Foster City Financial Update 3Q 12/13

City of Foster City

For the Nine Months Ended
March 31, 2013

General Fund Revenues: City Loses its Largest Sales Tax Generator; Excess ERAF Helps Make Up Difference

Sales tax returns received in April from the State Board of Equalization have confirmed that the City's largest sales tax producer began shifting their sales office to other localities starting in October 2012. The shift is anticipated to be complete in the quarter ended March 31, 2013. The City stands to lose over $1 million in sales tax revenues each year. City staff have been in communication with this sales tax producer over the past few years, and while their decision to relocate sales offices was not unanticipated, the departure at a time when the City was closing its structural deficit was unfortunate. (Note: the City is not allowed to specifically identify its sales tax generators due to confidentiality in compliance with State law.)

The City did receive a $1.1 million payment from the County Controller's Office of Education Revenue Augmentation Funds (ERAF) that were collected in excess of the actual amounts required by State law. ERAF funds were instituted in 1991 that shifted over 10% of the City's property tax dollars to education. Those funds are collected based on estimates, and a very complex calculation is performed each year by the Controller to determine actual ERAF payments owed to the schools. This year's "refund" back to the City was somewhat larger than in prior years, however it is expected that these refunds will shrink significantly in the coming years. The City has not budgeted these excess ERAF payments as they have never been predictable nor "guaranteed."

Due to greater than expected collections of property, transient occupancy, franchise and business license taxes, the City expects the General Fund to finish the year with $31.2 million in revenues, nearly $900,000 higher than originally anticipated in the FY 2012-2013 budget.

A brief recap of specific revenue sources follows:

☺ Property Taxes - recovery from the reductions in assessed valuations during the economic recession portend revenues exceeding the original forecast by $469,000.

☹ Sales Taxes - the loss of the largest sales tax producer will find sales tax revenue missing the target by nearly $900,000.

☺ Transient Occupancy Taxes - higher-than-anticipated occupancy at the local hotels leads to TOT projections $150,000 better than expected.

☺ Franchise Taxes - a drop in franchise revenues from PG&E due to reduction in energy prices and consumption was offset by the increase in the Recology franchise rate from 5% to 10% on January 1, 2013.

☺ Real Property Transfer Tax - projections of $110,000 greater than original forecast due primarily to the sale of the Electronics for Imaging property to Gilead Sciences and

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Included in this report:

Highlights:

- The loss of the largest sales tax payer will negatively impact future budgets by $1 million per year. Otherwise, General Fund revenues are trending higher than forecast.
- Development activities are progressing earlier than anticipated, which will bode well for future revenue forecasts.
- CalPERS' revised rate smoothing policy will see pension costs rise by over 30% in the coming 5 years.
- San Mateo County follows Foster City's lead by dedicating 100% of "boomerang" redevelopment housing funds for affordable housing.

City Loses Largest Sales Tax Generator

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increasing median home prices of single-family and townhome residences.

- ☺ Recreation Programs - revenues are falling $157,000 lower than expectations, however, related expenditures also drop due to reduced costs of programs from lower-than-anticipated attendance.
- ☹ Permits - recurring building permit revenue (excluding significant development) is falling $150,000 lower than original projections, which anticipated a higher level of tenant and home improvements than is being realized.
- ☹ Interest Income - interest rates have slightly increased in the past quarter, but have fallen from the original projections. Current investment yield on the City's portfolio is 0.867%.

The loss of the largest sales tax generator will reduce the sales tax base by nearly 25% which in turn impacts the long-range forecast. The positive revenue trends in the areas of property, transient occupancy and franchise taxes, combined with the ongoing development of various commercial and mixed-use properties in Foster City, will still allow the City to achieve a balanced budget for FY 2013-2014 while it assesses the long-range impact of the sales tax losses described above.

Update on the Sustainable Foster City Plan and Development

The City continues to implement the priority tasks in the Sustainable Foster City Plan. A Proclamation Day is being planned in June that will kickoff the holistic efforts incorporated in the Plan. On the heels of that event will be the first of a series of public events that will seek to encourage those that live, work and play in Foster City to "think! Foster City" first when it comes to the retail, personal services, and dining experiences of the community. The City and Chamber of Commerce staff are continuing to coordinate and identify opportunities to provide the right mix of retail and commercial business offerings that support Foster City residents and prospective employees. The City will be hiring a commercial / retail consultant to assist it in identifying those opportunities and to ensure that the City's commercial / retail properties serve to protect, maintain and grow its merchant base. The City also rolled out its Online Economic Dashboard to provide metrics to prospective businesses, developers, real estate brokers, and residents as to why Foster City is a great place to live, work and play.

Here is a quick update on key development projects:

- ♦ 15-Acre Site - The New Home Company, LLC and its partners continue to work through the planning process with the Planning Commission and Planning staff to process the land-used entitlements so that they can purchase the property from the City by the end of 2013.
- ♦ Pilgrim-Triton - "The Plaza at Triton Park" continues to lease up nicely. "Triton Pointe" is expected to pull building permits by the summer of 2013. And discussions are underway with the developers of "Phases B and C" to finalize site specific development agreements in the coming year.
- ♦ Gilead Sciences - Gilead continues development of its South Campus and has discussed moving forward with the construction of a second Lab building with Planning staff.
- ♦ Extended Stay Hotel - the developer of the proposed 120-unit extended stay hotel is making substantial progress with Planning staff and the Planning Commission to bring forward this new hotel on the former Black Angus site.
- ♦ Chess-Hatch - the developer in the Chess-Hatch area immediately north of 92 is working with the City to finalize the development agreement for the site.
- ♦ Charter Square - the owner of Charter Square Shopping Center has filed an application for a general plan amendment and rezoning of the site to construct 95 townhomes and 10,000 square feet of retail in a redevelopment project on the site.

Good News on Funding of Affordable Housing Projects in San Mateo County

As reported in the prior edition of the Quarterly Update, the County Controller redistributed the sum of $3,268,301 to the Estero Municipal Improvement District from the $12.7 million swept from the City's former redevelopment agency. The City Council took the bold step of dedicating 100% of those funds back to affordable housing in Foster City on December 17, 2012. Foster City was one of only two agencies in San Mateo County to take this action and dedicate these funds towards affordable housing (the other being San Mateo). While much of the other remaining funds would be returned to the State to offset its obligation to fund education, over $3 million was also set to be given to the County of San Mateo.

The Mayor sent a letter to the County and all other cities in the county urging that they follow Foster City's lead and dedicate 100% of their returned funds towards affordable housing needs in the County. That letter was like the pebble thrown into the pond, and the ripple effects from that letter stirred housing advocates and the County into action in addressing this issue. The waves created culminated with the County Board of Supervisors taking action on April 9, 2013 to dedicate 100% of its "boomerang" funds towards housing for the homeless and other affordable housing needs in the County. Of the $13 million received by the County, 25% of these funds will go towards homeless shelters and programs in the County, while the remaining 75% (nearly $10 million) will be going towards funding affordable housing projects that can be "shovel ready" within the next 2-5 years.

Foster City is working with Mid-Pen Housing to determine how best to leverage those County funds for the 15-Acre Site development when they become available, which is not expected until March 2014.

A recent publication by Mid-Pen Housing indicates that there was demand for over 100,000 living units by families at low– to moderate-income levels in San Mateo County, and yet the inventory in the County meets just over half of that need. Foster City has been a leader for years in providing affordable housing, using redevelopment funds to subsidize the availability of below-market rate units. Now that redevelopment agencies are a thing of the past, the shared problem of providing a stock of affordable living spaces for the teachers, bank tellers, retail salespersons, and others that provide services and make a living in this county is more acute.

Beyond the City's and the County's efforts, Foster City will need to look at long-term strategies for ensuring that affordable housing is viewed as one of several components of an effective economic development strategy so that employers have the human resources that they need to thrive economically in a competitive global marketplace. Funding those affordable housing initiatives will be the subject of a nexus study conducted by the City in FY 2013-2014.

General Fund Expenditures Expected to be $400k Less Than Forecast

As we close in on the final three months of the year, the City's General Fund is expected to finish the year with at least $400,000 in expenditure savings in four key areas:

- City Manager's Office - the City Council authorized staff to outsource FCTV services when the Video Technician position became vacant. This change in delivery of FCTV services will save the City approximately $40,000 in FY 2012-2013, and ongoing savings of approximately $56,000 per year starting in FY 2013-2014.
- Fire Department - the sharing of fire administration and prevention services with the City of San Mateo continues to progress. The Assistant Fire Marshal position and two (2) Battalion Chief positions were eliminated due to earlier-than-anticipated retirements. Offsetting these reduced costs was the approval to hire a Administrative Battalion Chief to support the management of the Foster City fire operations. Net savings anticipated for the remainder of the year will be $200,000.
- Property Tax Administration - the final tax administration fees from the County will be $19,000 less than budget.
- Special Recreation Fund - as indicated earlier, expenditures in the Special Recreation Fund will fall below budget due to enrollments in programs lower than the original budget. Expenditures are expected to be about $170,000 lower than the original budget.

City of Foster City

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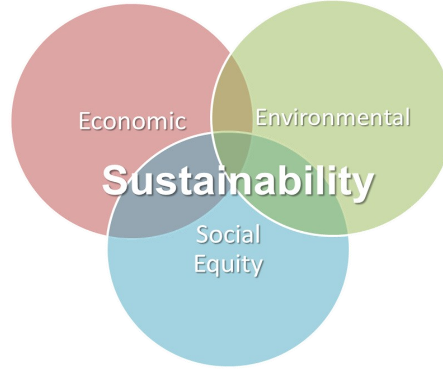
Sustainable Foster City:

Sustaining and Enhancing the Quality of Life in Foster City



Federal Sequestration, State Budget, and CalPERS Policy Changes Play a Significant Role in the City's Economic Forecast

Federal Sequestration

Congress and the President could not come to a compromise solution of the Federal Budget in time to avert the "fiscal cliff", and so various sequestration (automatic cuts) were put into place starting in April 2013. The ramifications of these cuts have been first felt in regards to air traffic controllers and security agents at airports in the United States with several flights cancelled in the first few days of the sequestration, for which Congress is currently deliberating options to allow the FAA with greater latitude in terms of its cuts. The remaining impacts of sequestration have not yet been felt locally, and we should remain watchful for any impacts that may be noted affecting our region or our community.

Governor's May Revise Budget Expected Soon

Governor Brown released his proposed FY 2013-2014 budget in January, and is expected to issue his May Revise on or about May 15. The initial budget projects a balanced budget with increased funding for education due to the passage of Proposition 30—the sales and income tax increase measure. The Governor's budget continues the process of realignment of state services pushed to the local level, the most significant of which is the impact on county jails. The education increases are overshadowed by a proposed change in the funding of schools that provide enhanced revenues to those schools that serve poorer, disabled, or non-English speaking students. The San Mateo-Foster City School District and, to a lesser extent, the San Mateo Union High School District may be negatively impacted if the Governor's proposal is passed without amendment.

CalPERS Changes its Smoothing Policy - Increases in Employer Rates Expected in FY 2015-2016

The Chief Actuary at CalPERS submitted a proposal to the CalPERS Retirement and Health Benefits Committee to revise the current rate smoothing policy that impacts the projection of employer rates by smoothing out investment gains and losses. The current policy identifies the impact of investment gains and losses and amortizes them over a rolling 15 year period. The Chief Actuary argued that this delays the recovery of plan assets during years of sustained losses and places the Plan itself in financial jeopardy. His proposal was, in effect, to reduce the amortization period of those gains and losses from a rolling 15 years down to a direct rate smoothing period of 5 years. Furthermore, he recommended that the full impact of the change be implemented ratably over a 5-year period starting in FY 2015-2016. The Retirement and Health Benefits Committee approved the recommendation on April 16, and on April 17 the full CalPERS Board approved the Committee's recommendations. These changes will be included in the Actuarial Report that is issued in November 2014, and the impact on rates would go into effect starting with the FY 2015-2016 budget year.

Based upon the latest information provided by CalPERS at the San Mateo County Finance Officers Group (SAMFOG) meeting on April 26, the employer rates for public safety may increase from 32.9% in FY 2014-2015 to 41.4% in FY 2019-2020. For the Miscellaneous Plan, the employer rate may increase from 20.1% in FY 2014-2015 to 25.6% in FY 2019-2020.

The City will continue to analyze the impacts of this change in policy as it prepares the five-year financial forecast as part of the FY 2013-2014 Preliminary Budget.