Agenda Item #4.1
For Council Meeting of: October 22, 2024

CITY OF SANTA ROSA
CITY COUNCIL

TO: MAYOR AND CITY COUNCIL
FROM: ALAN ALTON, CHIEF FINANCIAL OFFICER, FINANCE DEPARTMENT
SUBJECT: GENERAL FUND BUDGET REDUCTIONS

AGENDA ACTION: NO ACTION REQUIRED

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## RECOMMENDATION

It is recommended by the Finance Department that the Council hold a Study Session regarding budget reductions in the General Fund. This item is presented for the Council's information and no action is required except for possible direction to staff.

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## EXECUTIVE SUMMARY

This Study Session will provide the City Council with an update of the condition of the General Fund and present reductions, both ongoing and one-time, to the budget that have been identified that could become effective in the current fiscal year.

## BACKGROUND

The City's General Fund structural deficit is a result of several factors building up over a number of years. These factors include increased staffing, increased cost of labor and supplies, new service levels in the community and slowing growth in key revenue areas, primarily sales tax.

The Fiscal Year (FY) 2021-22 budget was initially approved with a General Fund deficit of $11.01 million. Like many agencies, the City experienced unanticipated revenue growth and higher vacancy rates during the pandemic, turning the projected deficit into a surplus. As a result, a mid-year adjustment in FY 2021-222 increased revenues by $9.5 million and offsetting expenditures by $8.2 million as follows:

Revenue Adjustments:

$6,000,000 – Increased Sales Tax
$1,500,000 – Increased Property Tax
$2,000,000 – Increased Real Property Transfer Tax (RPTT)

Expenditure Adjustments:

$7,500,000 – Labor Agreements
$150,000 – Staffing Changes
$500,000 – Public Safety Building Boiler Line Replacement
$1,550,000 – Fire Department Overtime

In FY 2022-23 the budget was passed with a balanced budget for the first time in nearly a decade. The City began to see revenue growth ease as volatility from the pandemic slowed and costs rose with inflation. In addition, inflation in healthcare and other benefits have contributed to the rising costs of staffing. The balanced budget for FY 2022-23 was short lived, and the FY 2023-24 was presented to City Council with a $2.5M deficit and adopted with a $3.3M deficit through adding additional positions at adoption.

In August of 2023, the City Manager and Chief Financial Officer informed the City Council that the General Fund was unstable, with a widening structural deficit.
The future financial impacts from expiring labor agreements were unknown, but fiscal stability funds would provide a brief window to address expenditure reductions and research potential revenue enhancements.

FY 2024-25 was adopted with a $13.3 million deficit and included increases for anticipated and ratified new labor agreements.

The General Fund's largest revenue source is Sales Tax, which has begun to decline from the high trend of pandemic spending. Sales Tax revenue may re-gain positive growth in the coming years but is projected to be modest. The following chart provides the previous 5 years of sales tax budgeting versus actual amounts received by the City. Fiscal Year 2024/25 sales tax budget was held flat against the prior year to account for slowed growth.

| Fiscal Year | Budget | Actuals | Variance (under) |
|---|---|---|---|
| FY 2020/21 | $ 54,298,000 | $ 65,523,210 | $ 11,225,210 |
| FY 2021/22 | $ 68,520,200 | $ 71,236,599 | $ 2,716,399 |
| FY 2022/23 | $ 74,745,226 | $ 73,294,983 | $ (1,450,243) |
| FY 2023/24 | $ 75,866,735 | $ 70,071,011 | $ (5,795,724) |
| FY 2024/25 | $ 75,866,735 | NA | NA |

The City uses a Long-Range Financial Forecast (LRFF) that forecasts General Fund revenues and expenditures for a five-year period. Staff has reported on the structural deficit during City Council budget presentations and illustrated the condition of the budget with the LRFF.

General Fund 5-Year Forecast Presented at FY 2024-25 Adoption 6/18/2024:

| | FY 24-25 | FY 25-26 | FY 26-27 | FY 27-28 | FY 28-29 |
|---|---|---|---|---|---|
| Revenues | $213.0 | $218.1 | $224.8 | $230.0 | $235.0 |
| Transfers In | 2.3 | 2.3 | 2.3 | 2.3 | 2.3 |
| **Total Revenues & TI** | **$215.3** | **$220.4** | **$227.1** | **$232.3** | **$237.3** |
| Expenditures | 220.2 | 227.0 | 238.5 | 252.3 | 263.8 |
| Transfers Out | 8.4 | 9.8 | 13.2 | 10.3 | 9.8 |
| **Total Expenditures & TO** | **$228.6** | **$236.8** | **$251.7** | **$262.6** | **$273.7** |
| **Budgeted Deficit** | **($13.3)** | **($16.4)** | **($24.6)** | **($30.3)** | **($36.4)** |

General Fund 5-Year Forecast Presented at FY 2023-24 Adoption 6/20/2023:

| | FY 23-24 Budget | FY 24-25 | FY 25-26 | FY 26-27 | FY 27-28 |
|---|---|---|---|---|---|
| Revenues | $201.9 | $206.4 | $211.3 | $216.8 | $222.4 |
| Transfers In | 2.9 | 2.4 | 2.4 | 2.5 | 2.5 |
| **Total Revenues & TI** | **$204.8** | **$208.8** | **$213.7** | **$219.3** | **$224.9** |
| Expenditures | 200.9 | 206.6 | 212.2 | 218.8 | 226.1 |
| Transfers Out | 6.4 | 7.7 | 9.1 | 9.3 | 9.5 |
| **Total Expenditures & TO** | **$207.3** | **$214.3** | **$221.4** | **$228.1** | **$235.6** |
| **Surplus (Deficit)** | **($2.5)** | **($5.5)** | **($7.6)** | **($8.8)** | **($10.7)** |

Balancing the General Fund will require both increases in new, ongoing revenue and reductions in ongoing expenditures. In August, the City Council approved placing two revenue measures on the November 2024 ballot to increase to the City's Transient Occupancy Tax and make changes to the City's General Business Tax ordinance. These measures, should they be approved by voters, will produce between $4 million and $5 million of new General Fund revenue, which does not completely address the budget deficit.

## PRIOR CITY COUNCIL REVIEW

None.

## ANALYSIS

Staff will undertake a phased approach to reducing the General Fund budget. The initial phase is to identify cuts that could be made in the current fiscal year, including both ongoing and one-time cuts. This includes identifying vacant positions that could be cut, reductions in operating budgets, and returning project funding to the General Fund. These cuts will boost General Fund reserves through one-time cuts and reduce the operating deficit through ongoing reductions. The second phase will be focused on ongoing deficit reduction measures as part of budget development for FY 2025-26 and FY 2026-27.

Amid the complexities of our current fiscal environment, we are adopting a targeted approach to manage our budget responsibly. Our strategy involves focusing on three primary areas for potential reductions: administrative, operational, and programmatic functions. The intention is to optimize resources thoughtfully while ensuring that our community's essential services remain intact, albeit with some necessary adjustments.

Our first area of focus is administrative cuts, which aim at reducing overhead and streamlining the administrative functions within each city department. This includes minimizing expenditures associated with management planning and support services. Measures currently under review include reducing travel and training costs, exploring salary adjustments and furloughs, and implementing strategic staff reductions where feasible. Additionally, we are conducting comprehensive assessments of administrative support roles to identify opportunities for efficiency improvements and potential restructuring.

In the domain of operational cuts, our objective is to enhance the efficiency of daily services while curtailing overhead. Strategies being explored involve reducing fleet size, which will help lower operation and maintenance costs, and renegotiating service contracts to gain more favorable savings. We are also incorporating lean management techniques to streamline our processes further. Residents should be prepared for some changes in service levels, including possible delays in customer service, reduced hours of operation, and a decrease in service availability. These adjustments are devised to secure long-term savings while maintaining the quality and reliability that our community expects.

Finally, our approach to programmatic reductions requires us to evaluate the potential elimination of specific services. This involves making tough decisions that ensure fiscal sustainability while minimizing the impact on our community. Although some services may alter or discontinue, we are committed to prioritizing core services that our residents depend upon, maintaining a balance that reflects both our budgetary constraints and our service commitment.

We are dedicated to navigating these changes with transparency and diligence and will continue to engage with stakeholders to inform decision-making processes.

**City-Wide Staffing**
In light of our ongoing budget constraints, it is crucial for us to critically evaluate staffing levels, particularly given that staffing expenses comprise a significant 76.3% of our total General Fund budget. The police and fire departments alone account for 57.8% of our overall personnel cost from this fund, highlighting the substantial financial commitment we have toward maintaining these essential services.

Acknowledging these figures necessitates a thorough assessment of staffing sustainability. To facilitate a deeper understanding of this dynamic, we have included an attached chart illustrating the notable increase in personnel costs over the past five years. This data highlights the trajectory of our financial obligations and underscores the necessity for strategic review.

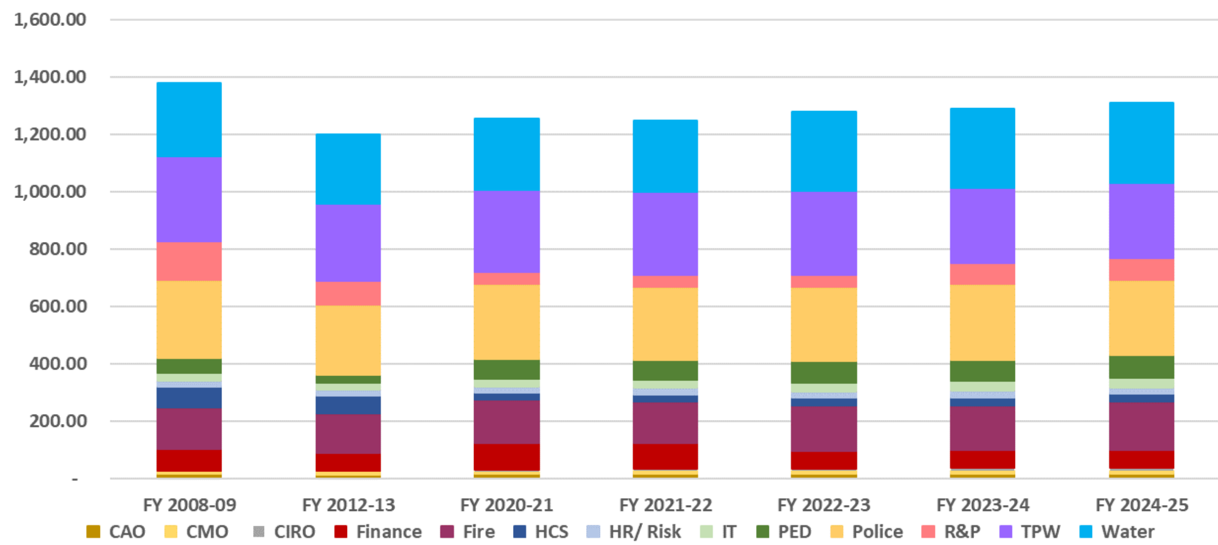
Moreover, our administration is actively conducting a comprehensive review to pinpoint roles that have been added during this period. The objective of this analysis is to offer invaluable insights that will guide our strategic decisions, ensuring that we can optimize staffing structures in alignment with our fiscal realities.

Our goal is to evaluate possible adjustments without compromising the quality of essential services our community relies on. This includes scrutinizing potential areas for staff reduction and considering how we might restructure roles to maintain efficiency and service standards.

The following charts provides historical employee counts across all funds, included are a high point of 1,376.90 employees in FY 2008-09 and a low of 1,197.90 employees in FY 2012-13.

| DEPARTMENT | FY 2008-09 | FY 2012-13 | FY 2021-22 | FY 2022-23 | FY 2023-24 | FY 2024-25 |
|---|---|---|---|---|---|---|
| City Attorney | 15.80 | 12.90 | 15.90 | 15.90 | 15.90 | 15.90 |
| City Manager | 12.00 | 12.00 | 9.00 | 11.00 | 11.00 | 11.00 |
| Communications & Intergovernmental Relations * | - | - | 7.00 | 7.00 | 9.00 | 9.00 |
| Finance | 75.35 | 63.85 | 89.60 | 62.60 | 62.60 | 62.60 |
| Fire | 143.75 | 137.75 | 148.00 | 157.00 | 157.00 | 169.00 |
| Housing & Community Services | 74.00 | 63.50 | 24.00 | 27.00 | 27.00 | 27.00 |
| Human Resources | 20.40 | 17.70 | 21.00 | 22.00 | 23.00 | 23.00 |
| Information Technology | 28.00 | 24.00 | 30.00 | 31.00 | 33.00 | 33.00 |
| Planning & Economic Development | 49.20 | 27.80 | 68.00 | 74.00 | 74.00 | 78.50 |
| Police | 274.75 | 246.75 | 256.00 | 259.00 | 264.00 | 264.00 |
| Recreation & Parks | 132.60 | 82.65 | 42.00 | 44.00 | 74.00 | 76.15 |
| Transportation & Public Works | 298.05 | 268.00 | 288.00 | 292.00 | 261.00 | 261.00 |
| Water | 253.00 | 241.00 | 248.50 | 276.00 | 278.00 | 278.00 |
| **Total FTE Positions** | **1,376.90** | **1,197.90** | **1,247.00** | **1,278.50** | **1,289.50** | **1,308.15** |

The following stacked bar chart graphically represents the pre-Great Recession staffing, the post-Great Recession staffing for context, and a look back on the last five years of staffing.




**Budget Reductions**
General Fund departments reviewed their operations and identified approximately $3.2 million of ongoing reductions that could be made in the current fiscal year. These cuts included vacant positions and reductions in contracts and other operating expenses. In addition, departments identified another $1 million of vacancy reductions and $1.9 million of operational costs to be reduced as part of the FY 2025-26 budget.

Staff also reviewed projects funding with PG&E settlement funds that have not been spent. These project balances were reviewed with departments and based on that review identified $9.4 million of one-time funding that could be returned to the General Fund reserves.

Staff is evaluating other options to balance the budget, including:

**Modified Zero Based Budgeting (ZBB).** Staff has met with outside consultants to assist the City with pursuing a form of ZBB. In its most simplistic form, ZBB requires an organization to build a new budget, aimed at basic services, from the ground up. In doing so, efficiencies may surface, and unneeded appropriations can be discontinued. In the development of the FY 2025-26 Budget, the City is exploring a modified technique of ZBB to guide departments in budget development. By disregarding the previous year’s budget or benchmarks as a starting point, departments will take a more creative approach to budgeting for operational needs and resources, hopefully resulting in a leaner and less costly annual request.

**Elimination of the General Fund Pension Stabilization Fund.** Sunsetting the Pension 115 Trust offers several advantages for managing a city's pension obligations. When faced with a such a large deficit, sunsetting a Pension 115 Trust, can be justified along with a combination of strategic financial management and the need to prioritize immediate fiscal stability. There is currently approximately $12 million in the General Fund 115 Trust. These funds could be used as a one-time funding tool to make the City's next payment of unfunded liability due to CalPERS which would provide equal budgetary savings. This strategy would eliminate the Pension Stabilization Fund going forward until the City could reach organizational stability and be reinstituted in the future.

**CalPERS Early Retirement.** An early retirement program would grant an eligible employee additional years of service towards their pension with CalPERS. The City has begun requesting necessary information from CalPERS to begin an analysis. An actuary study will need to be performed by CalPERS that shows savings for the City to be eligible and potential position restrictions going forwards would need to be understood.

**General Fund Fleet Reduction.** Fleet reductions will focus on gaining efficiencies across the City's vehicles including reduction of units, consolidation of uses and less expensive vehicle classes, these reductions will need to consider electrification requirements.

An important aspect of this initiative is our commitment to sustainability. As we evaluate ways to optimize our fleet, we must also account for electrification requirements, which involve transitioning to electric vehicles (EVs) in line with environmental goals and regulations. Integrating EVs not only supports our climate objectives but also offers long-term cost efficiencies in terms of fuel and maintenance.

Through careful analysis and strategic planning, we aim to implement these fleet reductions without compromising the essential services that our vehicles support.

## FISCAL IMPACT

There is no action taken at a study session, so this item does not create a fiscal impact for the General Fund.

## ENVIRONMENTAL IMPACT

This action is exempt from the provisions of the California Environmental Quality Act (CEQA) under CEQA Guidelines Section 15306 Informational Collection. Section 15306 consists of basic data collection, research, experimental management, and resource evaluation activities which do not result in a serious or major disturbance to an environmental resource. These may be strictly for information gathering purposes, or as part of a study leading to an action which a public agency has not yet approved, adopted, or funded.

## BOARD/COMMISSION/COMMITTEE REVIEW AND RECOMMENDATIONS

The Long-Term Financial Policy and Audit Subcommittee reviewed this issue as an information item at its regular meeting on October 10, 2022.

## NOTIFICATION

Not applicable.

## ATTACHMENTS

None.

## PRESENTER

Alan Alton, Chief Financial Officer