The past several years have been some of the most fiscally complex years facing the City of Manteca and our sister cities in the Central Valley. Together we have faced unemployment levels nearing 20% and have been located in the epicenter of the mortgage crisis. While other areas throughout the nation and our state are beginning to see signs of economic recovery, most cities in our region will be among the last to show significant signs of improvement.

Staff has been working closely with the City Council since January 2009, to formulate strategies to meet the fiscal challenges facing the City. When the first Council workshop was held in 2009, pro-forma projections for the General Fund calculated an estimated shortfall of $11.3 million in Fiscal Year 2009-10, growing to $14.2 million in Fiscal Year 2010-11.

Council took immediate action and formed a citizen's Budget Advisory Committee (BAC). After several meetings to discuss the challenges facing the City, the BAC formulated several recommendations including freezing current vacant positions, approving suggested staff reorganizations, supporting staff maintenance of the Landscape Maintenance Districts, updating development fees, creation of a separate fund for Development Services, and to open up negotiations with all employee unions. Each of these suggestions was implemented, beginning with the Fiscal Year 2009-10 budget.

Working as a team, the City Council, management and City employees joined together to execute salary and benefit strategies that would address the General Fund shortfalls through the end of Fiscal Year 2010-11. By putting into action the recommendations of the BAC and implementing negotiated employee salary and benefit packages, the City reduced the projected General Fund shortfalls to an estimated $4.0 million for Fiscal Year 2009-10 and $3.4 million for Fiscal Year 2010-11.

In preparing for the Fiscal Year 2011-12 budget, staff met with Council on January 27, 2011 to review updated pro-forma projections for the General Fund. The Council was presented with three scenarios for the next five-year planning period. Assumptions for each scenario were based on conservative, most likely or optimistic revenue projections. The main drivers for the revenues were property tax and sales tax projections. The projected General Fund deficit for Fiscal Year 2011-12 ranged from $3.9 million to $5.4 million, depending on economic recovery. When the assumptions were carried out to Fiscal Year 2015-2016, the deficit ranged from $1 million to $5 million. Based on the information presented, it was clear revenues alone would not be able to bridge the City's structural deficit. Council instructed staff to begin to work with each of the City's bargaining units to enlist their support to address increasing personnel costs. Each unit had in place negotiated Memoranda of Understanding that did not expire until December 31, 2011. Council acknowledged that it was critical to gain the support of each unit to open up negotiations early and to have new Memoranda of Understanding agreed upon prior to December 31. While this has resulted in the late adoption of the Fiscal Year 2011-12 budget, through the support of all of the employees of the City, approximately $4.2 million of projected ongoing personnel costs have been reduced from the General Fund. Employee concessions through June 30, 2015 vary by bargaining unit, but in general include:

- Additional employee contributions to retirement plans
- Negotiated caps on employee health benefits, vacation accruals and administrative leave accruals
- Implementation of reduced retiree health benefits
- No negotiated cost-of-living adjustments
- Elimination of compensatory time off (CTO) for the Manteca Police Officers Association
- Annual furloughs ranging from 27 hours to 99 hours
- Employee layoffs for some divisions

Through the cooperation and support of our employees, a plan is now in place that will allow for the reduction and anticipated elimination of the City's structural deficit by the end of the next five-year planning horizon. The timing for the elimination of the structural deficit is now strongly dependent on the stabilization and eventual moderate growth of the City's two main revenue sources – property tax and sales tax.

Economic Conditions

While the Nation and other regions in the State are beginning to show increasing signs of recovery from the national recession, the turnaround in our region is moving more slowly. Sales tax throughout the region is beginning to show signs of improvement. The latest information indicates that sales tax receipts in our region grew by 9%. In comparison, because the expansion of the City's economic base, including Costco, Bass Pro Shops, Best Buy, JC Penney and JM Equipment Company resulted in stabilizing sales tax in our community during Fiscal Year 2010-11, Manteca is only projected to experience modest gains in sales tax of 2%. Sales tax comprises 33% of General Fund revenues. This is now equal to property tax, which makes up 34% of General Fund revenues.

Based on discussions with the County Assessor's Office regarding projected property assessments for Fiscal Year 2011-12, the City is projected to experience a 5% decrease in secured property tax. This trend is anticipated to slow to a 1-2% reduction for Fiscal Year 2012-13, with slight gains thereafter.

Budget Overview and Highlights

The General Fund proposed budget for Fiscal Year 2011-12 is $27,074,746. This represents a12% decrease over the pro-forma projection of $30,788,323 presented to Council in January 2011. The Citywide proposed budget, excluding the Redevelopment Agency, is $97,787,926. This includes new funding requests for capital improvement projects totaling $15,114,330.

General Fund

The General Fund budget as presented projects an operating structural deficit of $1.5 million. Revenues are in line with the "conservative" projection presented to Council in the January 2011 pro-forma. The projected structural deficit based on the conservative scenario for Fiscal Year 2011-12 was $5.4 million. Reductions to the budget imbalance have been achieved through several measures, including:

1. Implementation of negotiated decreases to employee salary and benefit packages. New Memoranda of Understanding for all bargaining units are in place from July 1, 2011 – June 30, 2015. Revised salary and benefit packages include the elimination of cost-of-living adjustments, additional employee contributions to the California Public Employees' Retirement System (PERS), furloughs and layoffs.
2. The Parks Division assumed maintenance of all Landscape Maintenance Districts (LMDs). One additional team member has been added, increasing the number of employees to five who will continue to maintain the LMDs for additional General Fund savings.
3. Operational expenses for travel, training and supplies were again maintained at prior-year levels.
4. Temporary deferral of the General Fund contribution to the Gas Tax Fund. This deferral is based on the suspension of the Maintenance of Effort requirement for Proposition 42 funding that was eliminated with the passage of ABx8 6 and ABx8 9 – the "Fuel Swap of 2010."
5. Temporary deferral of the General Fund subsidy to the Recreation Fund. In preceding years, sufficient funds have been transferred to the Recreation Fund to account for activities that do not achieve full cost recovery. Sufficient funds currently

exist in the Recreation Fund to forego this subsidy this year. The amount of General Fund subsidy will be reviewed as part of the Fiscal Year 2012-13 budget process. In the interim, Recreation staff is working on establishing fees that better capture cost recovery.

Public Safety Sales Tax Fund

In November 2006, the citizens of Manteca passed a one-half-cent sales tax for public safety. As part of the adoption of this sales tax measure, a Citizen's Oversight Committee was formed to ensure that all expenditures meet the guidelines as set forth in the adopted ordinance. When originally adopted, the five-year expenditure plan projected sales tax revenues of $4.9 million for Fiscal Year 2011-12. Due to changes in the economy over the past several years, sales tax projections for the upcoming year are only $4.2 million. In response to declining revenues, a revised staffing plan was approved in Fiscal Year 2009-10. As currently adopted, the Public Safety Sales Tax Fund provides funding for 11 Police protection personnel and 12 Fire protection personnel.

Golf Course Fund

The Golf Course faces the same challenges of decreased consumer disposable income that is impacting the General Fund. During the past five years, overall revenues have declined, but appear to be stabilzing. One of the primary challenges to achieving fiscal stability in the Golf Course Fund had been the ongoing debt service related to the clubhouse. In prior years, the debt service represented 22% of all expenditures. As of June 30, 2010, the $2.2 million lease associated with the clubhouse expansion was fully defeased. The remaining debt service payment to the expansion of the golf couse and construction the parking lot and tennis courts will be paid off in 2013. With the retirement of the 1994 Capital Lease, debt service now comprises only 5.4% of all expenditures.

In the past, on average, $140,000 was loaned to the Golf Fund annually to meet cash flow obligations. As of June 30, 2011 the total cumulative amount due to the General Fund is $1.4 million. However, Fiscal Year End June 30, 2011 marks the first year in which Golf Fund revenues exceeded expenditures and no additional loan was required. This trend is projected to continue in Fiscal Year 2011-12.

Due to negotiated reductions in employee salaries and benefits, combined with the review of personnel allocated to the Golf Fund, expenditures have been reduced to a point in which the Golf Fund is able to begin to plan for capital purchases and expenditures. Included in the Fiscal Year 2011-12 budget are requests for three pieces of equipment that are critical to improve staff efficiences at the golf course.

While the financial position of the Golf Fund is improving, the General Fund continues to assist in the operations of the Golf Fund in two specific ways:

1. General administrative and overhead charges were suspended beginning in Fiscal Year 2007-08. This recommendation is continued for Fiscal Year 2011-12. As staff reviews the cost allocation plan in conjunction with the Fiscal Year 2012-13 budget, this recommendation will be reviewed.
2. In the past, the City Council has approved a contribution from the General Fund equal to the recreational benefit the Golf Course provides to the citizens of Manteca. The 2011-12 preliminary budget includes a proposed contribution of $155,000.

Areas of Consideration/Future Concerns

As a result of the collaborative efforts of Council, administration and employee bargaining units to control operating and personnel expenditures, the prognosis for the fiscal stability of the City is improving. Full recovery will be dependent on the City's ability to continue to contain expenditures, meet service level requirements and broaden our revenue base.

Complicating the City's ability to fully plan for the future are unknown impacts from the State.

Effective July 1, 2011, the Vehicle License Fee (VLF) was eliminated per SB89. For the City of Manteca, this totals a reduction to General Fund revenues of $250,000. The League of California Cities has challenged this action in court as a Constitutional violation. Litigation is still pending. In the interim, the City will not receive any VLF revenue.

Additionally, on June 30, 2011, AB X1 26 and AB X1 27 were passed by the State Legislature. Action was filed in the State Supreme Court by the League of California Cities and the California Redevelopment Association challenging the constitutional validity of the assembly bills. On December 29, 2011, the Supreme Court found that AB X1 27 was unconstitutional; however, it upheld the State's position on AB X1 26. As a result, effective February 1, 2012, all Redevelopment Agencies in the State of California have been eliminated. Information regarding the proposed Redevelopment Agency Budget for Fiscal Year 2011-12 has been included to ensure compliance with disclosure requirements regarding debt service requirements. The City of Manteca has elected to be the Successor Agency to the Manteca Redevelopment Agency and will oversee the unwinding of the Redevelopment Agency over the next several years. Staff will be fully evaluating the impact of the elimination of the Redevelopment Agency on the General Fund, including the Development Services Fund, as part of the Fiscal Year 2012-13 budget process.

In November 2010, California voters passed Proposition 22 – the Local Taxpayer, Public Safety and Transportation Act of 2010 – drafted to prevent the State from further taking, diverting or borrowing local government, transportation and public transit funds. It is our hope that through Proposition 22, no further reductions in City revenues will be realized through subventions of the State.

Conclusion

While the past 12 months have been challenging for the City, staff has continued to maintain service levels and meet Council goals and priorities, including:

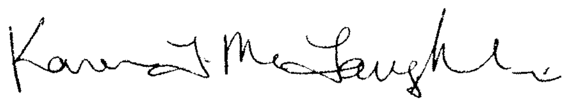
- On September 26, 2011, the Library Park Expansion was dedicated.
- Construction of a new Animal Control Facility was completed, and construction has begun on a new Vehicle Maintenance Shop.
- Plans have been approved for a new Multimodal Station, with an anticipated groundbreaking in June 2012.
- Staff continues to meet with the development community to review public infrastructure fees necessary to support future commercial, industrial and residential growth in our community.

In spite of the declines in the real estate market in our region, construction continues at the Woodbridge (Pulte Homes), Tesoro, Dutra Estates and Union Ranch East subdivisions. Manteca continues to lead the Valley in residential permits pulled. A total of 360 residential permits have been issued over the past 12 months.

During the next fiscal year, through enhanced economic development, staff will work to identify additional opportunities to both stabilize and expand our employment base. Meetings with our top employers will be conducted so we can ensure we are meeting their needs, and to develop successful partnerships between the business community and the City.

Measures have been adopted to lay the foundation for fiscal stability. Staff has developed a budget that strikes a balance of maintaining service levels within the limits of available resources, and continues to fund new projects to allow for future development and enhanced community amenities, while protecting our citizens from an uncertain financial outlook.

In preparing the Preliminary Budget, we have made our best efforts to balance these competing but equally important goals. Staff wishes to thank the Council for your leadership and support throughout the past year.



Karen L. McLaughlin

City Manager

Acknowledgements

Developing the Preliminary Budget is a team effort, involving the time and talents of City employees, department managers, citizen's advisory groups and staff members from the Finance Department. This year, the extended budget development was interwoven with the ongoing demands of day-to-day operations.

Without the dedication of these City staff members, this budget would not have been possible. With Council's continued support of long-term planning and willingness to provide leadership in difficult circumstances, together we can develop a plan for the long-term financial stability of our City.