

Quarterly Financial Report

city of newport beach | finance department

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FACTORS INFLUENCING THE ECONOMY

Even though political and economic turmoil in Europe continues to create volatility in global financial markets, European leaders have made progress in addressing the region's debt crisis. While both Europe and China showed signs of cooling economic activity amid weaker manufacturing data, we continue to believe that the United States economy is continuing to improve at a relatively modest but consistent pace. However, in an increasingly global market place, politics and economic activity abroad continue to influence domestic economics. A severe contraction in Europe or China could still derail the progress of the United States economic recovery.

In a recent Economic and State Budget Update presentation in Sacramento, Michael Coleman, fiscal policy advisor to the League of California Cities stated the "U.S. Economy is recovering... gradually... and with trepidation." Several months of positive but modest domestic economic news support this view.

The soft recovery has contributed to a gradual but steadily improving unemployment rate. In March, the unemployment rate fell to 8.1% from 8.3% percent in February. Albeit slow and gradual, the jobs market is finally showing a sustained decline to its lowest level of the recovery. However, some economists warn that the jobs market may take another three years to reach normal unemployment levels around 6%. Consumer confidence continues to show strength despite volatility in gas prices.



While the recovery in the United States generally remains somewhat lackluster by historical standards, year three of the 1991 and 2001 recessions proved to be a pivotal year when economic activity yielded explosive economic growth. Wells Fargo economists are predicting that 2012 will be the "Gear Year," the year the recovery finally gains traction. It won't be about explosive growth like the previous recessions but it will be the year that national attitudes surrounding economic recovery finally agree the recovery is fully functional and sustainable.

Fiscal Year 2011-12

REVENUE UPDATE

In total, General Fund Revenue estimates are only slightly less optimistic than our midyear estimate reflecting an overall decrease of \$100,260. While there is continued optimism and prospect of additional growth in Sales taxes and Transient Occupancy Tax revenues, a few concerns regarding property tax collections materialized over the last quarter and are discussed below.

FISCAL YEAR 2011-12 REVISED REVENUE PROJECTIONS

Revenue Source	FY 2010-11 Actuals	Original Budget	Mid Year Revised Est.	3rd QTR Revised Est.	Change from Mid Yr Est.
Property Taxes	\$ 71,630,345	\$ 72,155,615	\$ 72,612,217	\$ 71,629,617	\$ (982,600)
Sales Tax	18,455,181	18,788,167	19,219,170	19,760,000	540,830
Property Tax - In Lieu of Sales Tax	6,284,266	6,300,000	6,500,000	6,500,000	-
Transient Occupancy Tax	13,082,451	12,786,000	14,000,000	14,181,510	181,510
Business Licenses	4,111,245	3,910,000	3,850,000	3,850,000	-
Franchises	3,730,819	3,936,000	3,498,000	3,498,000	-
Community Development	5,492,327	5,465,260	5,845,441	5,845,441	-
Other	27,948,689	25,621,741	27,120,034	27,280,034	160,000
Transfer-In	3,116,700	6,500,000	4,000,000	4,000,000	-
Total Revenues & Transfers	\$ 153,852,024	\$ 155,462,783	\$ 156,644,862	\$ 156,544,602	\$ (100,260)

PROPERTY TAX

Overall, the housing market continues to remain under pressure. Supporting this view, County Assessor Webster Guillory, stated "the real estate market took a significant downturn at the end of this year" at his annual Orange County Property Tax Valuation update. While the secured property tax levy in Newport Beach increased 1.27% over the prior fiscal year, the Newport Beach median single family residence sales price decreased 6.08% in 2011 to \$1,197,500 and decreased another 5.43% to \$1,132,500 thus far in 2012. The 2012 median is 30.30% off the 2007 high of \$1,625,000 and 11.49% below 2004 levels. This is a long-term indicator that the secured property tax levy will remain at historically suppressed levels for some time to come.

In the last quarterly financial report, we noted that secured property tax collections had trended upward significantly which was the primary impetus for increasing the overall property tax projection upward by \$456,000. We also noted that there was some downside risk that the higher than expected distributions represented a simple payment trend anomaly. While we have considered that taxpayers are paying their tax bills in a more timely fashion than in recent years and therefore, accelerating the overall distribution trend, we have not adjusted for this possible anomaly yet.

The immediate indicators that gave rise to our sharp and immediate revision to the third quarter property tax estimate are two-fold. 1) Redemptions, penalties and interest distributions have declined abruptly, or \$500,000 below budget, a further indicator that taxpayers have returned to a more timely payment schedule. A note from Treasurer Tax Collector Shari Freidenrich confirmed "the County Treasurer is on track to have the highest collection rate on secured property taxes in the past six years." 2) More significantly, an upgrade to the Assessor's Office electronic reporting system has caused delays in the production of the Supplemental tax update. From a discussion with the Auditor Controllers Office, we understand the County Assessor has only been able to produce one of four usual supplemental assessment updates. According to a direct conversation with Mr. Guillory, on May 3, 2012, the Assessor's Office will provide one additional supplemental assessment to the Tax Collector before June. This delay, however, may result in very little additional Supplemental tax collections for the remainder of fiscal year 2011-12. More likely, the delayed supplemental billing will represent an increase to fiscal year 2012-13 supplemental collections rather than any further revenue recognition in fiscal year 2011-12. This information was determined after the production of the 2012-13 proposed budget documents and will be presented as an amendment to the 2012-13 budget. The projected shortfall in fiscal year 2012-13 for supplemental revenue is a \$500,000 decrease to our property tax revenue estimates. These two estimates combined resulted in a \$1 million decrease from our mid-year property tax revenue estimates.

SALES TAX REVENUE

Sales tax remittances continue to represent a brighter story than property taxes. We have nudged our sales tax estimate upward \$541,000 which represents a 7% increase on a year over year basis. This estimate is consistent with our trend analysis and sales tax consultant estimates.

Big-ticket spending often postponed during recessionary periods is coming back to life. Due to previous economic fears, the age of an automobile is near a record-setting 11 years old and is also why the housing affordability index is not stimulating much housing activity. Should fears begin to subside, big ticket spending could play catch up this year among both consumers and businesses.

Restaurants and auto sales continue to rank as the highest sales tax generating segments. When comparing the fourth quarter of 2011 to 2010, new auto sales increased 12.6% and restaurants sales improved 5.7%. While representing smaller segments of sales tax generation, retail, apparel stores, service stations and light industry all posted double digit gains in this same quarter over quarter comparison.

TRANSIENT OCCUPANCY TAX

Similar to Sales Tax, another bright spot in the City's budget continues to be TOT collection. In a year over year comparison, commercial and residential TOT revenues increased 11.6% during fiscal year 2010-11 significantly improving over the previous double dip declines experienced during 2009 and 2010. Based on the collection trend to date, we are expecting 2011-12 TOT revenues to increase 8% over 2010-11 representing a \$181,510 increase over our mid-year revenue estimate and \$1.4 million over our original budget estimate. Once again, Pelican Hills Resort is leading hoteliers in total TOT production and year over year growth.

DEPARTMENT GENERAL FUND EXPENDITURE PERFORMANCE

Department	FY 12 Original Budget	FY 2011-12			FY 2010-11	
		Amended Budget	YTD as of 3/31/12	Percent Expended	YTD @ 3/31/11 - Audited	Percent Expended
City Council	\$ 940,397	\$ 1,137,377	\$ 846,107	74%	\$ 859,916	82%
City Clerk	546,465	555,365	426,015	77%	337,984	68%
City Manager	1,921,739	1,944,724	1,327,193	68%	1,553,932	63%
Human Resources	2,393,167	2,397,667	1,624,665	68%	1,600,262	69%
City Attorney	2,292,941	2,302,827	1,424,941	62%	2,114,197	81%
Finance	6,892,716	6,891,046	4,756,594	69%	5,430,495	67%
Police	41,502,813	41,667,012	30,173,535	72%	31,260,416	73%
Fire	34,353,768	34,725,815	25,234,970	73%	25,302,249	74%
Planning	3,457,855	3,230,793	2,395,176	74%	2,147,727	65%
Building	5,482,077	5,679,759	4,006,519	71%	3,140,118	74%
General Services	22,212,918	22,348,925	16,210,704	73%	15,993,703	68%
Library	6,889,590	7,644,001	5,203,247	68%	4,805,002	67%
Recreation	8,418,226	8,491,404	6,080,204	72%	6,051,082	71%
Public Works	5,834,035	6,134,766	4,360,222	71%	4,092,212	70%
Electrical	774,984	796,456	693,977	87%	790,402	59%
C.I.P.	4,610,730	5,523,267	2,384,785	43%	939,218	16%
OPEB	2,314,000	2,314,000	1,157,000	50%	1,064,000	50%
FFP	4,016,812	4,016,812	4,016,812	100%	31,300,000	100%
Debt Service	780,000	780,000	780,000	0%	765,000	0%
Total	\$ 155,635,233	\$ 158,582,015	\$ 113,102,667	71%	\$ 139,547,915	74%

DEPARTMENTAL EXPENDITURE PROJECTIONS

For the FY 11-12 budget, the City Manager requested and received \$8 million in structural budget cuts from the departments, and all departments continue to effectively manage their budgets in accordance to the City's Fiscal Sustainability Plan.

Currently, it is expected that Departments will achieve an additional \$3 million of operational savings. These savings are almost entirely as a result of personnel vacancies and are expected to produce a one-time windfall in FY 11-12. Departments are actively recruiting for these vacancies so the magnitude of these savings is not expected to reoccur, nor were they budgeted in FY 2012-13.

FISCAL YEAR 2011-12 CITY MANAGER ASSIGNMENTS

Council Policy F-2, Reserve Policy, delegates the authority to the City Manager to modify or create new assignments of fund balance; however appropriation of those assignments must be approved by the City Council. A schedule of City Manager Assignment activity during FY 2011-12 is below:

City Manager Assignments	Beginning Assignment Balance	New Assignments	Budgeted Assignment Uses	Relinquished Assignments	Estimated Ending Assignment Balance
Neighborhood Revitalization	\$ 650,000	\$ -	\$ 419,160	\$ 230,840	\$ -
Tidelands Management	200,000	-	-	200,000	-
Marian Bergeson Pool Contribution	330,000	-	-	330,000	-
Airport Issues	100,000	100,000	-	100,000	100,000
MOD - Tree Replacement Program	75,000	-	-	75,000	-
Economic Development	75,000	-	-	75,000	-
Median Maintenance Program	50,000	-	-	50,000	-
Lower Bay Dredging	2,500,000	300,000	2,500,000	-	300,000
FFP Reserve	-	1,416,399	-	-	1,416,399
IT Internal Service Fund	-	3,000,000	-	-	3,000,000
CIP FOR FY 13	-	1,600,000	-	-	1,600,000
Civic Center Move/FFE	-	200,000	-	-	200,000
Facilities Master Plan Consultant	-	250,000	-	-	250,000
CPS Infrastructure Buyout	-	600,000	-	-	600,000
Total City Manager Assignments	\$ 3,980,000	\$ 7,466,399	\$ 2,919,160	\$ 1,060,840	\$ 7,466,399

At the end of FY 2010-11, the City Manager assigned \$3,980,000 from the General Fund-fund balance to be carried over and available for Council approved programs during FY 2011-12. By fiscal year-end, \$2,994,160 is projected to be utilized and \$985,840 is expected to be returned to fund balance and available for new priority programs. These relinquishments have two categories: 1) assignment (fund balance) was not needed as the responsible department performing the service was able to cover the expenditure within their annual approved budget (neighborhood revitalization/tree replacement/median maintenance) 2) program did not move forward during FY 2011-12 (Marian Bergeson pool/Airport Issues).

The City Manager has made \$7,466,399 in new assignments for FY 2011-12. All assignments, with the exception of the airport issue, were intended to ensure funding is available for our core values: maintaining our facilities and infrastructure and investing in our IT Strategic Plan. Assignments are estimates as of the financial analysis available March 31, 2012, and will be adjusted for actual year end results in the General Fund.

Fiscal Year 2012-13 Budget

FISCAL YEAR 2012-13 BUDGET GOALS

Listening to the community and City Council, the City Manager prepares for the budget cycle by identifying the unique qualities and specific City services that will contribute toward becoming and staying the *Shining City by the Bay*. The core values as confirmed by Council are:

A high quality physical environment

This means the natural environment and maintaining quality community centers, parkways and medians, roads, trees, alleys, beaches and more. We believe that Newport Beach has a different look and feel from other communities as you enter it, and we want to maintain that look.

Public safety and how City services and programs reinforce safety

From core public safety services like police and fire to programs (recreation and senior services, CERT and more) and infrastructure (parks, libraries and more) that draw people out into their community, we give our residents great things to do and enjoy – when people are out and about and involved, bad elements stay away.

Civic engagement

This is a community that loves its many strong community activities, events and groups and wants to be actively engaged with its city government.

Accountable, Responsive City Government

We should be about superior customer service, fiscal sustainability, accountability, transparency and ensuring an accessible and open environment. We want to ensure our community views us as the standard of excellence in city government.

PRIORITIZING SCARCE RESOURCES

Communicating our core values to the organization allows us to focus our resource allocation decisions toward programs and services that enhance these core values. That being said, FY 2012-13 is the third consecutive year of minimal to flat revenue growth in Newport Beach. In order to present a balanced budget for FY 2012-13, the City Manager instructed all director's to maintain FY 2011-12 departmental budgetary levels so that any increases in revenue

estimates could be allocated to new or improved programs and services that would support these core values. This also supports a continued focus on transformation of the Newport Beach city government to a more accountable and performance-based organization. As such, the executive team is not only improving what we are best at, but also what we should “not” be doing. This budget builds in new opportunities to contract out certain services when it can be demonstrated that the private sector can perform these services with the same or better level of service and for less cost. These changes can be seen in some departmental budgets with reduced costs for personnel and increased costs for professional services.

OUTLOOK FOR FISCAL YEAR 2012-13

We have not only survived the recession, we have become a stronger albeit smaller organization. This was not without hard choices and significant budget reductions. We have maintained our key budget principles, and these have assisted us with increasing our General Fund Reserves in each year of the recession to a level that is the highest in the more than 100 year history of Newport Beach. Building reserves without compromising service levels to our community, also, maintaining and building our physical environment, and allocating resources to our IT Strategic Plan and performance management system to set the stage for continuing to become a more educated, versatile and smaller city government.

OUR BUDGET PRINCIPLES

1. Adhere to 2010's Fiscal Sustainability Plan.
2. Use the upcoming years as an opportunity to thoughtfully and methodically change the way our local government conducts business.
3. Our “Shining City's” success includes our investment in our infrastructure.
4. We should stop doing some things.
5. We must continue to address pension costs, comprehensively and aggressively.
6. Public Safety is paramount - but there are still smarter, better ways of delivering public safety services without compromising safety.

FISCAL YEARS 2012 AND 2013 GENERAL FUND COMPARATIVE BUDGET

	2011-12 Original Budget	Projected 2011-12 Year End	Proposed FY 2012-13 Budget
GENERAL FUND REVENUES:			
PROPERTY TAXES	\$ 72,155,615	\$ 72,612,217	\$ 72,975,146
SALES TAXES	\$ 25,088,167	\$ 25,719,170	\$ 26,793,879
TOT TAXES	\$ 12,786,000	\$ 13,715,150	\$ 14,390,158
ALL OTHER GENERAL FUND REVENUES	\$ 38,926,001	\$ 40,455,757	\$ 41,642,213
SUBTOTAL GENERAL FUND REVENUES	\$ 148,955,783	\$ 152,502,294	\$ 155,801,396
GENERAL FUND EXPENDITURES:			
GENERAL GOVERNMENT	\$ 13,379,052	\$ 13,620,633	\$ 14,477,488
PUBLIC SAFETY	\$ 75,856,581	\$ 76,392,827	\$ 77,394,664
PUBLIC WORKS	\$ 28,821,937	\$ 28,947,199	\$ 29,329,249
COMMUNITY DEVELOPMENT	\$ 8,939,933	\$ 9,243,500	\$ 9,168,326
COMMUNITY SERVICES	\$ 15,307,816	\$ 17,743,778	\$ 16,926,916
OPEB	\$ 2,314,000	\$ 2,314,000	\$ 2,466,000
DEBT SERVICE	\$ 780,000	\$ 780,000	\$ 750,000
OPERATING BUDGET SAVINGS	\$ -	\$ (3,000,000)	\$ -
CAPITAL PROJECTS	\$ 2,094,130	\$ 2,094,130	\$ 3,600,000
SUBTOTAL GENERAL FUND EXPENDITURES	\$ 147,493,449	\$ 148,136,067	\$ 154,112,643
OPERATING SURPLUS / AVAILABLE FOR ASSIGNMENT	\$ 1,462,334	\$ 4,366,227	\$ 1,688,753

GENERAL FUND PROPOSED FISCAL YEAR 2012-13 BUDGET

The General Fund is the key operating fund within the City's budget and is generally of most interest to residents as it is predominantly, 78%, funded by tax revenues.

REVENUE FORECAST

As stated previously, FY 2012-13 will be the third consecutive year of minimal to flat revenue growth in the City of Newport Beach. Although the economy continues to gradually improve, our projections remain conservative in keeping with our Fiscal Sustainability Plan.

We are projecting FY 2012-13 General Fund revenues at \$155.8 million, an increase of approximately \$3.3 million from our FY 2011-12 amended revenue budget. Property tax revenues which account for almost 47% of total General Fund revenues, or **\$73.0 million, are estimated to minimally increase by 0.5% from revised FY 2011-12 revenues, or \$360,000. The housing market recession is not over, and all local and state governments are experiencing low to negative growth in their assessed valuations (AV). Newport Beach continues to maintain positive growth in our AV, although only +0.5% in last year's case. This is not common in our neighboring cities and counties, as many have experienced declines in AV during the recession and are just now experiencing small positive growth. The Orange County Assessor continues to warn cities to be conservative when estimating property tax revenue, he assured us at his February 2012 meeting that he was still performing re-assessments which were decreasing property values in all areas of the County even in the beach cities.

****SPECIAL NOTE ON PROPERTY TAX ESTIMATES FY 2012-13:** As previously discussed in the quarterly financial report, Finance recently confirmed with the County Controller's Office that supplemental taxes will not be received for the second half of FY 2011-12 (approximately \$500,000) due to implementation challenges with a new software in the County Assessor's Office. These revenues should be received during the first quarter of FY 2012-13, but too late for eligible modified-accrual accounting rules. Also confirmed, penalties/interest & redemption property tax collections are significantly down, approximately \$500,000 for Newport Beach, in the second half of FY 2011-12. The Controller's Office confirmed this is county-wide, and they are reporting a noticeable improvement in timely secured collections which has caused all cities to realize significantly less in penalties/interest & redemptions. The proposed budget does NOT include adjustments for either of these issues as it was printed before confirmation was made. Both issues will be addressed in the final budget document.**

REVENUE FORECAST (continued)

Sales Tax and Uniform Transient Occupancy Tax (TOT) are the next largest components (26% cumulatively) of the City's General Fund. The FY 2012-13 sales tax estimate is \$20.6 million, an increase of almost \$1 million or 5.0% over FY 2011-12 estimated revenue. TOT is also estimated to increase \$835,000, or 5.0%, over the FY 2011-12 estimated final revenue. Consumer confidence has continued to improve and our sales and TOT taxes are reflecting that improvement. We have almost returned to pre-recession levels in sales tax and have surpassed those levels in TOT thanks in large part to Newport Coast's Pelican Hill Resort. We have estimated conservative growth in both areas after talking to our major hotels and our economic consultants, and we are confident these revenues will remain strong.

We are including a one-time revenue estimate of \$2.5 million in FY 12-13 for the sale of the Airborne Law Enforcement Program (ABLE) helicopters and related equipment. FY 2012-13 intergovernmental revenue is projected to be about \$600,000 less than FY 2011-12, due to the completion of several grants.

EXPENDITURE FORECAST

In FY 2012-13, proposed General Fund expenditures, including 'new' General Fund capital improvements, pension and OPEB payments, total \$154.1 million. New General Fund capital improvement project funding for FY 2012-13 is proposed to be \$3.6 million, an increase of \$1.6 million over the previous year. Our goal is to increase the FY 2013-14 funding for new General Fund capital improvement projects to \$5 million, which is the level we believe, is in keeping with our goal of maintaining our physical environment.

The proposed FY 2012-13 General Fund operating budget is \$148 million. This represents an increase of 3.0%, or \$4.3 million, from the FY 2011-12 estimated final budget which is net of a projected \$3 million of operational savings. The City Manager required all directors to maintain existing budget levels so that resources could be allocated to other priority projects that support our core values. The increases to operating departments were primarily limited to contractually obligated CPI adjustments within contracts, step increases and an increase in the contribution to the Information Technology Internal Service fund of \$1 million. The estimated \$3 million in operational savings expected for FY 2011-12 is not

included as a reduction to the FY 2012-13 proposed budget. It is almost entirely the result of vacancies in the public safety and miscellaneous departments and will be needed to maintain high quality service levels in FY 2012-13.

Reshaping the City's workforce: To maintain our competitive advantage we need to invest in our employees to keep them abreast of changes in their service areas, to stay current with technology and to adapt the overall workforce to the needs of the community. We don't want to just be a smaller organization, we want to invest in our employees to continue to be the best, always strive to improve service and business process and be that "smarter" organization while maintaining our culture of superior customer service.

In keeping with this message, the recommendation in the proposed FY 2012-13 budget are personnel changes that result in the net reduction of 8 full-time positions. The City Manager instructed department directors that in order to add or reclassify a position they had to work together to ensure we did not grow the organization. Each addition or reclassification had to accompany a reduction of equal or greater value. A position could only be reclassified if a director could correlate how that position will support the core values of the organization, improve performance, reduce costs or increase resources. With this reduction of 8 full-time positions the City will have 755 full-time employees, down 78 positions since our City Manager took the reins in FY 2009-10.

SUMMARY

We are committed to Fiscal Sustainability and living within our means. We will continue to tackle the difficult issues of pension costs, funding our CIP program for streets, lights and signals and neighborhood revitalization, funding our new facilities and maintaining them, and investing in our IT Strategic Plan so technology can be used to continue to be that "Shining City by the Bay". This financial status update will be provided by the Finance Department to the Finance Committee at its meeting of May 7, 2012, and included as part of the City Manager's Quarterly Business Report May 22, 2012.

City budget and salary information is available online at newportbeachca.gov/salary.