesses that have not been in our database. This effort alone has been worth more than $1.4M this last year. We have made similar auditing efforts on City leases, trust accounts, overdue bills, and other opportunities. We have also done well in securing grants, but most of those do not pay for regular operating costs.

Is there an end to this?

Answer: That's my nightly prayer. Nothing could be harder than telling employees about lost jobs or asking team members to move to other departments due to bumping rules that never anticipated anything so devastating as this. We exist to serve the public, and we are struggling in some areas to do so even on very basic functions of City government. We are seeking an organizational size that we can sustain and to stop the constant trauma.

There are the first signs of a slow recovery in our economy. Economists say that there will be winners and losers among cities as we come out of this downturn. The powerful urban areas will be logical winners. Cities like Fresno are on the bubble. We might come out a winner if we are in a position to attract new economic investment. We have to be in a position to compete with other areas, and that depends in part on how well we perform at City Hall. So, yes, I'd like to think we can work toward an end to this, and I think that how we perform now will make us competitive, or not, to be a community with a positive future. That's why we will keep working on economic development, on neighborhood revitalization, on our emerging Downtown economy, and on support for one another.

At this point, all I can do is share with you "the truth I know." Again, I truly appreciate all of you. I express my gratitude for your support and my sadness for your pain. I pledge to give you my personal best, and I know that is true for the Mayor, the members of the City Council and our senior management team.

Voluntary Employee Meetings

I will make myself available to address City employee questions in the City Council Chamber on the following dates:

Monday, March 28 -- 1 to 2:30 p.m.
Tuesday, March 29 -- 1 to 2:30 p.m.

I am asking Department Heads to make the time available for you to attend on a voluntary basis.

Thank you,

Mark Scott

City of
FRESNO
Office of the City Manager

DATE: February 3, 2011

TO: ALL EMPLOYEE BARGAINING GROUPS

FROM: Mark Scott, City Manager
Bruce Rudd, Assistant City Manager

SUBJECT: REQUEST FOR SUPPORT

Thank you for the opportunity to discuss our budget situation last Friday. As you know, we have both a cash flow and a financial health challenge affecting our General Fund. Our problems include:

- Nearly a $6 million revenue shortfall in the current fiscal year and approximately $15 million shortfall in FY12.
- No General Fund Emergency Reserve (and, in fact, negative fund balances in other funds that impact the General Fund).
- Zero balances in our Vehicle/Equipment Replacement Funds.
- Inadequate Risk Management Funds (for general liability, worker's compensation or litigations costs).
- Potential impacts from State budget cuts or transfers of costs to local governments.
- Significantly increasing health care and worker's compensation costs.
- Anticipated negative impacts on the City's credit rating if negative balances are not repaid and minimal operating reserves established.

Based on the above, we explained our concern that we need significant compensation concessions from all employee groups – and we need the concessions on an unconditional basis.

We ask that each bargaining group agree to the following:

- Effective March 1, 2011, a permanent 5% reduction in base salary for all employees. Future salary increases would be made from this lower base.

- A permanent change in the City's share of Medical Trust contribution from 80% to 70%, effective July 1, 2011. (This is in lieu of the previous discussion of a $100/month reduction to the City's contribution.)

Taken together, these changes will save the City General Fund approximately $1.67 million in FY11 and $7 million in FY12 (and each future year). Additional savings will be realized in other funds, which will benefit the City's financial health (such as balance sheet, credit ratings, minimum reserve balances, infrastructure maintenance, etc.) and help maintain service levels and jobs.

We need considerably more than these savings to balance our budget and rebuild our balance sheet. However, this would go a long way and would allow us to avoid even more serious cuts in service levels and jobs.

We seek your response by the end of February. We understand that a March 1st implementation requires a quick turn-around, but we have little choice but to move expeditiously. We have to cut deeper with every month we delay.

As we discussed last week, Bruce and I are available to meet with you and/or your groups at your convenience, either at City Hall or in your workplace. We encourage and welcome your members' ideas and creativity on how to address our budget problems. We are already receiving good suggestions. At the same time, we need your approval of the above requests. Because we all rise or fall with the stability and reputation of the City of Fresno, we ask that all bargaining groups (all departments and all funds) share equally in this contribution.

We greatly appreciate your willingness to consider this vitally important issue. Thank you for your leadership and service.

(From Mayor's FY12 Budget)

Financial Overview

Financial Health and Accounting Issues

As with most cities in today's economy, there are structural financial weaknesses that require attention, prioritization and strategic direction. As the City's revenue base has eroded, there is an increasing need to consider overall financial health as a factor in Budget resource allocation decisions. For instance, the City is burdened by debt and employee compensation obligations that have remained constant, or even grown, while revenues have declined. In the City's 2010 Comprehensive Annual Report (CAFR), City managers and auditors have disclosed issues that cause concern about our financial situation.

This section of the FY 2012 Mayor's Proposed Budget focuses on such highlighted issues that relate to financial health, including:

- Lack of General Fund Operating or Emergency Reserves
- Existing Negative Fund Balances
- No Cushion for Operating Deficits
- Heavy Debt Service Loads (often tied to underperforming assets)
- Increasing "Compensated Absence" Liability (i.e., accumulated employee leave time)
- Increasing "Other Post-Employment Benefit (OPEB)" Liability
- A Potentially Underfunded Risk/Liability Fund
- Uncertainty of Future Redevelopment Agency Funding
- Overall Credit Rating Risk

This year's budget is also affected by two unusual accounting issues that are described below:

- One-time accelerated accrual of sales tax
- Adoption of a "27th Pay Period" funding plan

Financial Health Issues – Detail

1) Lack of General Fund Operating or Emergency Reserve Funds – Over the last 3 years, the City's Operating and Emergency Reserves have diminished to nearly zero. By City Council policy, the City's Emergency Reserve Fund was supposed to be frozen at 5 percent of General Fund operating revenues (approximately $10 million). However, due to declining revenues and the requirement to repay negative fund balances (see below), the General Fund Reserves have been depleted. In normal times, City budgets typically include a limited number of other reserves or contingencies that can be tapped in an emergency. However, there are almost no transferable balances in funds that would normally be available (such as Vehicle Replacement or Risk/Liability Funds, which often hold unrestricted funds contributed to them by the General Fund).

2) Negative Fund Balances – As indicated above, the City of Fresno has gradually allowed a variety of funds to "go negative." By FY 2011, excluding revenue timing differences, the sum of negative fund balances had grown to approximately $36 million. This has happened for a variety of reasons, including for example:

    - Overspending on a capital budget project (Shaw-Marks interchange)
    - Temporarily overspending grant funds (HOME, CDBG)
    - Overcharging the Planning Enterprise for ineligible costs
    - Inadequate revenue to cover debt service (Parking, Convention Center or Impact Fee funds).

During the November, 2010 mid-year budget review, the City Council approved a recommendation by the Mayor and City Manager to apply up to $9.5 million of the General Fund Emergency Reserve to offset an equivalent portion of the $36 million negatives, leaving approximately $26 million to be repaid over time.

Exhibit 1 to this section includes a discussion of the strategies to (a) cease any further growth of negative balances and (b) schedule responsible repayment as soon as practicable. The report also projects the status of each fund by end of FY 2012 and beyond.

3) No Cushion for FY 2012 Spending – The obvious implication of #1 and 2 above is that the City must adopt a FY 2012 budget that is realistic and immediately implementable. With no reserves, the implication of overspending is significant. There is also little tolerance for "shock expenses," so the Mayor's Proposed Budget, for instance, actually allocates a contingency for fuel prices. Revenue projections are conservative because the City cannot afford to overestimate.

4) Heavy Debt Service Loads/Underperforming Assets – The debt service load in the General Fund is for FY 2012 will be $17,349,100 million, or approximately 8 percent of all Operating Revenues. This is a significant burden, and to make it worse, several of the supported assets are underperforming. This is requiring an even greater subsidy by the General Fund. The biggest debt service draws on the General Fund include the Convention Center, the Convention Center Parking Facility, the Stadium, and the No Neighborhood Left Behind Program. Most of the debts will be carried by the General Fund far into the future.

5) Increasing Compensated Absence Liability – The CAFR measures the annual change in liability for employees' accumulated leave time (called "Compensated Absence" in accounting vernacular). This is calculated as the actual dollar value of leave time (vacation, holiday, sick leave, administrative leave, etc.) which employees have a right to use or be paid for in the future. While employees cannot use or claim all of the leave time at one time (unless they leave City service), it is a concern when the total liability grows rapidly. From FY 2009 to FY 2010, the City's Compensated Absence liability rose from approximately $45 million to $60 million. Staff attributes the growth to employee bargaining agreements, to negotiated deferrals in cash payments for leave time, and to the impacts of furloughs during the year-end holiday season (when leave time would otherwise have been used). This is a big jump in liability, requiring careful evaluation of future employee agreements and personnel practices.

6) Increasing OPEB Liability – Several years ago, the Governmental Accounting Standards Board (GASB) started requiring governments to show the actuarial liability of non-pension "other post-employment benefits." The City of Fresno has not, historically, provided the expensive retiree medical benefits that many other California cities have provided. The City's liability is still relatively low. However, in FY 2010, the auditor pointed out a trend that must be studied. The City's OPEB liability now stands at $84 million in the FY 2010 CAFR. Staff believes that this growth is largely attributable to program that allows sworn Public Safety personnel to convert accumulated holiday leave time into a Health Retirement Account (HRA). By doing so, the HRA funds allow retired employees to pay the premiums and remain in the City's medical plan into their later years, which increases retiree health costs substantially.

7) Potentially Underfunded Risk/Liability Fund – As with most large cities, the City of Fresno is largely self-insured for liability and litigation exposures with re-insurance at $3 million per incident. On an annual basis, GASB requires the auditor to include an actuarial valuation of outstanding claims and cases. For the second straight year, the auditor has expressed a concern that the City's exposures may exceed funding that the City sets aside to pay claims, settlements and judgments. While these valuations are necessarily subjective, the City's overall financial stresses require a cautious approach to managing overall risks. Staff and the auditor plan to re-evaluate our entire risk program and valuation methodology. It is critical that the City manage its exposures.

8) Uncertainty of Redevelopment Agency Funding – The Governor's efforts to eliminate Redevelopment authority is a threat both to the City's ongoing economic development and revitalization programs and to the City's financial statements. While we hope that the State Legislature and/or courts will act favorably for RDA's, there is risk that past or future commitment will be challenged.

Over the last several months, it has become apparent that assets on the General Fund and Airport books (debts payable from the RDA) are significantly overstated. As a result, the City's financial statements will be adjusted accordingly in the FY 2011 CAFR. It is currently an unknown if this reinstatement may affect the RDA's ability to draw all of the tax increment that it might otherwise collect.

9) Deferred Maintenance – Nearly all governments have had to defer infrastructure and facility maintenance due to shrinking resources. The City of Fresno is no exception. The City continues to look for alternate funding sources, new technologies, and other solutions. Every effort is made to invest in maintenance that offers the earliest payback and those that have the highest public benefit.

10) Credit Rating Risk – Staff is working diligently to demonstrate to the investment community that the City of Fresno recognizes its financial challenges, reports them fully and accurately, and has viable strategies to address them into the future – even during the downturn. A downgraded credit rating costs a city money due to interest costs. Thus, it remains critical that the Administration and City Council make the hard decision to adopt a realistic budget, reflecting a sustainable organization. And, it is critical that the City make steady progress in addressing the weaknesses in our financial reports, eliminating negative fund balances, building new fund reserves, reducing debt loads and accelerating deferred maintenance. The recent adoption of the Reserve Management Act is a positive step in establishing the City's ongoing commitment.

Accounting Issues Unique to FY 2012

1) One-time Sale Tax Accrual Adjustment – The City will benefit in FY 2012 by a one-time adjustment in how we accrue the June sales tax receipts. The June payment is actually received in July. The City of Fresno, therefore, has always recognized the payment in the following fiscal year. Staff learned last year that most large cities recognize the revenue in the fiscal year for which it is collected. By advancing the accrual by one month, the City's budget will get 13 months of sales tax in FY 2012. In the future, the City will return to 12 monthly accruals, as normal. This change has a one-time positive impact of $3.2 million.

2) Adoption of a "27th Pay Period" Funding Plan – The City pays its employees on a bi-weekly basis, as is typical in local governments. This approach works well for managing Police and Fire payrolls, which are governed by complex Fair Labor Standards Act regulations.

The problem with a bi-weekly payroll is that it does not conform neatly to a 365-day year. Therefore, once every 11 or 12 years, organizations experience a 27th pay period within a single fiscal year. FY 2012 is one of those years. For the City of Fresno, this represents roughly a $10 million additional cost to all funds (and $5 million in the General Fund).

Rather than incurring the entire 27th pay period cost in one single year, the FY 2012 budget includes the following assumptions:

- The City will have a one-time, one-week pay period in June of 2012. This will reduce the 27th payroll costs by half ($2.5 million in the General Fund) and pushes out the other half for 6 years.
- The budget also shows a $400,000 per year allocation to the 27th Pay Period Reserve Fund, created by the new Reserve Management Act, to plan properly for the next time an extra pay period falls within a fiscal year.

This approach has no negative impact on employees and provides proper financial planning for future costs.

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10) Credit Rating Risk – Staff is working diligently to demonstrate to the investment community that the City of Fresno recognizes its financial challenges, reports them fully and accurately, and has viable strategies to address them into the future – even during the downturn. A downgraded credit rating costs a city money due to interest costs. Thus, it remains critical that the Administration and City Council make the hard decision to adopt a realistic budget, reflecting a sustainable organization. And, it is critical that the City make steady progress in addressing the weaknesses in our financial reports, eliminating negative fund balances, building new fund reserves, reducing debt loads and accelerating deferred maintenance. The recent adoption of the Reserve Management Act is a positive step in establishing the City's ongoing commitment.

Accounting Issues Unique to FY 2012

1) One-time Sale Tax Accrual Adjustment – The City will benefit in FY 2012 by a one-time adjustment in how we accrue the June sales tax receipts. The June payment is actually received in July. The City of Fresno, therefore, has always recognized the payment in the following fiscal year. Staff learned last year that most large cities recognize the revenue in the fiscal year for which it is collected. By advancing the accrual by one month, the City's budget will get 13 months of sales tax in FY 2012. In the future, the City will return to 12 monthly accruals, as normal. This change has a one-time positive impact of $3.2 million.

2) Adoption of a "27th Pay Period" Funding Plan – The City pays its employees on a bi-weekly basis, as is typical in local governments. This approach works well for managing Police and Fire payrolls, which are governed by complex Fair Labor Standards Act regulations.

   The problem with a bi-weekly payroll is that it does not conform neatly to a 365-day year. Therefore, once every 11 or 12 years, organizations experience a 27th pay period within a single fiscal year. FY 2012 is one of those years. For the City of Fresno, this represents roughly a $10 million additional cost to all funds (and $5 million in the General Fund).

   Rather than incurring the entire 27th pay period cost in one single year, the FY 2012 budget includes the following assumptions:

   - The City will have a one-time, one-week pay period in June of 2012. This will reduce the 27th payroll costs by half ($2.5 million in the General Fund) and pushes out the other half for 6 years.
   - The budget also shows a $400,000 per year allocation to the 27th Pay Period Reserve Fund, created by the new Reserve Management Act, to plan properly for the next time an extra pay period falls within a fiscal year.

   This approach has no negative impact on employees and provides proper financial planning for future costs.