



May 2021

Honorable Mayor and Members of the City Council:

The staff of the City of King are pleased to present the Recommended Biennial Budget for FY 2021-22/ FY 2022-23.

Introduction

Budgets for all funds are incorporated into the budget document. Staff is once again proposing a two-year budget, which is consistent with the budget process approved by the City Council in 2016. At the end of the first year, staff will present a year-end review and recommended budget adjustments for the second year. The City Budget Advisory Committee reviewed the recommendations at their meeting on May 17, 2021 and unanimously recommended the City Council approve the budget as proposed.

The document is a proposed work plan for the upcoming two fiscal years based upon the collective expertise and consensus of the entire City staff leadership team. The total proposed City budget is \$24,087,756 in FY 2021-22 and \$18,538,906 in FY 2022-23. It is balanced and makes progress toward accomplishing each of the major budget goals/priorities that were approved by the City Council in the first step of the budget process.

The major goals that were established for the budget include the following:

- Pay off remaining debt in the General Fund.
- Maintain and expand implementation of measures in the Comprehensive Plan to End Youth Violence.
- Expand maintenance and upgrade of the City's streets, sidewalks, wastewater system, and parks.
- Attract new businesses and construct the Downtown Plaza project and other improvements designed to revitalize the downtown area.
- Add multi-family market rate, affordable and seasonal employee housing units to address housing needs.
- Continue efforts to pursue grants to fund high priority projects and programs designed to improve overall quality of life in the community and to meet community needs.
- Continue efforts to improve City processes to increase efficiency and customer service.

In addition, the City Council approved operational goals for each department, which are also addressed. They are presented in the Overview Section of the budget document along with FY 2019-20/ FY 2020-21 Accomplishments.

The substantial changes in economic conditions due to the pandemic and relief efforts have made this a challenging period to project revenues and needs. However, when the pandemic began, the City reacted quickly to develop and approve a comprehensive plan to cut costs necessary for response to potential revenue impacts. As a result, while the City has experienced reductions in a variety of revenue sources, it has been less than the projected shortfall. This has left the City in a relatively stable position moving forward.

Given this fact, a number of items have been returned to the proposed budget for FY 2021-22 that were eliminated in FY 2020-21 when the pandemic began. There is a limited amount of new discretionary revenues available, so other changes and additions to the budget are minimal. However, the City's plan to address the economic impacts of the pandemic included an accelerated effort to pursue grants, which has experienced some successes. As a result, the City is able to fund new significant projects and programs in the proposed budget utilizing grant revenues despite the minimal changes to the General Fund.

At the time of budget preparation, the guidelines for use of funding provided by the American Rescue Plan Act have not yet been released by the U.S. Treasury Department. Therefore, allocation of this anticipated funding will primarily be handled through a separate process. The goal will be to align the expenditures with the City's major budget priorities as much as possible. The City has been notified it will receive a total of \$2,650,000. The budget does include the allocation of \$500,000 for the Lynn Street sewer project because it has been clearly established that sewer projects will be an eligible use.

General Fund

The total proposed General Fund is \$8,766,374 in FY 2021-22 and \$9,099,482 in FY 2022-23, which includes expenditures, repayment of debt, capital improvements, grants, transfers out and carryovers. The primary focus of the budget process tends to be on the General Fund because it constitutes the major portion of the budget, funds the majority of traditional government services, and is the most constrained since funding sources are primarily limited to taxes and fees. Recommended General Fund allocations are based on strategies targeting the budget goals established.

The most exciting feature of this budget is that it is projected to repay the remainder of the negative fund balance in the General Fund. The last time the City had a positive General Fund balance was in 2005. Due to a number of financial crises, the California Policy Center ranked King City the second most

financially distressed city in California in 2014. By 2016, the City had accumulated nearly \$5 million in debt in its General Fund. Therefore, this budget represents a significant accomplishment in overall fiscal management by the City to reach this point of recovery. Each year of the two-year budget includes \$200,000 to pay off the remainder of the debt and begin to accumulate a reserve. The debt is in the form of an internal loan from the City's Wastewater Fund, so it will also be important to the City's efforts to fund major sewer system infrastructure improvements that are needed.

Property and sales tax projections are based on estimates provided by the City's consultants. Property tax is projected to experience a healthy 10% increase in FY 2021-22 and a 3% increase in FY 2022-23. Meanwhile, sales tax projections are even more positive, which are projected to increase by 17% in FY 2021-22 and 4% in FY 2022-23. The most substantial decrease in revenues from the prior budget is the cannabis tax. Projects have been slow to come online, and the cannabis tax rate on cultivation was reduced. However, the City's first cultivation businesses are now in operation, so while substantially lower, staff is more confident that the figures in this budget will be achieved.

The most significant highlights of changes in the General Fund expenditures include the following:

- Addition of a full-time Public Works Director position
- Addition of one full-time Public Works Maintenance Worker position
- Funding to contract maintenance of specialized landscaped areas
- Increase in funding for Public Works and Parks repairs
- Consultant services for redesign of the City's website
- Increased internet costs for new fiberoptic service
- Geographic information system (GIS) software
- Increase in property and liability insurance costs
- Fire Station equipment purchases

The most significant need identified at this time is the deficiency in staffing levels in the Public Works Department needed to address ongoing maintenance needs. Therefore, the majority of new items are focused on this issue. While the Public Works Director is a new full-time executive level position, the impact to the General Fund is significantly reduced because a large portion of the cost will be funded from other funds, grants and expenditures previously budgeted in contract services.

Property insurance costs are increasing due to the impacts of recent natural disasters on the insurance market. Liability costs have increased due to recent claims, but the City also experienced a decrease in workers compensation costs due to a decrease in those claims.

The budget includes increased funding for expansion of the Youth Diversion Program provided under contract by Sun Street Centers. However, the majority of this cost is being funded by a State grant, which is incorporated in the projected revenues. Sufficient grant funding also remains to continue to fund the ProYouth HEART after-school program at its current level.

Enterprise Funds

Enterprise Funds are those that are managed as independent operations and funded entirely by fees for services, including depreciation costs. This currently includes the City's Sewer Fund and King City Community Power (KCCP).

The Sewer Fund is projected to begin FY 2019-20 with a positive balance of \$17,680,856 million. The City has been accumulating funds needed for major capital improvements, consisting of upgrade of the wastewater treatment plant and replacement of sewer lines. The City will soon begin to draw down on that balance as the work on these projects are projected to begin within this upcoming budget period. Expenditures and revenues are programmed consistent with the analysis prepared as part of the wastewater rate study, including the recommended rate increases.

The KCCP budget has been significantly impacted by the California Public Utility Commission (CPUC) approval of a substantial 41% increase to the PG&E Power Charge Indifference Adjustment (PCIA). PCIA is a charge to community choice aggregation customers to reimburse PG&E for long-term financial obligations the utility controlled on behalf of customers who have since left to enroll in KCCP. This issue has impacted all community choice energy providers. Therefore, meeting its reserve goal has been delayed, but KCCP continues to achieve the operational goals established as the basis for forming the community choice energy program. Rates are maintained lower than PG&E. In addition, expenditures are allocated over the two-year period for a major solar streetlight project, purchase of emergency generators, solar assistance for low-income housing, and planning for a solar, wind or battery power project.

Special Revenue Funds

Special Revenue Funds are supported primarily by grants or special fees and other revenues. Many are funded from development impact fees. Like the General Fund, some of these funds had negative balances in the past, but all are projected to have positive balances within this budget period. In the Overview Section of the budget document, all funds and corresponding fund balances are listed. In the Special Funds section, summaries of each fund are presented, but only funds with projected expenditures are included. In addition, detail for any funds established for single purpose grants and projects are not provided in this section. Those projects can be found in the Capital Improvement Program.

The primary new expenditures in this category include funds for renovation of the Visitor and History Center, which is funded by the Library Impact Fee Fund due to archives that will be housed in this facility. The Fire Impact Fee Fund also includes budgeted funds for a new Utility Rescue Truck, which will be partially funded by a grant and the General Fund. Details on these projects are set forth in the Capital Improvement Program.

Capital Improvement Program

Capital improvements are programmed on a five-year cycle, but only funding in the first two years is appropriated. The proposed Capital Improvement Program (CIP) reflects a gradual increasing financial commitment to the City's priority of addressing deficiencies in its infrastructure. It also reflects the City's enhanced effort to solicit grant funding for projects. As a result, despite a relatively minor investment of General Fund monies, the budget includes what staff believes to be a comprehensive CIP representing a substantial investment in the community.

Major items include increased funding for the annual Street Improvement Program, construction of the Citywide Sidewalk Improvement Project, design and planning for the Multimodal Transportation Center, paving of the taxiway at Mesa Del Rey Airport, sewer line replacements on Lynn Street and Pearl Street, Phase I expansion of corner bulbouts in the downtown area, and installation of solar streetlights on Jayne Street. The first two years of the CIP involve a projected expenditure of \$13 million to \$15.5 million with only \$550,000 of that derived from the General Fund.

The most significant project will be upgrade and replacement of the City's Wastewater Treatment Plant. The project is projected to cost nearly \$45 million over the 5-year period. Environmental review is underway, and design is scheduled to commence in 2022. The project will be funded from a combination of development impact fees, sewer fees, grants and debt financing. Timing of construction will be determined by the success and timing of grant application efforts.

Long Range Financial Plan

The foundation of the Biennial Budget is the Long Range Financial Plan, which consists of 10 year revenue and expenditure projections for the General Fund. It has been particularly instrumental in developing strategies to pay down the debt, while addressing critical needs and developing plans for future reserves. On an ongoing basis, long range financial planning is important in order to plan for and adjust to fluctuations in the economy and other changes impacting the City's revenues and expenditures. Ideally, reserves should be increased during strong economic periods and utilized during recessions in a manner where overall revenues and expenditures are balanced and consistent service levels can be maintained.

It is difficult to accurately project revenues on a long-term basis. Therefore, it is not expected that revenues and expenditures will occur precisely as projected. Instead, the primary benefit is that the long-term impacts of decisions can be determined and evaluated when adjustments are made. This is important because the impacts of small budget imbalances can appear minor in an annual budget, but dramatic over a ten-year period. As a result, the Long Range Financial Plan is intended to be a flexible rather than static document. Addressing changes over a 10-year rather than a one-year period enables the City to better stabilize what otherwise can involve drastic shifts in funding and service levels.

Two scenarios of the Long Range Financial Plan are presented. Scenario I is the base plan, which is limited to projecting the future impact of the expenditures proposed in the Biennial Budget. Scenario II is referred to as the Deferred Maintenance Plan. It adds expenditure projections and revenue enhancement recommendations for priority unfunded needs, particularly deferred maintenance items.

The first page of each scenario is the projected revenues. The second page is the projected expenditures. The third page displays the projections and assumptions that are incorporated into the model that calculates the future projected figures in each of the tables.

In the past, staff has attempted to incorporate revenue assumptions that take into account projected periods of economic growth and recession. Recessions typically occur within a 10-year period. Therefore, one of the important purposes of the Long Range Financial Plan is to plan for those economic downturns. Staff determined that developing forecasts is particularly challenging at this time because the pandemic and Federal stimulus spending have added major factors that alter normal economic trends. As a result, staff has instead used a more conventional method of projections, which attempts to predict the average over the 10-year cycle and that average is entered for each year.

As a result, the assumptions include a projected average inflationary factor of 3% over the 10-year period. Staffing costs are projected to continue to rise slightly above that for a few years until the City reaches parity with the local market and then levels off to reflect an annual cost of living adjustment equal to CPI. As a rural community with a limited tax base, the City's revenues rarely experience the full benefit of periods of national economic growth. Therefore, revenue growth is projected at slightly below CPI. Health care and pension costs are projected to continue existing trends of cost increases well above CPI. Since the assumptions incorporate these consistent links with inflation, changes in the rate of inflation should not upset the model substantially because both revenues and expenditures should adjust accordingly as long as the underlying core assumptions are relatively accurate.

The first objective of the Long-Range Financial Plan is to demonstrate recommended expenditures are sustainable in the future, which is a key reason it is integrated in the budget process. The most important purpose is to prevent approving new expenditures that appear to be feasible at the time, but later negatively impact the financial stability of the City by initiating unsustainable expenditure trends. The Scenario I – Base Plan accomplishes this. Under these projections, over the 10-year period, budgets continue to be balanced. The City is forecasted to continue to grow a reserve that will level off at roughly 12% in the later years of the Plan. This confirms that the City has met its primary goal of the last sales tax increase, which was to stabilize the ongoing operational budget.

However, while the City has made significant progress in addressing its major budget priorities, there are significant needs remaining. Therefore, staff has identified and incorporated the remaining highest priority needs into the Scenario II – Deferred Maintenance Plan. While the City has made tremendous progress in paying off its debt, deferred maintenance represents a different type of debt because it consists of an unfunded liability that will need to be addressed at some point in time.

Staff has completed an assessment of City facilities and identified the highest priority deferred maintenance items. They are limited to those determined important to address within a 10-year time period. The total cost impact is estimated to be in the range of \$2 million when factoring inflationary costs. As a result, staff is recommending an annual expenditure of \$200,000 be assumed.

The second key need is increased street improvements. While the City has made substantial progress in increasing street projects with funding from the State and the Transportation Agency of Monterey County (TAMC), there are several major streets in need of resurfacing that are not feasible to fund within the existing 5-year pavement management program. Staff estimates a minimum of \$300,000 additional funding is needed annually to address those priority projects. Street improvements are a beneficial investment because upgrading streets to a condition that requires only ongoing slurry seal treatments can save millions of dollars in the long-term by avoiding additional expensive reconstruction costs.

Projected expenditures for other needs incorporated into the Scenario II Plan include costs to maintain new parks that will be constructed in Mills Ranch over the next four to five year period, further expansion of the City's public safety efforts to address youth violence, minor staffing additions to the Public Works and Community Development Departments, and the ability to maintain a small amount of discretionary funding for other needs and goals that occur.

To meet this need, staff recommends an additional ½ cent sales tax measure be considered. The City's approach has been to pursue adjustments to the sales tax in incremental steps in order to maintain the rate at the lowest amount

feasible. During the last sales tax adjustment, the goal was to stabilize the operational budget, and cannabis tax revenues were projected to be sufficient to address capital needs. At that time, it was stated the City would need to identify other funding options if the cannabis tax projections were not fulfilled. While the cannabis tax is still forecasted to be an important revenue source for the City, projections for ongoing proceeds have been reduced by roughly \$1.5 million per year. The majority of that loss in projected revenue could be largely addressed through the sales tax increase. The Scenario II Plan figures demonstrate that each of the priority budget needs identified could be addressed while increasing the reserve to 15%, which would achieve the City's minimum policy goal amount.

The City could accomplish this while maintaining the local sales tax at a rate competitive with other jurisdictions in the area. Of the 19 cities in Monterey and San Luis Obispo counties, 14 have a sales tax at a rate of 1.5 cents or higher compared to the current King City rate of 1 cent. Therefore, it is recommended the Scenario II - Deferred Maintenance Plan be established as a preliminary goal for the City, additional measures be taken to further educate the community on these needs and recommendations, and staff be directed to solicit public feedback for Council consideration during the upcoming year.

Conclusion

The overall objective of the budget recommendations is to meet the community's needs and provide services in the most effective, efficient and responsible manner. Staff believes the budget recommendations provide an appropriate balance between the importance of fiscal responsibility and addressing critical needs. A thorough process was conducted to ensure funding allocations reflect Council direction and priorities, staff analysis, community input, and strategic planning efforts. All proposals are directed at accomplishing the City's mission of *"Meeting the needs of our entire community through caring, professional and responsive services."* As a result, it is staff's determination that the recommended FY 2021-22/ FY 2022-23 Biennial Budget represents the best utilization of the City's resources to address the interests of the community and lead to ongoing financial stability in the future.



Steven Adams
City Manager