Foster City Financial Update 2Q 10/11

City of Foster City

For the Six Months Ended December 31, 2010

General Fund Projected to Finish FY 2010-2011 with $17.2 million in Reserves

At the midway point in its fiscal year, the City / District expects to finish the year with over $17.2 million in unrestricted General Fund reserves, $700k ahead of original budget projections. Based upon the final results of the audit of its FY 2009-2010 CAFR, the City's General Fund finished the year with $22.2 million in reserves, $2.2 million higher than original budget projections.

Yet while reserves are expected to finish the year ahead of budgeted projections, revenues will fall nearly $1.4 million (or 5%) short of original budget projections, due primarily to lower-than-projected assessed valuation that reduces property tax revenues, a state adjustment of the City's 1/4% sales tax payment under the "Triple Flip" provisions, and lower-than-expected vehicle license fee revenues.

There are positive signs in other revenue areas that may bode well in the City's financial future as it approaches the FY 2011-2012 budget cycle. Transient Occupancy Taxes, Business Licenses and development-related permits are expected to finish the year higher than original projections, signs that perhaps the local economy may be picking up slightly.

On the expenditure side of the ledger, the only negative repercussions experienced thus far is the CalPERS' rejection of the City's hardship request, which will increase retirement costs $803,000 above original forecast. The City expects a 2% budgetary savings by year end that will reduce the CalPERS impact to a net expenditure increase of $163,000. Staff will be monitoring spending in 3Q and 4Q 2011 in an effort to ensure that General Fund Expenditures finish the year without the need for additional appropriations.

Water Consumption Curbed by Nearly 5% Due to Tiered Rate and Rainy Winter

Water consumption has been reduced by nearly 5% with the introduction of the tiered water rate structure in July 2010 and with significant precipitation in October through December 2010. This reduced water consumption is having the impact that was expected in terms of the District staying within its water supply assurance allocation from the SFPUC. Nevertheless, some residential customers are still using higher levels of water than allotted under the tiered-rate structure that is generating nearly $100,000 in revenues above what is required through December 2010. The District has transferred this revenue into the Water Sus-

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Included in this report:

Highlights:

- State overallocated Triple Flip Sales tax revenues in prior years, impacting FY 2010-2011
- Local sales tax, business license, TOT and building permits trending higher than expected
- Tiered water rates providing incentives for water conservation
- Economic outlook is mixed, yet increasing TOT and business license revenues show promise.
- Loss of key sales tax producers being watched closely.

Key General Fund Revenue Trends in FY 2010-2011

There are 10 key revenue sources that have a significant impact on the City's General Fund. Here are the trends we are following in FY 2010-2011.

Property Taxes ($13.1m)
Property Tax collections through December were higher than expected. Discussions with the County indicate that actual assessments may have been higher than was indicated in the 1Q 2011 report. However, surplus tax increment from the CDA will fall short by $1.3 million as previous reported. The next large wave of collections will come in May 2011.

Sales Tax ($3.05m)
Staff learned in early January 2011 that the State had overadvanced the City's portion of the 1/4% sales tax that is subject to the "Triple Flip" in prior years. The estimated local tax allocations in the past two prior years totalled nearly $1 million more revenues than should have been advanced to the City. The State is making that up in this budget year. Yet local sales tax collections have exceeded original projections, which softens the blow of the State's prior overadvancements. As such, we expect Sales Tax revenues to finish the year $616k behind original forecast.

Transient Occupancy Tax ($1.42m)
TOT revenue collections in 2Q were nearly 24% greater than projections. Occupancy at both hotels is up from the prior year.

Franchise Taxes ($1.04m)
Franchise tax collections have thus far exceeded expectations by $34k, or 3%.

Vehicle License Fees ($2.52m)
VLF fees received in December fell short of expectations by nearly 8%. We expect VLF fees to fall short of budget by $230k.

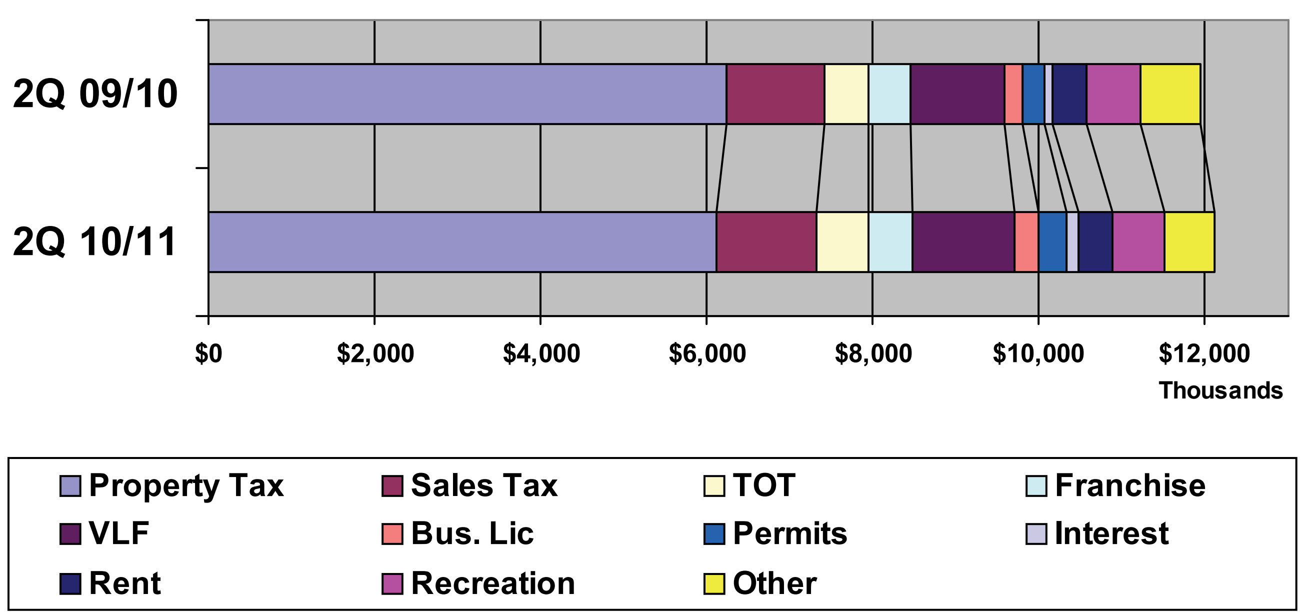
Business License Taxes ($746k)
Business license tax renewals are in the mail to businesses. Business license collection through 2Q 10/11 represents late payers or new businesses. Such collections are up by over 27% from the prior year. We project business License revenues to beat forecast by 21%, or $130k, by the end of the year.

Building Permits / Planning Fees ($1.59m)
Building permit and plan check activity in 2Q 10/11 is up by 31% from prior year, due primarily to building activity with Visa, Gilead Sciences and Pilgrim-Triton. We expect a $180k surplus by year end.

Investment Income ($371k)
Investment income is 47% greater than prior year primarily due to an increased investment in longer-term securities than in previous years that is providing greater yields, $132k greater than budget.

Rental Income ($836K)
Rental income is meeting budget projections in 1Q 10/11.

Recreation Programs ($1.03m)
Recreation program revenues were down by 5% compared to prior year, and we project to miss the target by $131k at year end.



Water Consumption Curbed by Nearly 5%; Reserves Expected to Meet Budget Projections

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tainability fund to fund rebate programs which will be widely marketed starting in the Spring.

Landscape irrigation users are reducing water consumption from historic levels, yet there is still a tendency by many of those irrigation users to overwater their lawns and shrub areas. If the irrigation penalty were imposed as of December 2010, the penalty would total approximately $150,000. The final penalty will be calculated at the end of June and will be payable by January of the following year. Staff and the District's irrigation consultant continue to work with irrigation customers to reduce water consumption to appropriate levels.

The District is expected to finish FY 2010-2011 with water reserves at or exceeding original budget projections of over $7.3 million, with potentially over $300,000 in Water Sustainability balances that will be used to fund rebate programs and other water reduction initiatives to ensure water consumption is kept within the supply assurance allotment.

Financial Issues to Watch Closely in FY 2010-2011

We are tracking the following trends in FY 2010-2011, including issues which have been made known to us in 2Q 10/11.

Surplus Property Tax Increment from CDA

As previously reported, when the CDA reaches its tax increment cap of $170 million during the year, surplus property taxes flowing to Estero Municipal Improvement District will more likely be $1.5 million for FY 10-11, or $1.3 million less than original projections. This is a one-time impact only. Ongoing revenues to the District beginning in FY 11-12 will be over $4.8 million.

PERS Public Safety Rates Higher

CalPERS rejected the City's request, along with 8 other agencies, to reamortize the unfunded pension obligation for Public Safety. The City will be reapplying for a "Hardship Request" and expects to hear an answer from CalPERS in time for creation of the FY 2011-2012 budget.

Sales Tax Revenues Lower due to Triple-Flip Overadvancement

Staff learned in January 2011 that the State had overadvanced the 1/4% portion of the Triple Flip sales tax allocation to the City. The result is that we were overallocated by $1 million in prior years, which is being made up in the current year.

Potential Relocation of Key Sales Tax Producers

The City has learned that certain key sales tax producers in Foster City may be potentially seeking relocation outside of Foster City. If this comes to fruition, the City could stand to lose substantial amounts of local sales tax revenues. Staff continues to have discussions with these sales tax producers to determine if there is potential for the company to stay local to Foster City. The likelihood of impact in FY 2010-2011 is slight, however the long-range impact could be substantial to the General Fund.

Economic Outlook

Staff is closely following key economic indicators (highlighted in **bold text**) and their potential impact on Foster City.

At the national and state levels, economists are seeing signs that the economy is in the early stages of recovery. Fourth quarter economic indicators - **retail sales**, manufacturing, **stock market**, corporate profits - have led many economists to believe that the economy will avoid another dip. However, the **housing market** has once again softened even amidst some of the lowest mortgage rates in history. Of biggest concern is the continued level of **unemployment** in the US (9.1%) and in California (12.4%). Congress passed the Tax Bill in December 2010 that extended unemployment benefits throughout the country. Unemployment remains persistent, however, and the general consensus remains that economic recovery will truly not begin until corporations and government begin to employ people in new jobs.

Inflation has stayed relatively low at 1.5% nationally. The Bay Area's CPI rate holds steady at 1.5% as well. This has a positive impact on growth of potential future costs for services and supplies, but low inflation affects **interest rates on fixed investments**, and thus reduces the potential earning power of the City's investment portfolio.

We also continue to watch performance of the **stock market** that af-

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City of Foster City

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Status of Other Key Funds at Close of FY 09-10

A brief look at other funds:

- CDA - CDA revenues are trending lower than expectations, primarily due to assessed valuation writedowns.
- Park In Lieu - fees of $4 million from the Pilgrim-Triton project are expected prior to year end, which will allow full funding of the synthetic turf projects.
- Measure A and Gas Tax - revenues are trending higher than expected.
- Longevity Recognition and PEMCHA - investment earnings have exceeded original projections.

Trends Affecting FY 2010-2011

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fects PERS rates. The market gained nearly 11% in 2010, and 19% since July 1. The PERS board has been considering changing their investment discount rate downward, which could have an impact to PERS rates by 5-10%. However, the likelihood of a change in the discount rate is slim as there would be significant pressure from the State Legislature to maintain the discount rate given the potential impact to the State budget.

Of key importance will be monitoring Foster City business trends and real estate prices that will affect short– and long-term impacts to property tax, sales tax, TOT, and business license revenues. As indicated earlier, it appears that sales tax (excluding the Triple Flip 1/4% portion), TOT and business license revenues all appear to be higher than expected. This continued trend could help the City's long-range revenue forecasts barring any unforeseen changes in any of those categories.

Governor Calls for Realignment of State Services, Shutdown of Redevelopment Agencies

Governor Jerry Brown issued his budget for FY 2011-2012 on January 10, 2011. The budget identifies a $25.8 billion deficit, and he is proposing a series of revenue enhancements in the form of tax extensions and increases and significant cuts in General Fund spending to solve the State's long-term deficit.

Two components in his budget that could have substantial impacts to local government are Realignment and Phasing Out Redevelopment agencies.

Realignment

The Governor proposes pushing back certain services absorbed by the State over the past 20 years to the local level. These services include reassigning urban wildland areas to local fire agencies, public safety programs such as COPS and booking fees, release of prisoners with low-level offenses, parolees, juvenile justice programs, and mental health services.

To fund these services, the Governor is proposing a ballot measure that would extend the 1.15% VLF tax and 1% state sales tax that would be reassigned to local agencies. The tax extensions would run through FY 2015-2016. There is uncertainty if the State Legislature needs a simple majority (50%+1) or super majority (2/3) vote to place the tax measures on the ballot. There is no "Plan B" if the tax measures fail.

Most of the impact will be felt by county government agencies, and there is concern as to what extent a "trickle down" effect will be felt by cities if counties look to push down costs of services to cities and special districts.

In order to get the tax measures in place prior to July 1, the Governor is calling the Legislature to pass the budget by the end of March 2011. Given a simple majority needed to pass a budget per the terms of Proposition 25 (2010), the budget could move quickly if Democratic leaders agree with the Governor's proposals.

Phase Out of Redevelopment Agencies

The most direct impact to Foster City would be the phase out of redevelopment agencies (RDA's) statewide. Under the proposal, all existing legally contractual obligations of an RDA would be honored. Beyond that, however, the RDA would not be allowed to collect further tax increment, reverting those funds back to schools and other taxing agencies that would reduce State funding of those entities. In addition, any general surplus revenues would be swept to the State, and surplus housing funds would be swept and given to local housing authorities to spend those funds for low-income housing needs, not necessarily in the jurisdiction in which those revenues were collected.

Since the Project One Area will hit its tax increment limit in May 2011, the long-term impact is minimal. However, surplus funds that are not legally obligated could be swept away from Foster City. City staff is working with legal counsel and the California Redevelopment Association to determine the most appropriate steps to ensure that Foster City CDA revenues stay local.

As further developments are noted, City staff will alert the City Council and propose any actions necessary to protect Foster City's interests.