Council Meeting of
February 27, 2007

Honorable Mayor and Members
of the City Council
City Hall
Torrance, California

Members of the Council:

Subject: 2nd Quarter 2006-07 Budget Review

RECOMMENDATION

The Finance and Governmental Operations Committee recommends that Your Honorable Body concur with the following recommendations:

- Accept the Second Quarter 2006-07 Budget Review Report
- Accept the City Treasurer's Investment Report

BACKGROUND/ANALYSIS

On Tuesday, February 6, the Finance and Governmental Operations Committee heard a presentation from staff on the Second Quarter 2006-07 Budget Review. At the meeting, staff reported that overall revenues for mid-year were projected to meet budget estimates and expenditures for the City are well within budgeted guidelines.

Additionally, staff reported that the Transit Department has begun the process of procuring an AVL system which applies state of the art technologies to provide a more efficient and effective management of the transit system. The AVL Capital Project (FEAP 266), approved in 2002, provided funding of $1.14 million for the purchase and installation of an AVL system. FEAP 266 did not address the funding for operating and maintaining of the system, 20 hours a day, seven days a week. The Transit Department stated that they would return to Council with a detailed staff report on operational funding options.

The Committee voted and accepted unanimously the Second Quarter 2006-07 Budget Review Report and the City Treasurer's Investment Report.

Respectfully submitted,

Finance and Governmental Operations Committee

Pat McIntyre

Councilwoman Pat McIntyre, Chair

Hope Witkowsky

Councilwoman Hope Witkowsky, Member

Paul M. Nowatka

Councilman Paul Nowatka, Member

Attachments:
A. Executive Summary
B. City Treasurer's Investment Report

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ATTACHMENT A

Committee Meeting
February 6, 2007

Honorable Chair and Members
of the Finance and Governmental Operation Committee
City Hall
Torrance, California

Members of the Committee:

Subject: Mid-Year 2006-07 Budget Review

RECOMMENDATION

The City Manager and the Finance Director recommend that the following items be approved by the Finance and Governmental Operations Committee and recommended to the Council for action:

- Accept the Mid-Year 2006-07 Budget Review Report
- Accept the City Treasurer's Investment Report

EXECUTIVE SUMMARY

Revenues for mid-year are projected to meet budget estimates and expenditures for the City are well within budgeted guidelines. As of mid-year all departments are within budget with the exception of the Emergency Medical Services Fund of the Fire Department and the Community Services Department which are expected to be within budget by year-end.

Torrance continues to have a strong underlying economy. The City's tax and economic base includes a mix of high-end residential properties and a sizable commercial and retail component. The City has a large property tax base of $20.7 billion in fiscal year 2006, increasing in assessed value by 8.9% over last year. Unemployment rates in the City of 1.9% (as of 12/06) have historically fallen under both State and national averages of 5.4% and 5.1% respectively. Taxable sales for the State and Torrance have continued to increase, although at a slower rate than the previous year, and are projected to reflect a modest growth through the fourth quarter of 2008.

A Snapshot of Torrance

Population: 147,405
Peak Daytime Population (2 p.m.): 203,011
Area: 21 Square Miles
1453 Full-time Employees
6 Fire Stations
1 Police Station, 1 Police Substation &
3 Police Community Centers
241 Sworn Police Employees
159 Sworn Fire Employees
6 Public Libraries
90,000 Street Trees
550 Miles of Sidewalks
46 Parks & Recreation Amenities

Budget Outlook

The economic forecast for California through mid-2007 is expected to continue to reflect a sluggish growth pattern. During the 2006 year, economic expansion slowed down primarily from high fuel prices, declines in home construction, and sales of light vehicles. The Governor of California has submitted his 2007-08 proposed budget. According to the Legislative Analyst Office (LAO) the budget "contains a significant number of downside risks and is based on a number of optimistic assumptions." The key proposals also raise serious policy and legal issues. Adverse outcomes in just a few of these areas could easily eliminate most or all of the proposed reserve."

LAO Forecast	2006	2007	2008
Personal Income	7.2	4.3	4.6
Wage Growth	1.8	1.2	1.6
Taxable Sales	6.2	4.2	4.7
Permits	162,000	130,000	135,000
CPI	4.2	3.0	2.0

Some of the areas that require policy changes are: shifting approximately $1.1 billion from a restricted transportation fund to the general fund; obtaining money from tribal gambling compacts; and $1.1 billion dollars of assumptions that the State will prevail on its appeal in two court cases in which the State lost in Superior Court. The Guillen case, which involves a retroactive application of a 2003 COLA to CalWORK's grant, and the other appeal involves the sale of pension obligation bonds to cover a portion of the State contribution to its retirement fund. The LAO believes the State budget has a shortfall of approximately $2 billion. At this time the Governor's proposal does not appear to adversely affect the City's budget. Having said that, staff will continue to closely monitor the activities of the State budget approval process.

Budgetary Concerns

At the start of fiscal year 2006-07, the City submitted a balanced budget with revenues and other funding sources equaling planned expenditures. During the year, revenues and expenditures are closely monitored as new laws, legislation, etc. can change which can have an impact on budget. The following items are areas where potential concerns exist with respect to budget being realized:

Workforce Investment Network (WIN): At mid-year, the WiN budget is projected to be in balance by fiscal year end. Under Council direction, the WiN budget was brought into balance by obtaining new grants through June 30, 2007, reducing four (4) staff positions, reducing three (3) staff members work schedules, closing the WorkSource centers for two weeks during the last week in December and the first week in January, and reductions in non-wage areas.

In addition to the above actions, the WiN Board and Policy Board have determined that the Carson/Lomita/Torrance Workforce Investment Area will seek a strategic merger with an adjacent area. In this era of continuing decline in federal dollars for domestic programs, this action will strengthen the services offered to the businesses and residents of the three cities.

Housing - Section 8*:* As reported at the fiscal year 2006-07 first quarter budget review, staff projected expenses exceeding revenues by $187,000. As reported earlier, in January 2006 the Federal Department of Housing and Urban Development (HUD) changed the methodology in its funding calculation for administrative fee reimbursements. The funding change resulted in the City's Section 8 program receiving sufficient housing assistance payments for its clientele but not sufficient funds to pay for administering the program. Last fiscal year, staff used reserves to assist in the payment of the administration fees; however, reserves are diminishing as administrative costs are increasing. The decline represents a 2.3% reduction over last year. Since then costs in this area have been reduced through cost through attrition and other personnel reassignments and reduction in non-wage areas. Staff believes by fiscal year end expenses will be in line with Housing revenues.

Utility Users' Tax*:* The Federal Government implemented a policy which eliminated the Federal Excise Tax. Some telephone utility users' tax suppliers have made inquiries with regards of continuing to apply the City's UUT on long distance service. The City believes that the City's UUT ordinance still applies to long distance service. Staff has been in discussions with the League of California Cities, as well as legal counsel, on the potential impact of the Federal Government's change in policy. If the policy change is mandated on cities, then the City of Torrance is projected to have a reduction in UUT revenues of approximately $5-6 million.

Workers' Compensation Costs: Costs have been declining over the last five years due to various factors, such as increased safety efforts by both employees and management that have resulted in a steady reduction in the number of claims. Departments' commitment to a Return to Work Program has reduced number of lost days from work. The 2004 Workers' Compensation Reform has provided ways to control costs. Medical care is now subject to use of treatment guidelines, utilization review and limits on physical therapy and chiropractic care. Temporary disability benefits are limited to two years. Permanent disability factors are now based upon objective factors, not just pain and/or work restrictions, which has resulted in a reduction in permanent disability awards. Reduction in the value of permanent disability awards for injured employees who continue working.

Fiscal Years	Number of Claims	Total Costs
2002/2003	339	8,903,409
2003/2004	297	8,217,881
2004/2005	275	7,254,044
2005/2006	251	5,993,650
2006/2007	105**	2,569,826**

**Figures for FY 2006/2007 are through 12/31/06.

The number of claims as of 12/31/05 was132. The estimated total claims for FY 2006/2007 is 210. Costs as of 12/31/05 was $3,191,944 and the estimated costs for FY 2006/2007 are $5,139,652.

Transit Automatic Vehicle Locator (AVL/CAD) System: The Transit Department has begun the process of procuring an AVL system which applies state of the art technologies to provide a more efficient and effective management of the transit system. The AVL Capital Project (FEAP 266) approved in 2002 provided funding of $1.14 million for the purchase and installation of an AVL system. FEAP 266 did not address the funding for operating and maintaining of the system, 20 hours a day, seven days a week. Staff will return with an item providing funding options.

As previously mentioned, currently all departments are within budget and are expected to be within budget by fiscal year end. Staff will continue to monitor City operations as we enter the budget process for the 2007-08 and 2008-09 fiscal years.

Respectfully submitted,

Eric E. Tsao
Finance Director

CONCUR:

LeRoy J. Jackson
City Manager

ATTACHMENT B

January 24, 2007

COMMITTEE MEETING
February 6, 2007

Honorable Chair and
Members of the Committee
City Hall
Torrance, California

VIA: Council Finance and Governmental Operations Committee

The Treasurer's Office and the Investment Advisory Committee have set out to develop and implement investment procedures that insure the City's investment objectives of a high degree of asset safety, an adequate liquidity to meet operating and capital expenditure needs, and a reasonable return of the City's investment assets given the City's foremost goals of safety and liquidity.

Investment Summary

As of December 31, 2006 total investments of $267.7 million consisted of the following categories:

1) Pooled Funds (Investment Portfolio)	$ 133.7 million
2) Restricted Funds:	
a. Debt issue proceeds	$ 16.4 million
b. Deferred Compensation	
1) 457	$ 110.4 million
2) 401(a)	$ 3.9 million
c. Retirement Health Savings Plan	$ 3.3 million

The pooled Funds consist of surplus funds invested and managed directly by the City Treasurer. To date the fund has generated year-to-date interest earnings of $2.7 million and the effective rate of return equaled 4.18%.

The restricted funds, made up of the Debt issue proceeds, Deferred Compensation funds and the Retirement Health Savings Plan are invested accordingly:

1) Debt issue proceeds are invested through a trustee appointed under the Debt Trust Indenture. The funds are invested at the direction of the City Treasurer.

2) Deferred Compensation fund is managed by a third party administrator - Great West Life. Investment options made available to the participants are selected and approved by the Deferred Compensation Committee. The fund is a self-directed program. Participants have the ability to direct their contributions among several different investment options.

3) The Retirement Health Savings Plan is managed by a third party administrator – ICMA Retirement. Investment Options are made available to the participants and are selected by ICMA Retirement. Participants can direct their contributions among several different investment options. This tax-deferred program has been offered to employees for the purpose of saving dollars to supplement the cost of health expenses upon retirement.

NOTE: The Deferred Compensation Plans and the Retirement Health Savings Plan are held in a custodial account for the benefit of the Participant or their Beneficiaries and is not an asset of the City of Torrance.

Investment Forecast

The Federal Reserve Board has chosen to keep its target for the federal funds rate at 5.25%. Economic growth has slowed over the course of the year, partly reflecting a substantial cooling of the housing market. Although recent indicators have been mixed, the economy seems likely to expand at a moderate pace on balance over the coming quarters. What does this mean to rates across the short and intermediate curve? Currently short term rates (one month through 1 year) have been rising, while rates between two to five years have been declining. It appears that the FOMC will continue to remain in a neutral approach through their next meeting in March. If incoming information implies strong inflation risks, they will be forced to consider additional firming but it all depends on the outlook for both inflation and economic growth.

GASB 31 Impacts on Investments

GASB 31 took effect June 1997. The intent of GASB 31 is to bring to light potential liquidity problems by requiring municipalities to mark to market their securities with a maturity greater than one year. This paper gain or loss must be booked against investment earnings at year-end.

One way to avoid the gain/loss issue is to limit all purchases to maturities of less than one year. This condition would then preclude a market valuation and allow investments to be carried on a book value basis. This situation could reduce earnings potential in the loss of yield that a security with a longer term would usually offer.

Within our investment policy we adhere to a buy and hold philosophy. Therefore, our current strategy will not change in light of GASB 31. We will continue to place a percentage of the portfolio out longer on the yield curve to take advantage of higher earnings. At the same time we keep in excess of 35% of the portfolio liquid in order to meet current and future obligations.

At the present time the monthly investment report tracks all securities by listing the face value, book value and market value. The portfolio paper gain or loss is the difference between book and market value. The unrealized gain/loss is noted monthly even though it is not physically applied to earnings until year-end.

Investment Strategy

For the past three months, the activity has been positive. All securities that have matured or been sold have been re-invested back into the market at a higher rate of return. The average yield on the matured securities was 3.792%. BY re-investing the same dollars the portfolio was able to invest in today's market and pick up an additional 1.38% for an average yield of 5.17%. The Portfolio increased over last quarter by almost $3 million.

Beginning in January, the City will begin to receive the seasonal revenue sources and the portfolio will begin to increase. Strategically, we will begin to place money out in the market. Currently, the yield curve is inverted. Although the market would encourage a very short portfolio, it is not our intent to chase interest rates. Our goal is to match purchases with cash flow needs. Therefore, we will continue to place investments out along the yield curve.

To be consistent with the City's objectives of high degree of Asset safety, all investments will be invested in high quality rated instruments or those guaranteed by the "full faith and credit" of the government.

Recommendation

Accept and file the 2nd Quarter Report.

Respectfully submitted,

Linda M. Barnett
City Treasurer

CONCUR:

LeRoy J. Jackson
Investment Committee Member