City of Santa Rosa
Update of
Long-Range Financial Forecast

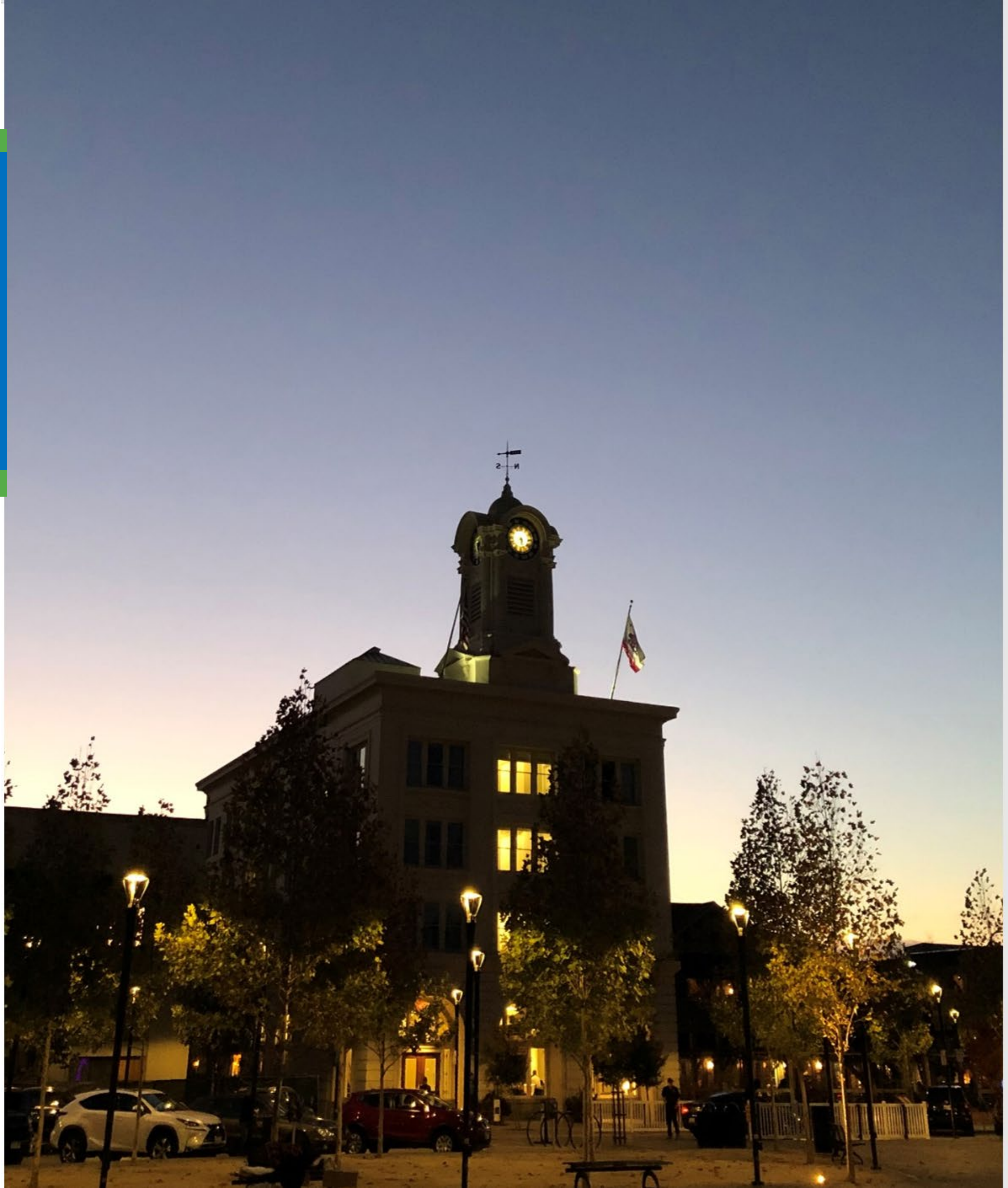
Presentation to Council Subcommittee on Long-Term Financial Policy and Audit

Andy Belknap, Senior Vice President
Bob Leland, Special Advisor

March 11, 2021

Management Partners

City of Santa Rosa



About Management Partners

26+ years — of service exclusively to local governments

Over **1,700** projects — successfully completed in 42 states

100+ associates — including generalists and subject-matter experts

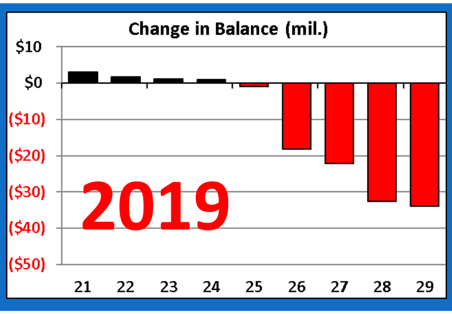
3 national offices — in Costa Mesa and San Jose, CA and Cincinnati, OH

Served **90%** — of California cities with more than 100,000 people (53 of 59)

Our Services

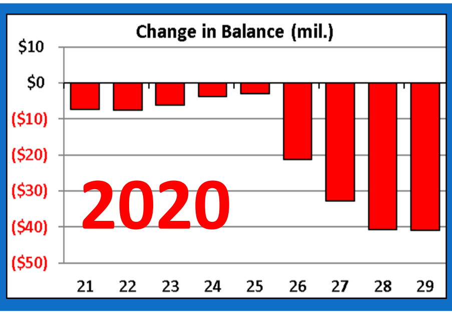
- Fiscal Planning & Budgeting
- Operations Improvement
- Strategic Planning
- Service Sharing
- Organization Analysis
- Organization Development
- Performance Management
- Process Improvement
- Facilitation and Training
- Executive Recruitment
- Executive Coaching

Project History



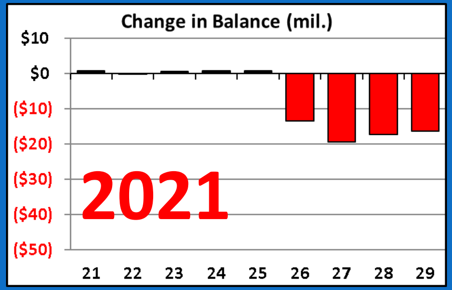
Created a long-range forecast model in Sep 2019

- Emphasis on rebuilding impacts, pension costs
- Model completed in Dec 2019



Fiscal model update for Covid-19

- Added pandemic revenue impacts in Apr 2020
- Budget strategies presented to Council in Sep 2020

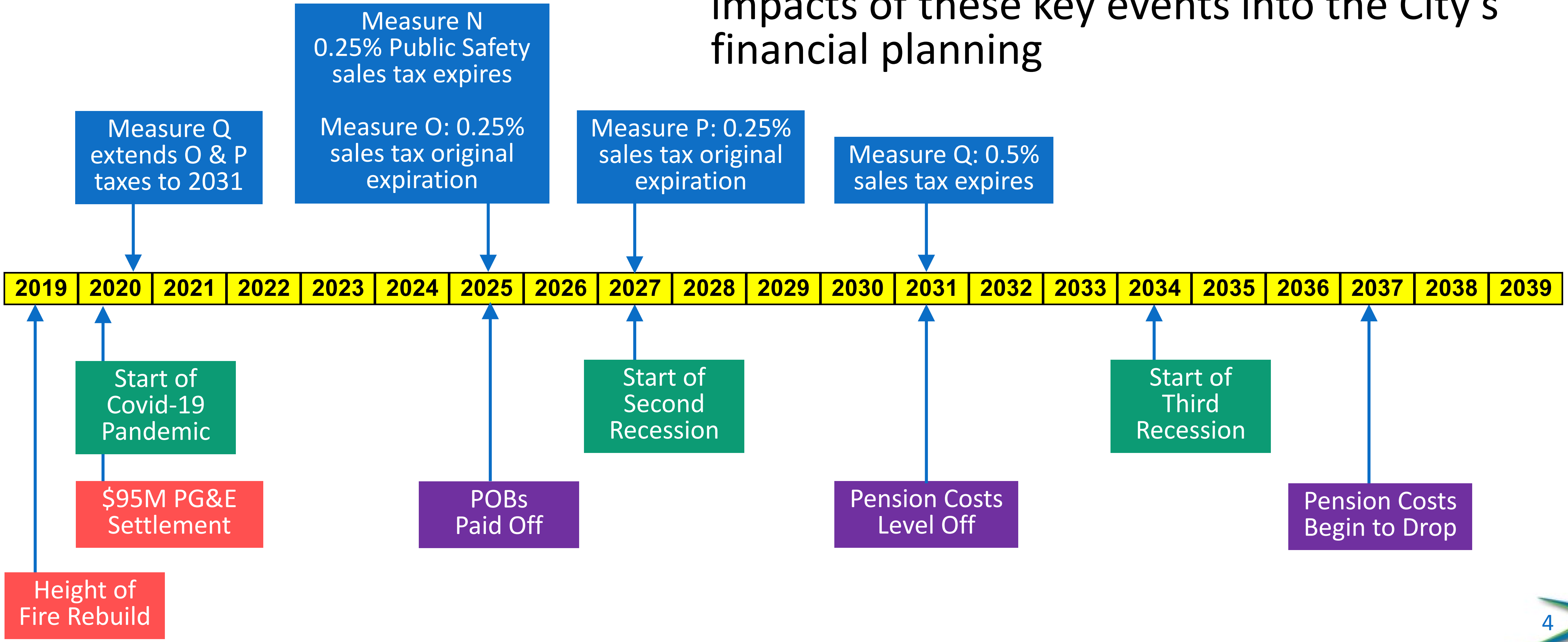


Fiscal model update in Feb 2021

- Revised pandemic revenue impacts
- Provides context for FY 2022 budget process
- Alternative scenarios for balanced long-term forecast

Timeline of Major Fiscal Events

- Long-term forecast is needed to incorporate impacts of these key events into the City’s financial planning



Updated Baseline Forecast

Key Revenue Assumptions & Rationale

Economic Cycles

- **Pandemic recovery moved up from FY25 to FY24**
  - Sales Tax stronger per Avenu's 3Q20 forecast
  - TOT, rec/park fees slower to recover
- **Future moderate recessions starting in FY27 and FY34**
  - Historically recessions occur every 6-7 years
  - Including in forecast provides "stress test" for sustainability of reserves

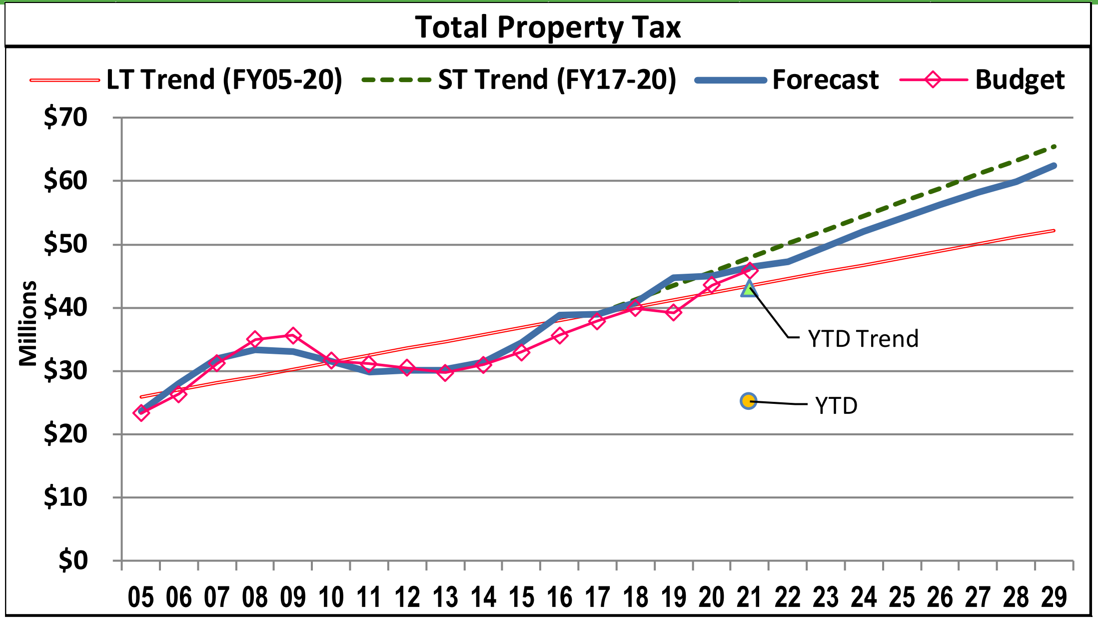
Local Sales Taxes

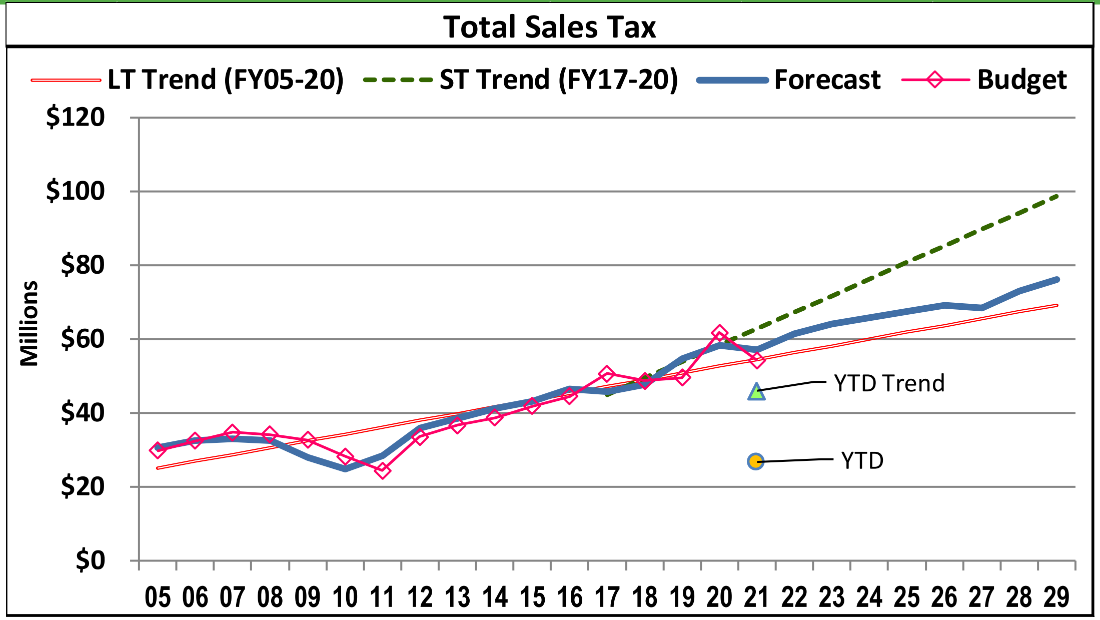
- **Measure N (0.25% public safety tax) expires in 2025, GF to backfill revenue loss**
  - Current measure sunsets without a 2/3rds vote to extend the tax
  - Public safety positions are a high priority service which will place pressure on GF to replace lost revenue if tax expires
- **Measure Q (0.5% general sales tax) expires 2031**
  - Current measure sunsets in 2031 without a majority vote to extend

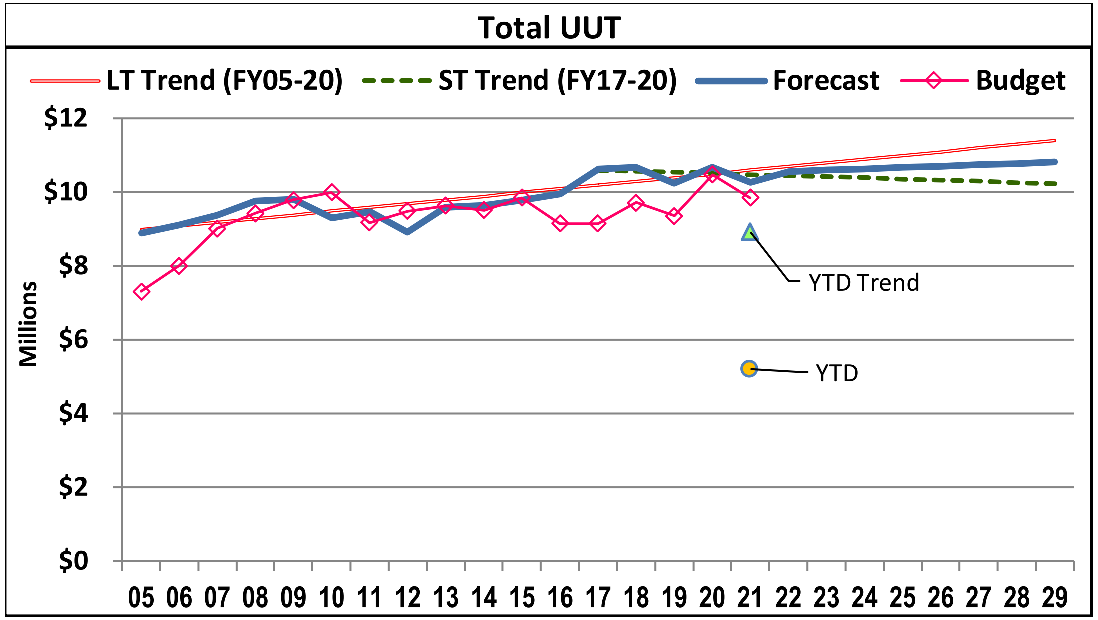
One-Time Funding

- **PG&E settlement is excluded**
  - Best practice is to use for one-time, not ongoing expenses; however, Council has discussed using $40M to support operations, which buys time to restructure expenses
- **ARPA federal aid is excluded**
  - Legislation pending; only include in forecast if augmenting reserves, not with new spending
- **FEMA reimbursements (beyond estimated FY21) are excluded**
  - Staff is preparing a schedule of potential reimbursements over the next few years; it can take years to settle disputes over eligible amounts

Largest GF Revenues are Relatively Stable



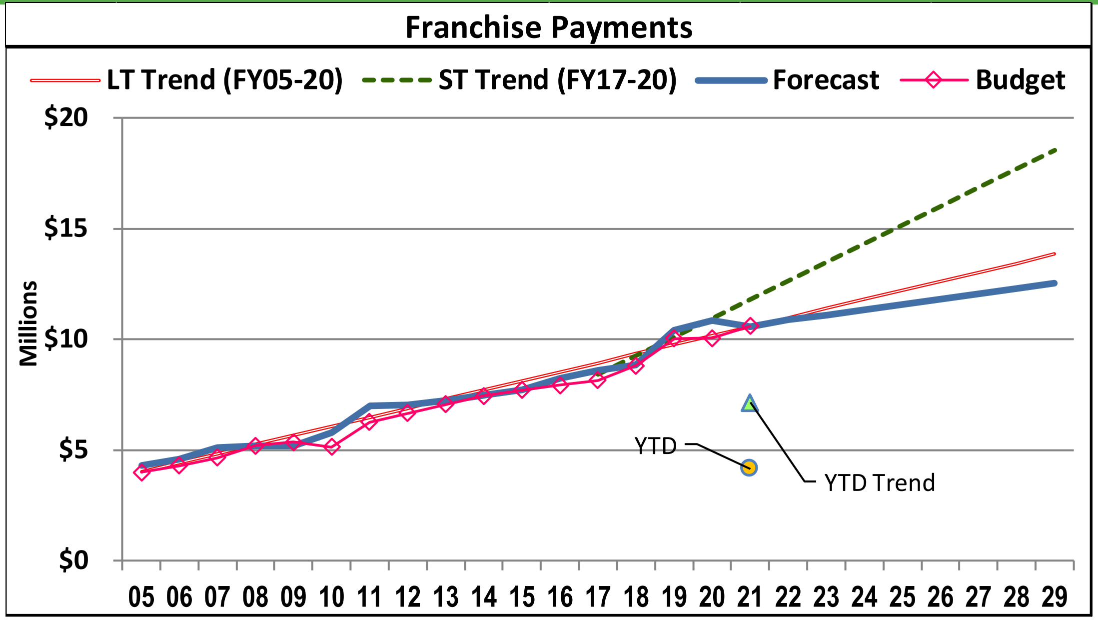


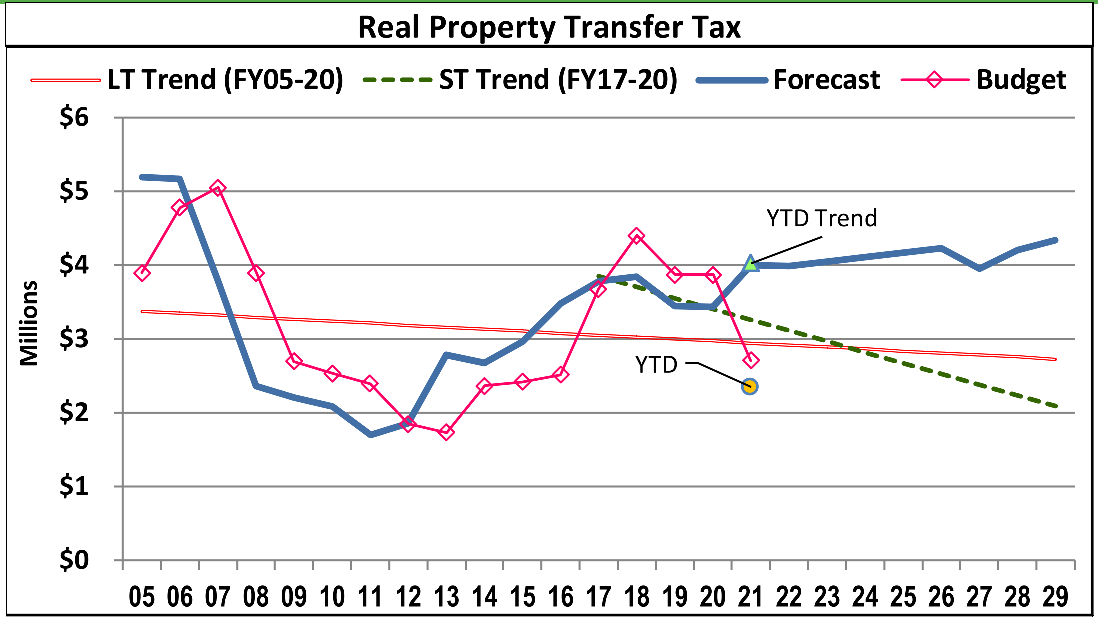


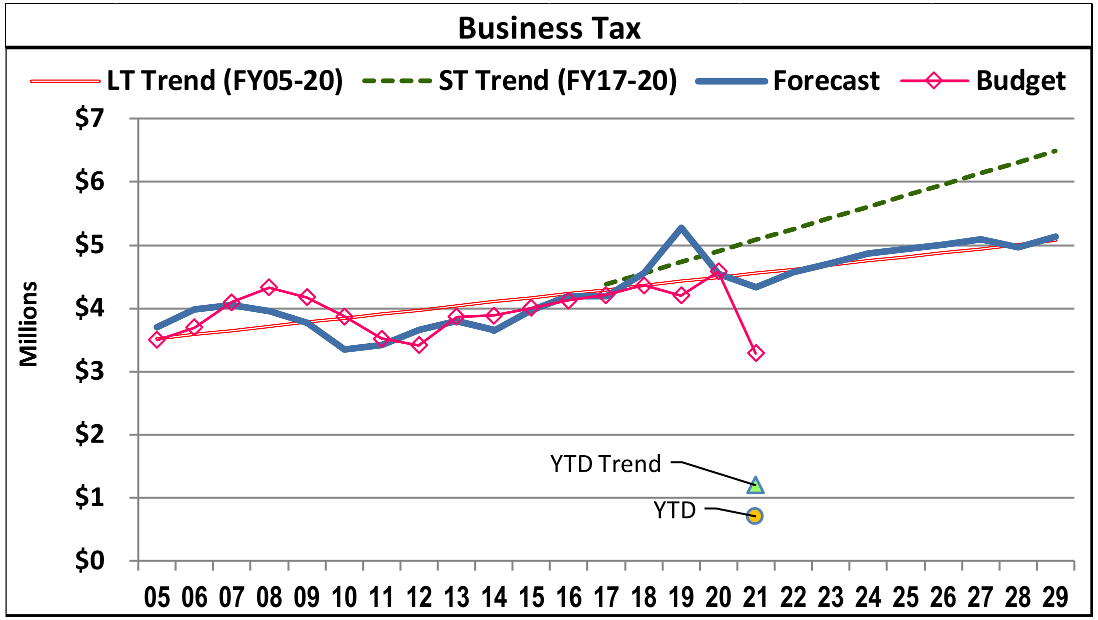
- Property tax has 1.036% inflator in FY22 (2% thereafter),; home sale prices are strong; assumes all rebuilds by 2025 and 500 new units/year ongoing; follows short-term trend
- Sales taxes recovering more quickly than original estimates; uses Avenu 3Q20 forecast; follows long-term trend
- UUT growth splits long-term and short-term trends

Note that uneven cash flow means YTD Trend not always indicative of final amount for FY21

Other Taxes Have Varying Impacts



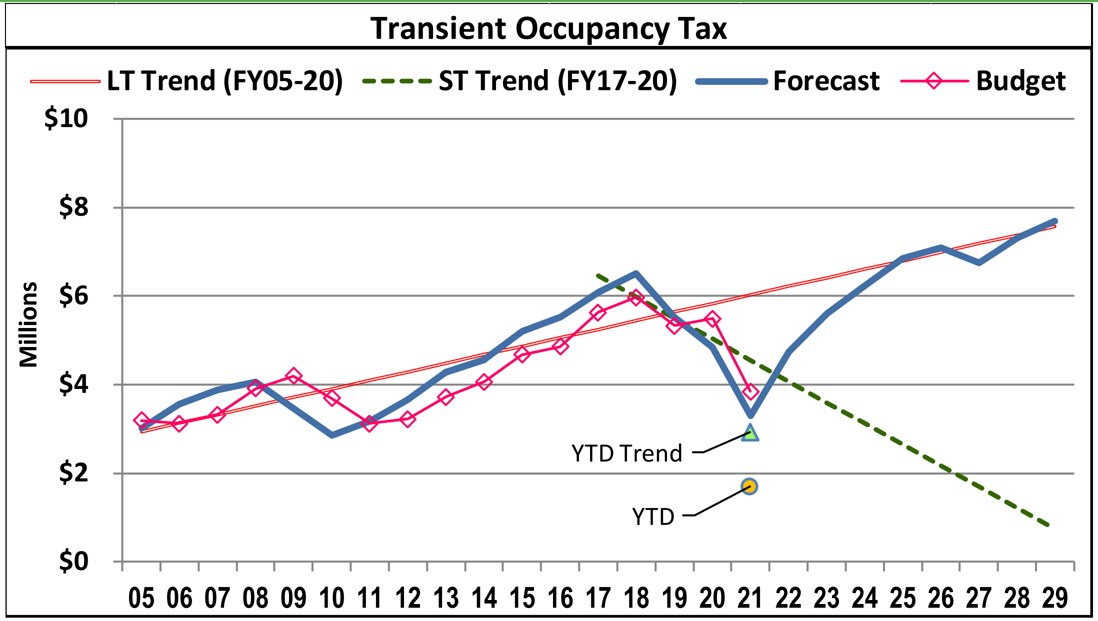


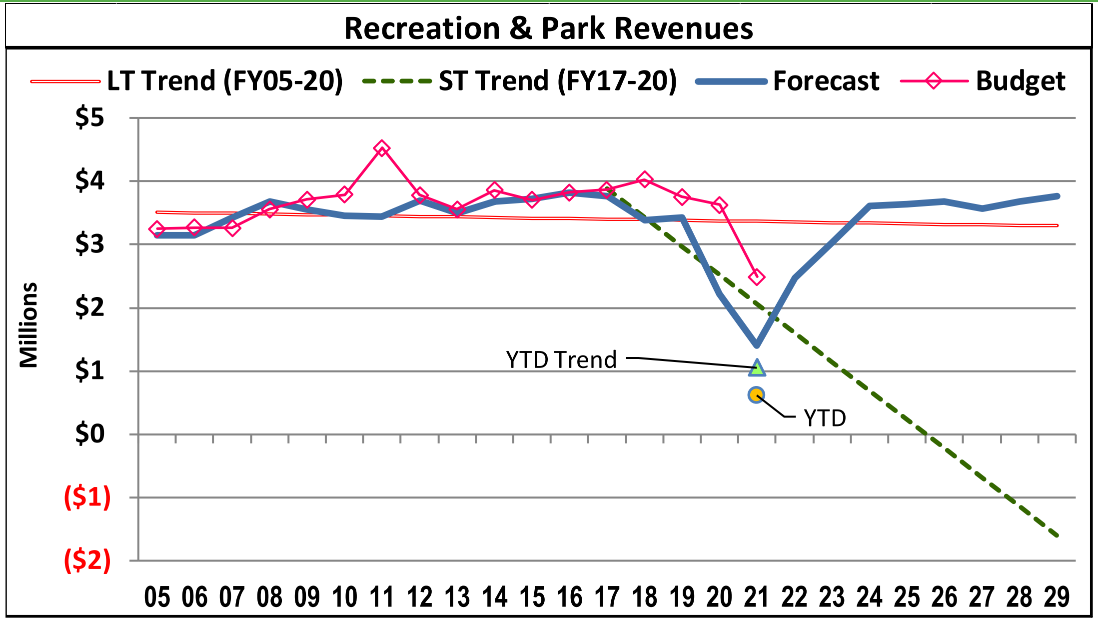


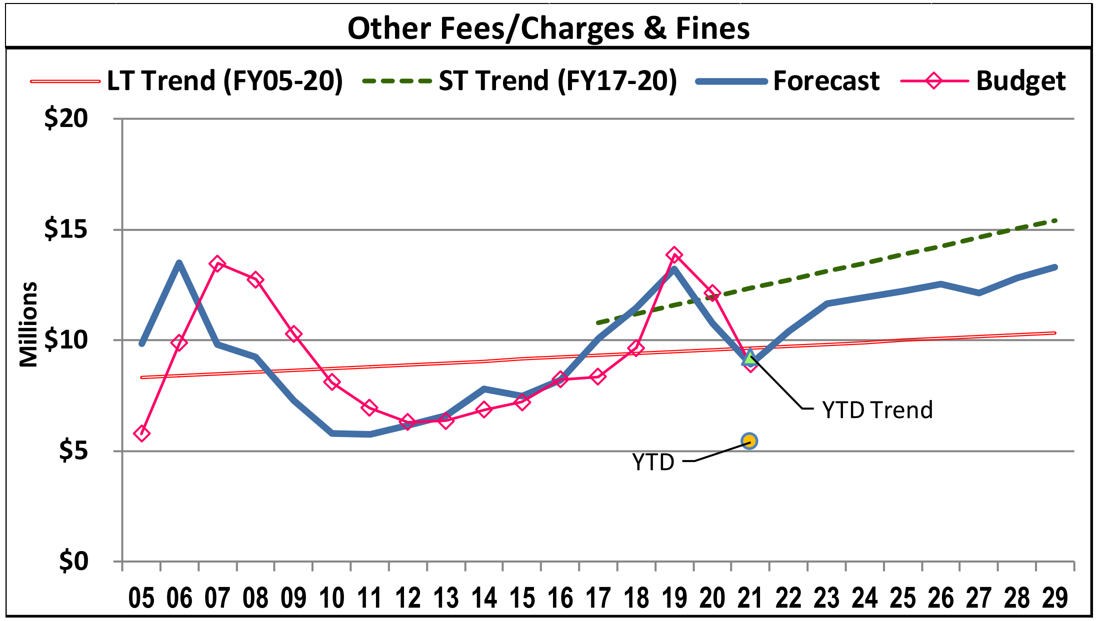
- Franchise payments have been historically stable; generally follows long-term trend
- RPTT is prone to volatility, but growing home sale prices have boosted FY21 revenues well over budget
- Business tax estimate anticipated lower FY21 revenues; forecast follows HdL projections for FY21 and FY22, then follows long-term trend

Note that uneven cash flow means YTD Trend not always indicative of final amount for FY21

Revenues Most Severely Impacted by Pandemic



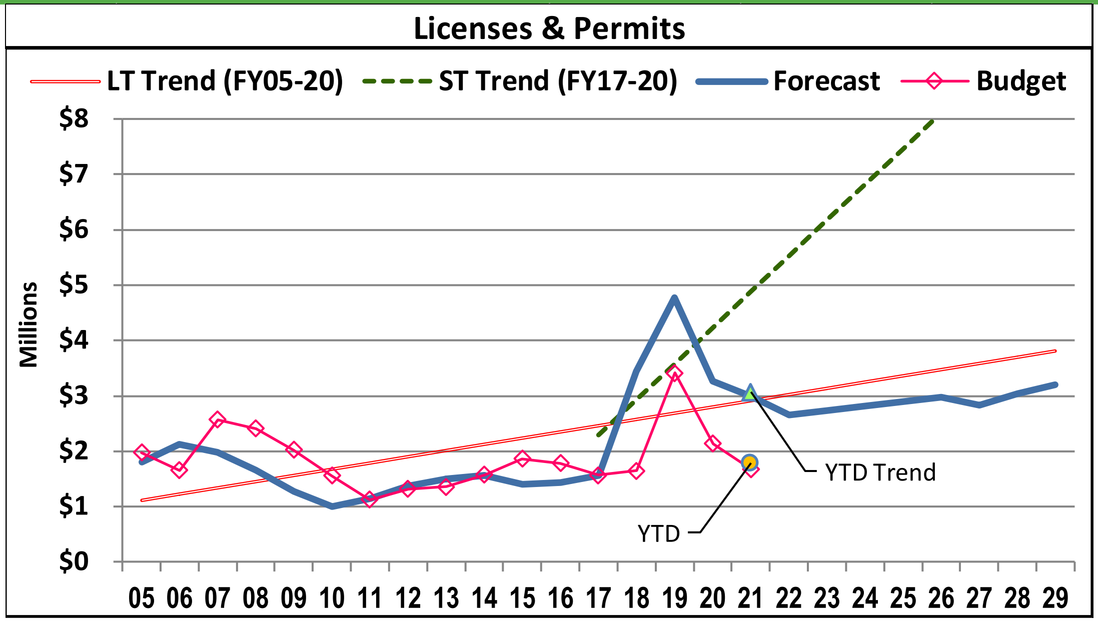


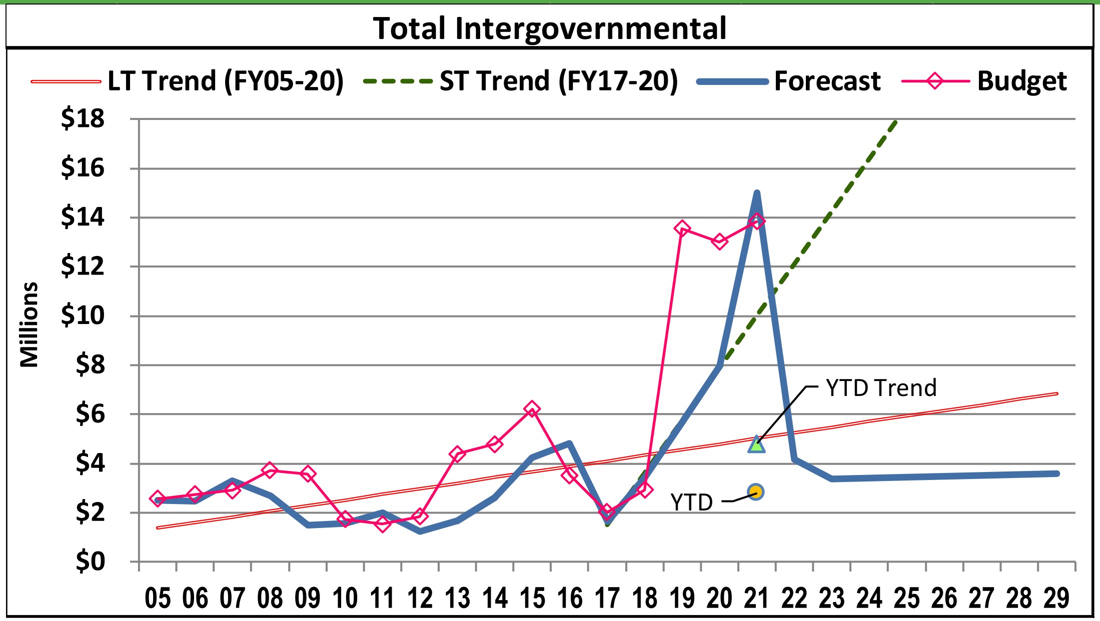


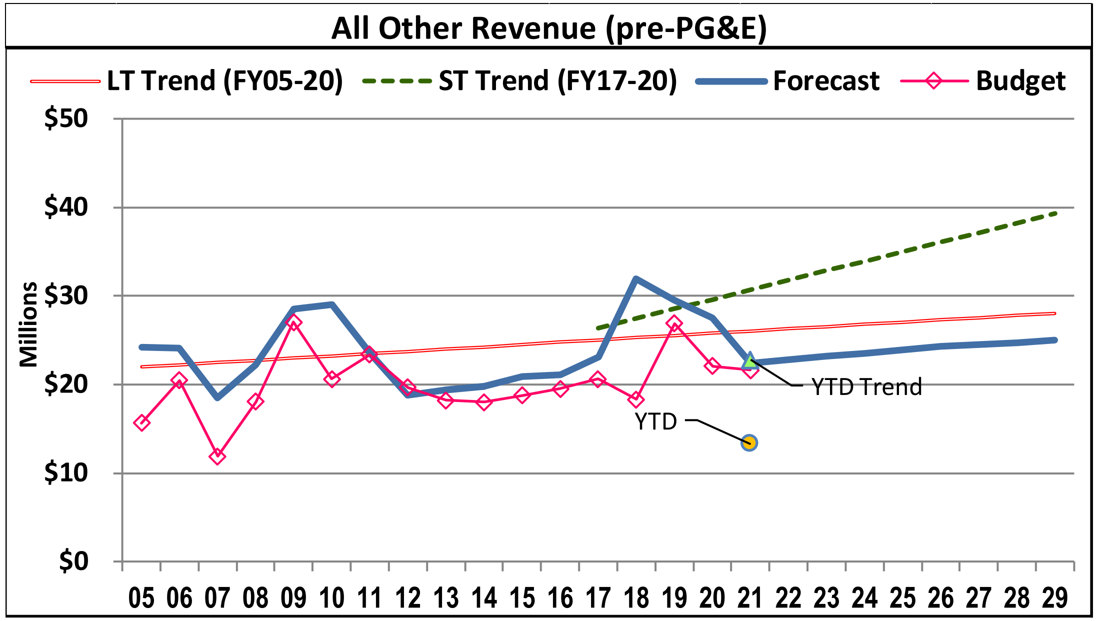
- TOT plunged in FY20 & FY21 due to pandemic impacts on travel, leisure and hospitality industries; recovery projected by FY25
- Rec & Park fees hurt by social distancing and event size limits; assumes recovery by FY24
- Other fees affected by lower activity levels in general, but still near long-term trend in FY21; assumes recovery by FY23

Note that uneven cash flow means YTD Trend not always indicative of final amount for FY21

Remaining Revenues Lower Than Recent Peaks







- Licenses & Permits peak in FY19 is from height of rebuild permits; forecast is nearer long-term trend
- Intergovernmental peaks in FY20-FY21 due to CARES Act and FEMA reimbursements; does not include potential new federal aid
- All Other Revenue peaks in FY18-FY19 due to insurance reimbursements and in FY09-FY10 from transfers in; does not include PG&E settlement

Note that uneven cash flow means YTD Trend not always indicative of final amount for FY21

Key Expense Assumptions & Rationale

Sustainability

- **Positions frozen for 5 years, restored starting FY26**
  - Uncertainty over Measure N requires City to conserve fund balance to better position itself for potential loss of these funds
- **Add 2 FTE/year starting FY23**
  - Population/workload growth will create pressure to unfreeze positions and/or add new positions over time; responds to this need in graduated fashion
- **$4M CIP transfer eff. FY22**
  - Ongoing needs for preventative maintenance and other projects; average of last 15 years

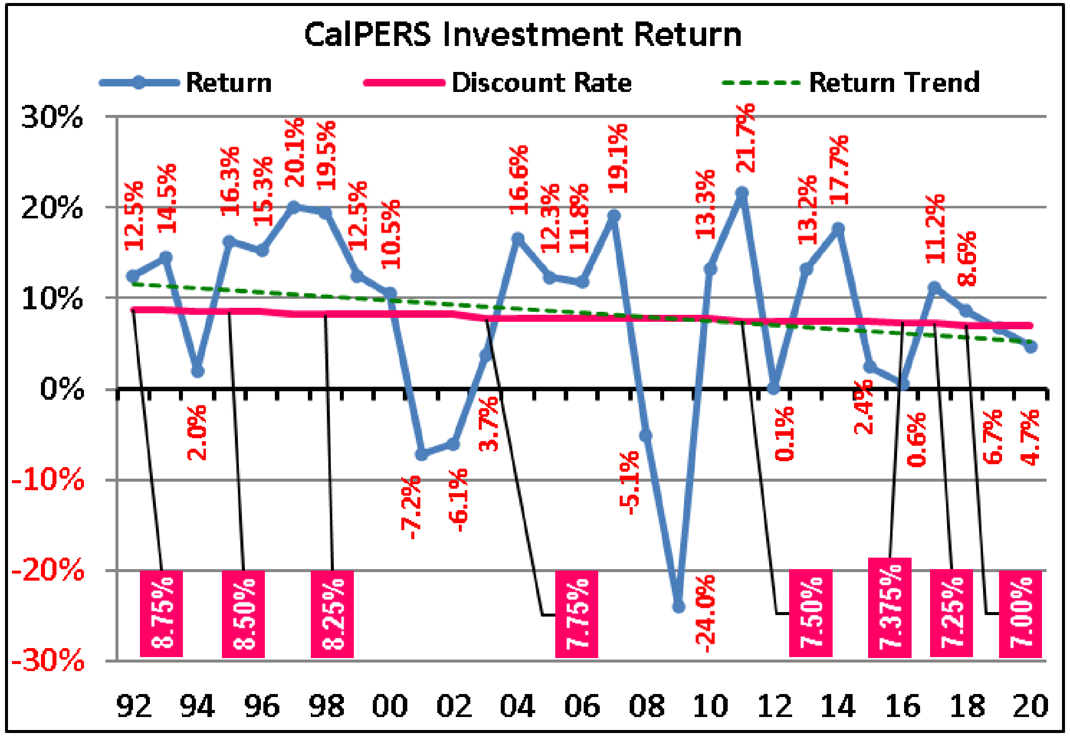
Cost Inflation

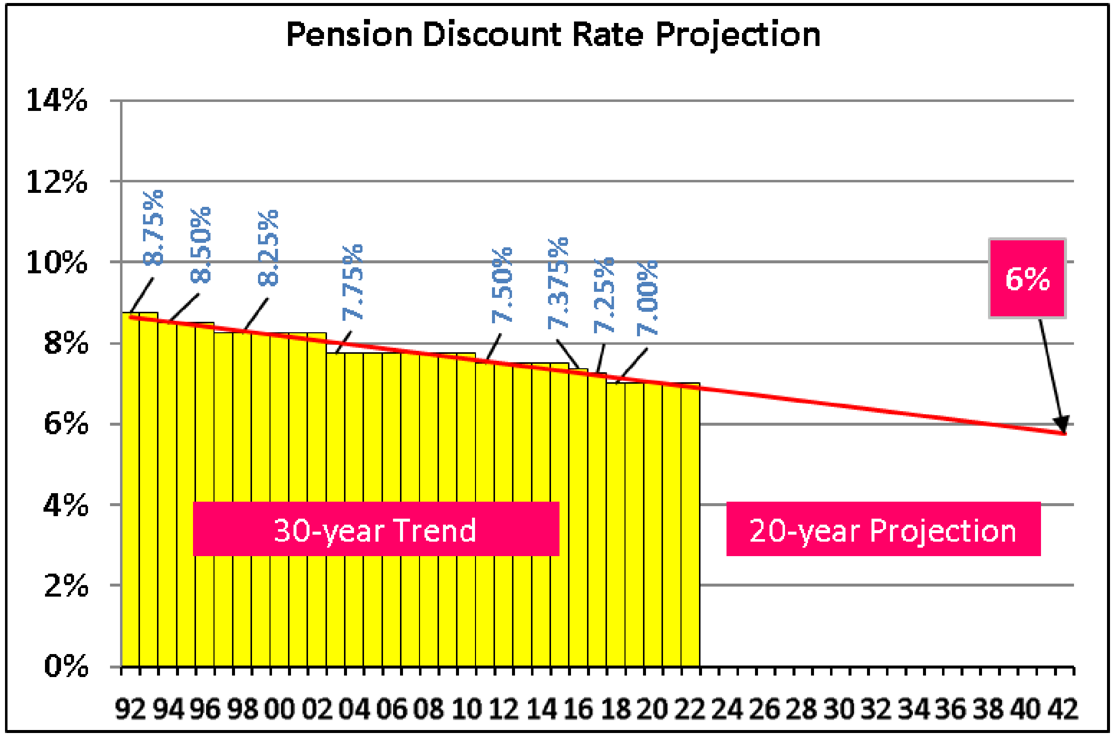
- **2% COLAs starting FY21**
  - MOUs have expired, but negotiations are ongoing; labor is largest expense and inflationary pressure must be included for forecast to be realistic
- **FY22 O&M/part-time/OT held to FY20 actuals**
  - Budget direction to departments is to hold these costs to the lesser of last year's actual or projected increase from FY21 budget; growth resumes in FY23 based on that FY22 level; cost of current positions would not be restricted
  - Reduces FY22 expense by $6.4M (3.3%) compared to forecast model growth for FY22

Pension Costs

- **6.2% average returns**
  - Investment returns have been gradually falling for 30 years
  - Wilshire Associates estimated average annual return over next decade at 6.2%
- **6% discount rate phased in over 20 years**
  - CalPERS wants to decrease rate volatility and improve funded status, which means an eventual reduction in the discount rate
  - 6% supported by continuation of past 30 years of discount rate change

Pension Returns & Discount Rate

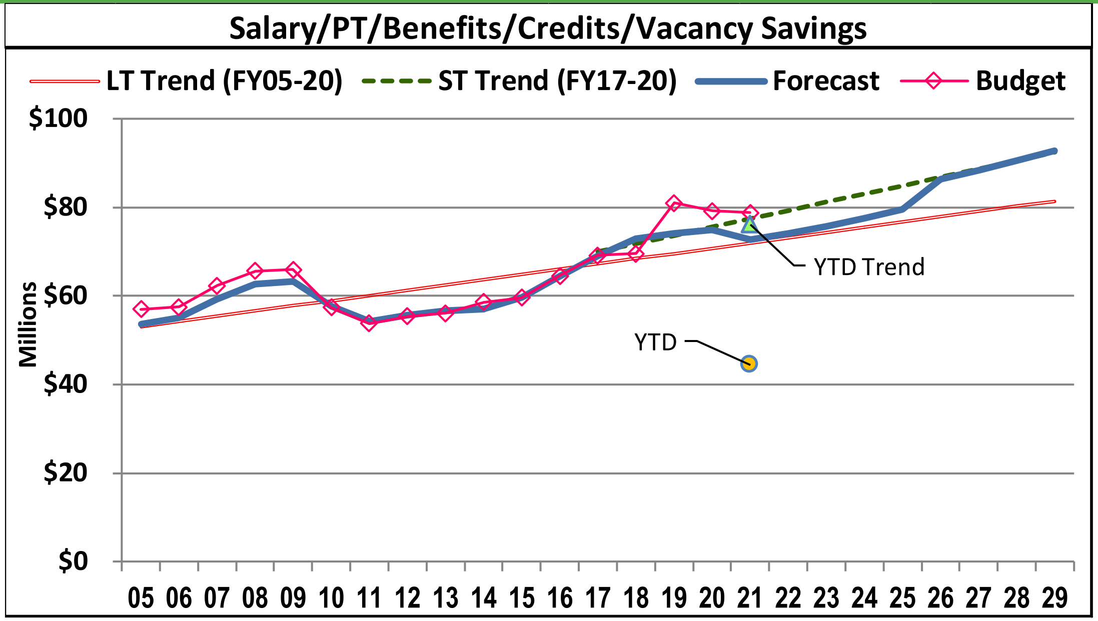


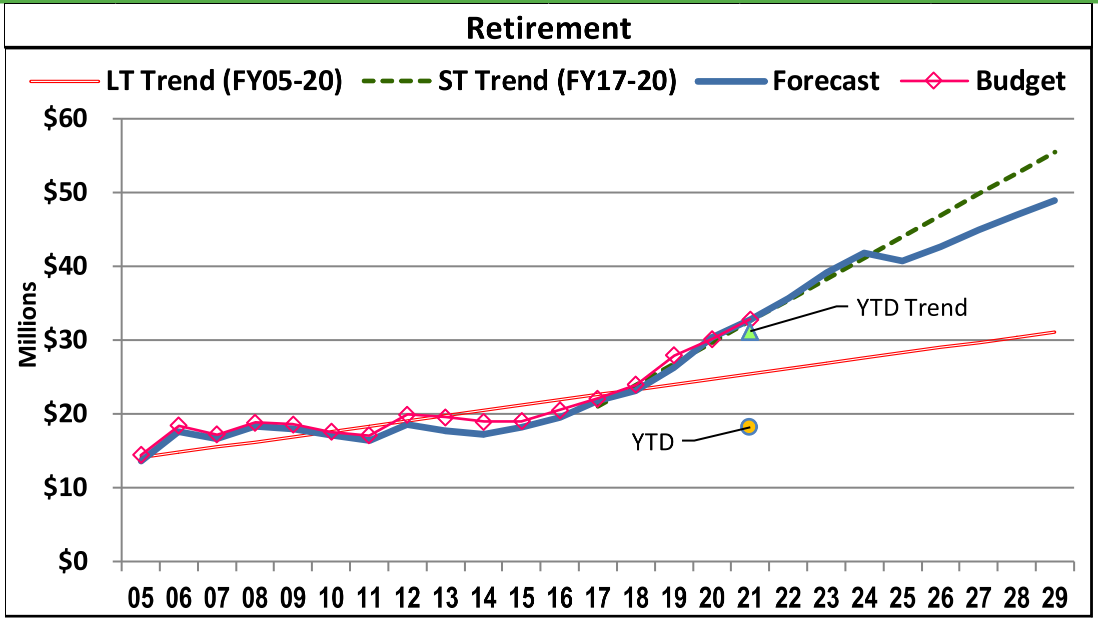


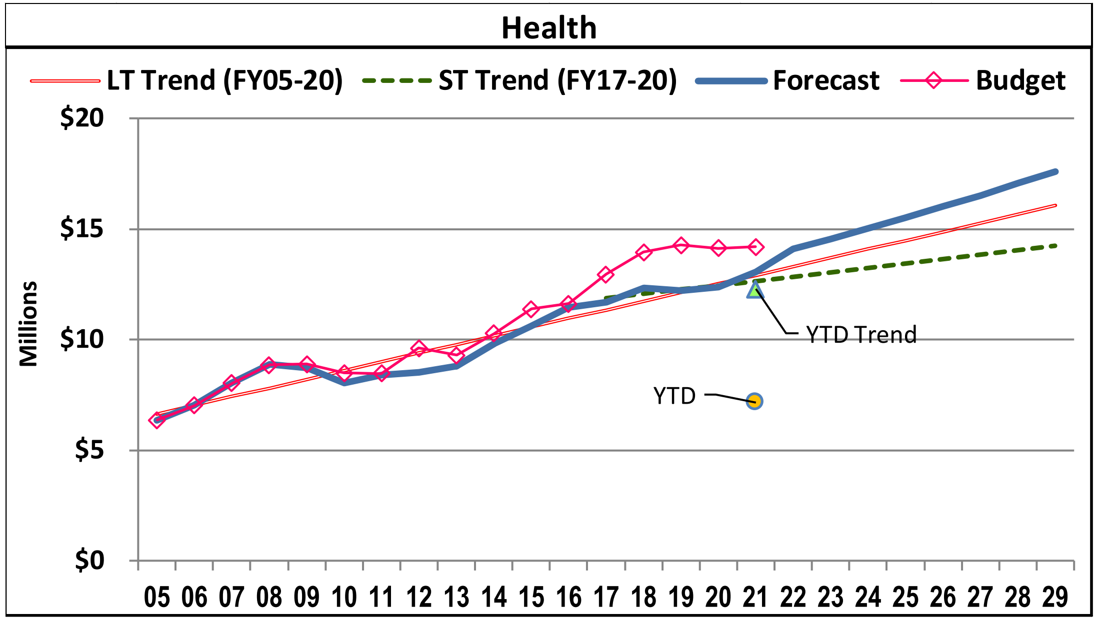
- Values above the blue line are years exceeding the discount rate (pink line) and values below are years falling short of that level
- Slow downward trend in investment returns over past 30 years

- Extending decline in discount rate over past 30 years hits just under 6% in 20 years
- CalPERS is reviewing its strategic asset allocation and discount rate in 2021; any change will be made in November to take effect 7/1/22

Personnel Expense Forecast



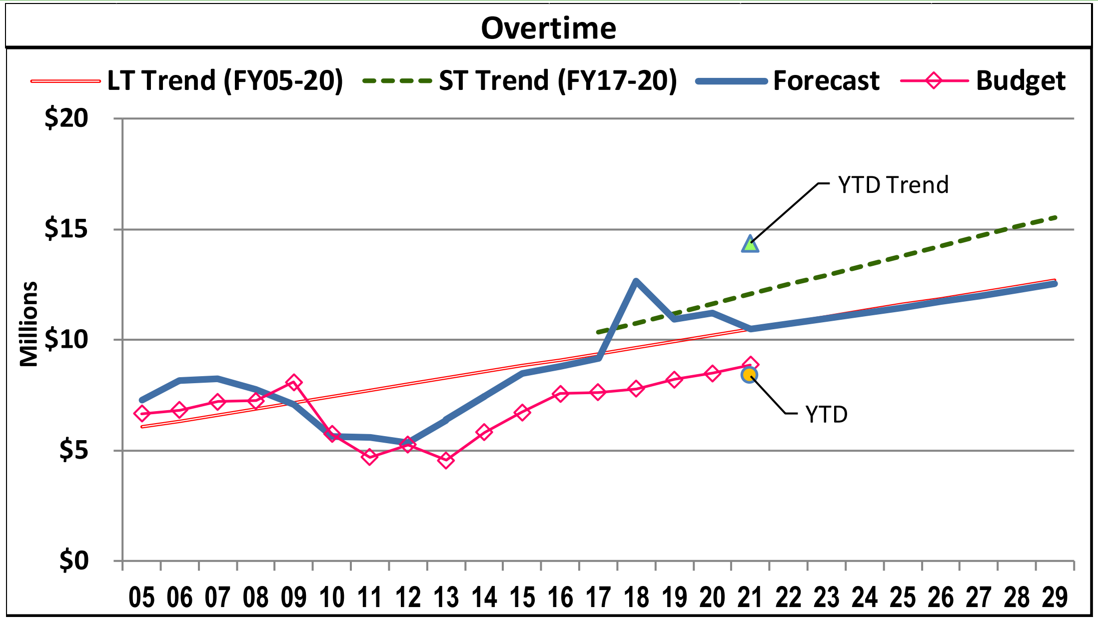


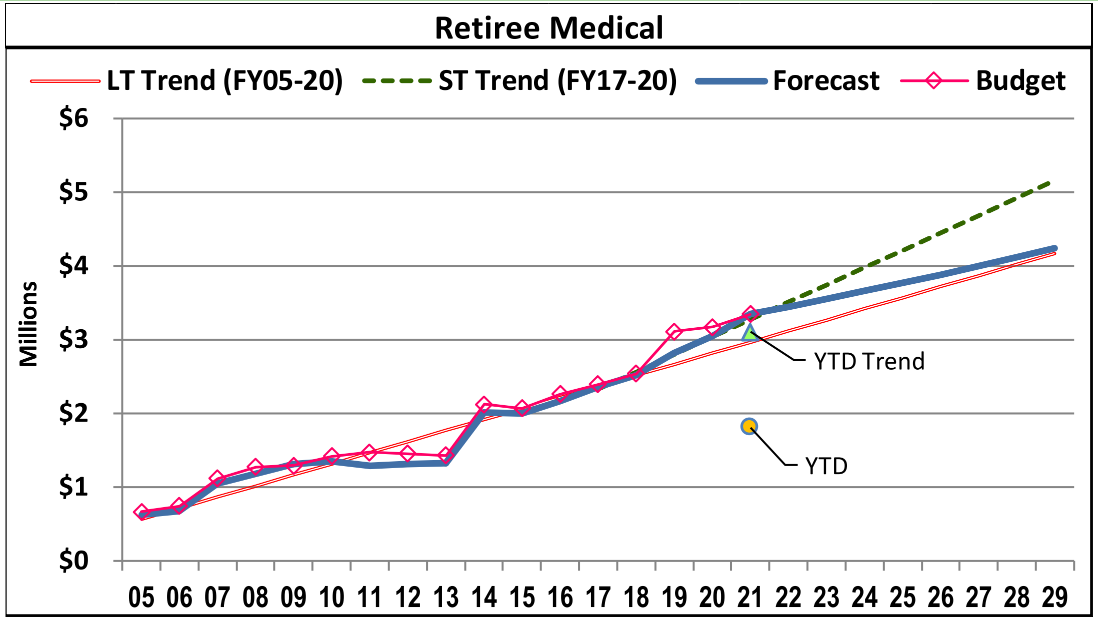


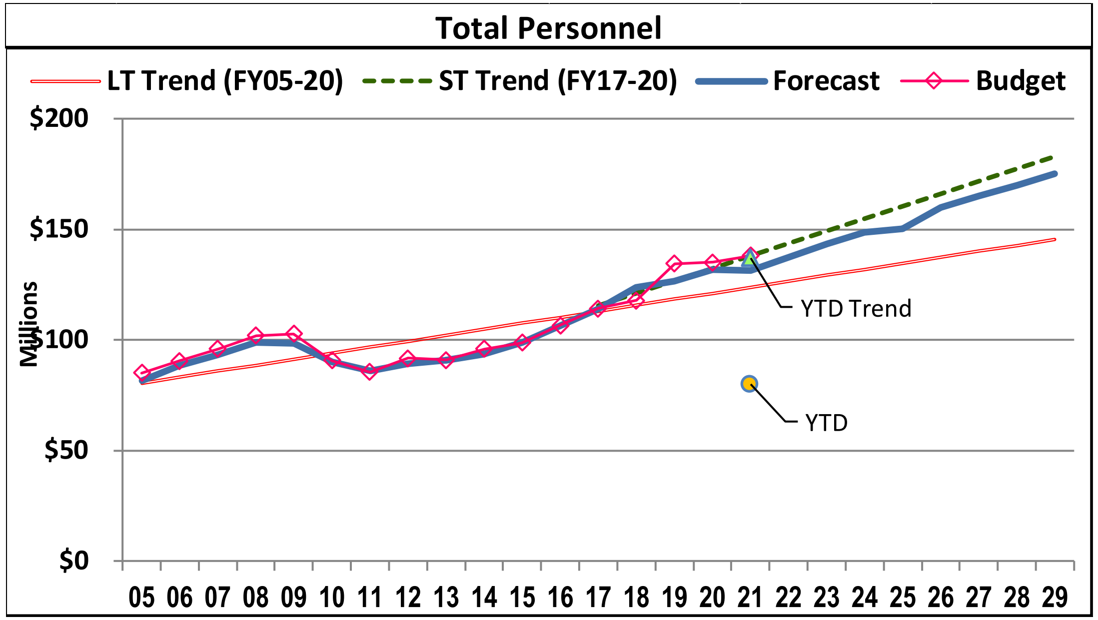
- Salaries/Benefits continue on short-term trend except for savings from keeping positions frozen for 5 years (resulting vacancy rate is 4.5% for FY21-25, 1.5% after)
- Retirement costs use the lower returns and discount rate; projections follow short-term trend; reduction in FY25 is due to end of POB debt service
- Health at YTD trend for FY21, follows long-term trend thereafter (90% of position control calcs)

Note that uneven cash flow means YTD Trend not always indicative of final amount for FY21

Personnel Expense Forecast



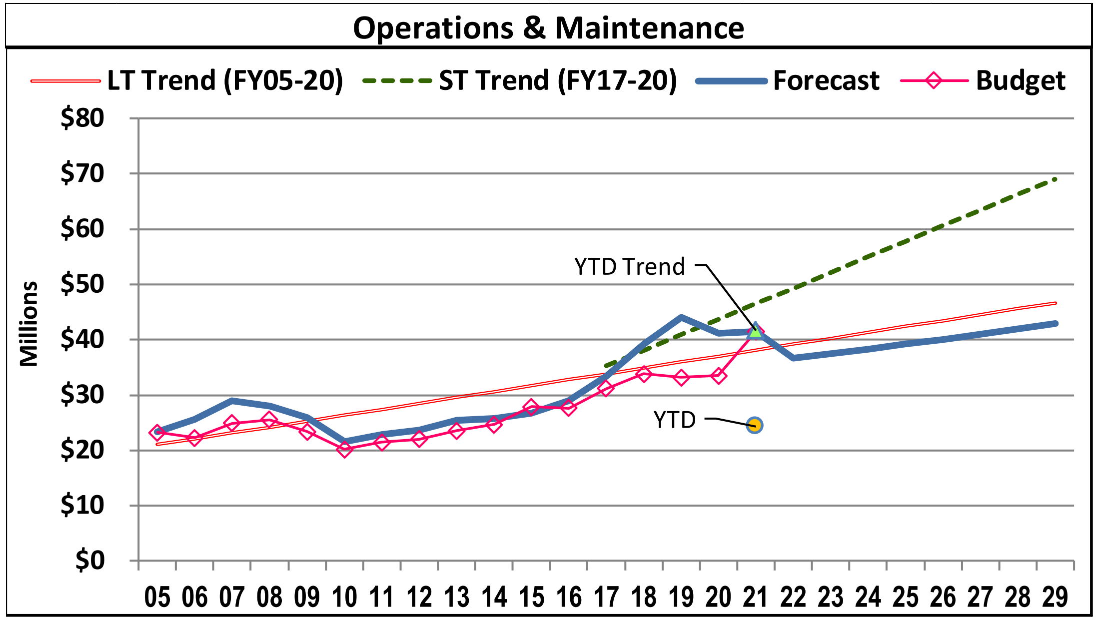


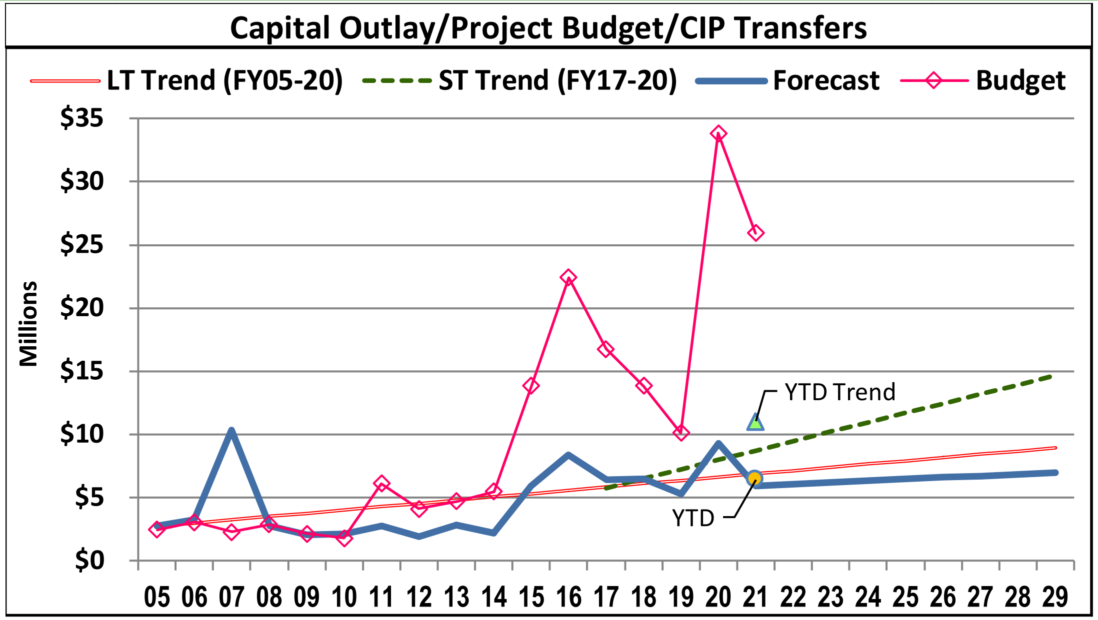


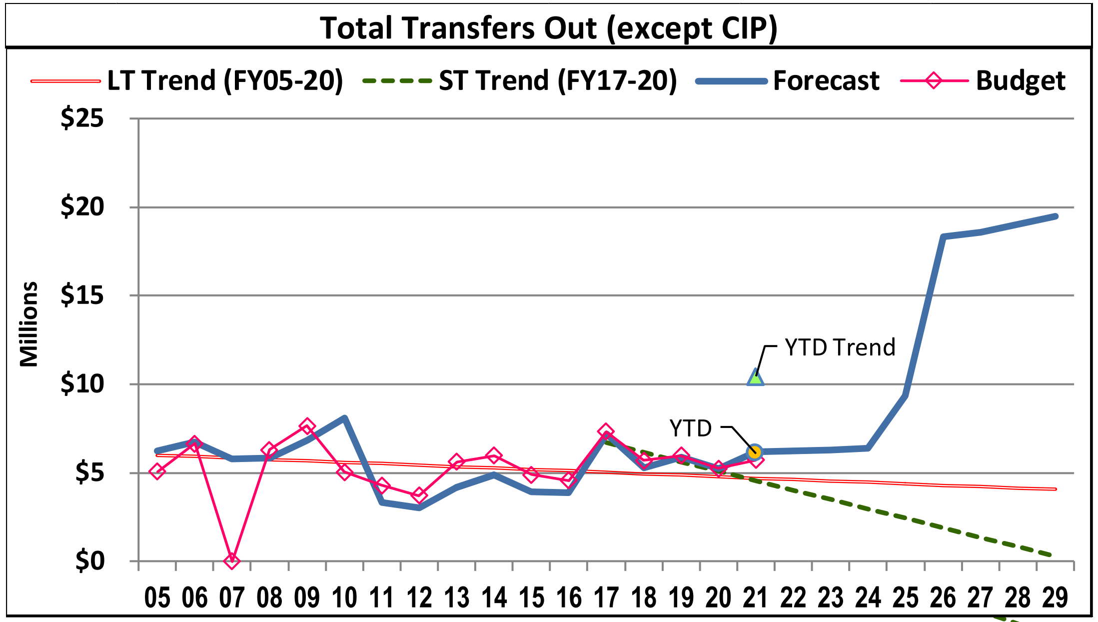
- Overtime in month 7 already near annual budget, forecast follows long-term trend
- Retiree medical forecast approaches long-term trend; need actuarial forecast for refined estimate
- Total personnel meets YTD trend & budget for FY21, then follows short-term trend

Note that uneven cash flow means YTD Trend not always indicative of final amount for FY21

Non-Personnel Expense Forecast



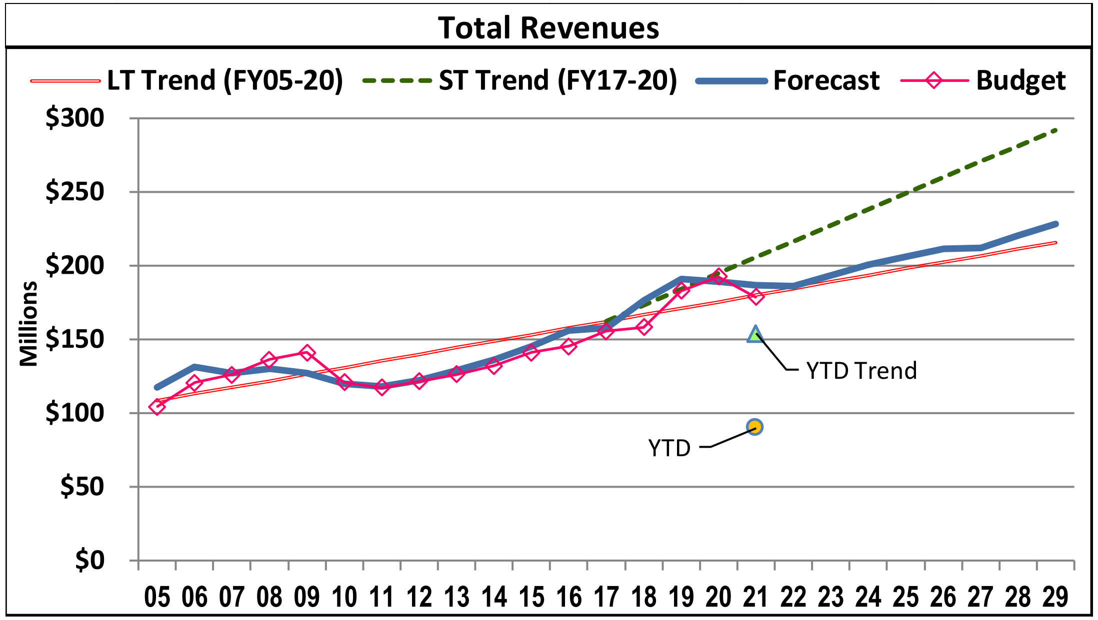


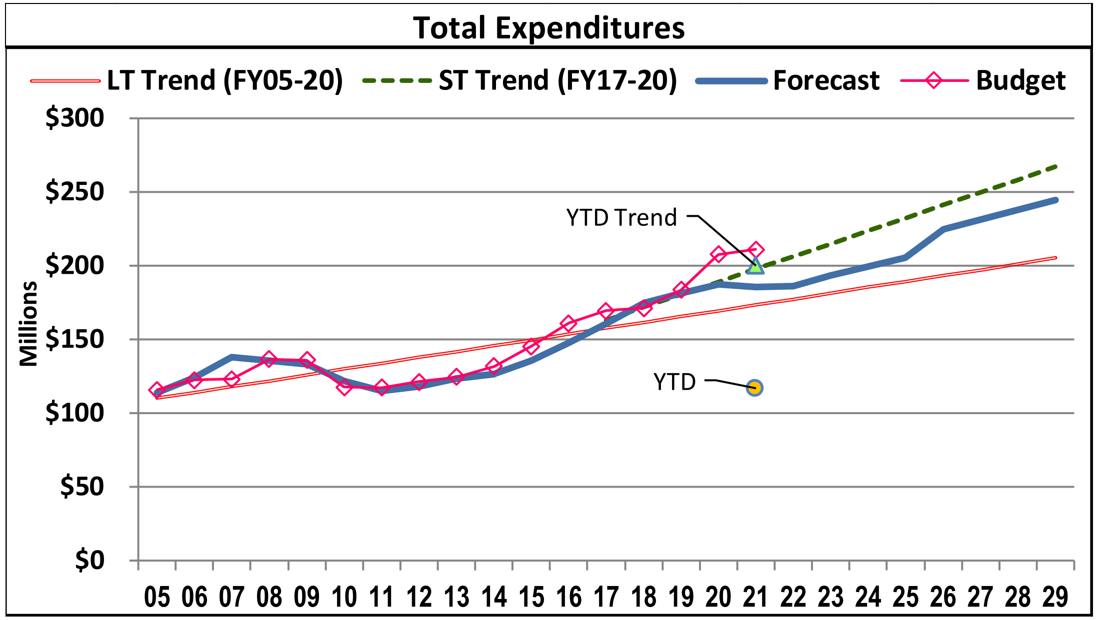


- O&M forecast at YTD trend & budget for FY21, parallels long-term trend thereafter
- Capital total is average of past 8 years (FY22 is $4M CIP, $2M project budget, $100K capital outlay); CIP budget in recent years includes carryover for existing projects
- Transfers Out grow starting in FY25 with GF backfilling for assumed loss of Measure N tax

Note that uneven cash flow means YTD Trend not always indicative of final amount for FY21

Summary of Total Revenues & Expense





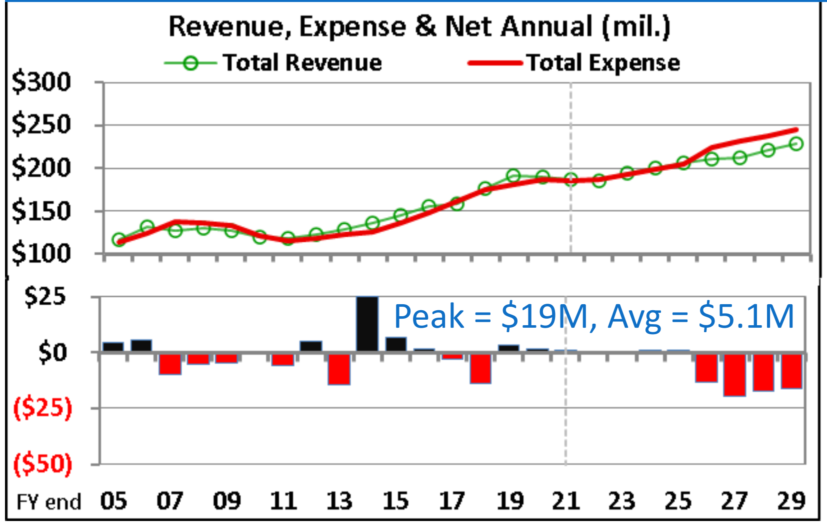
- Total revenue follows long-term trend starting in FY22

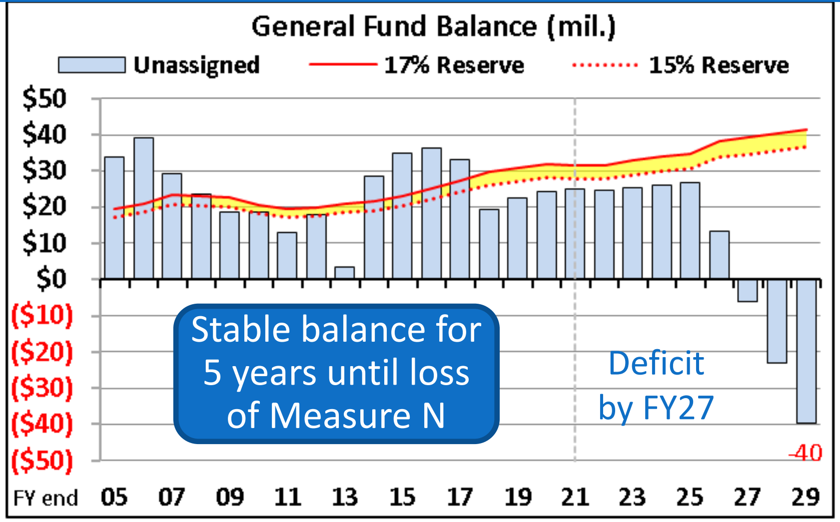
- Total expense YTD trend for FY21 is on the short-term trend line; projections thereafter split the two trends, and include the 5-year freeze of certain positions

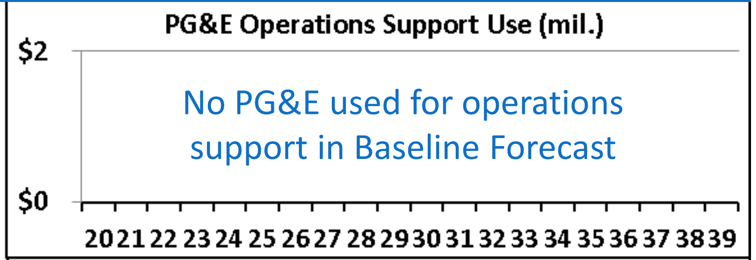
Note that uneven cash flow means YTD Trend not always indicative of final amount for FY21

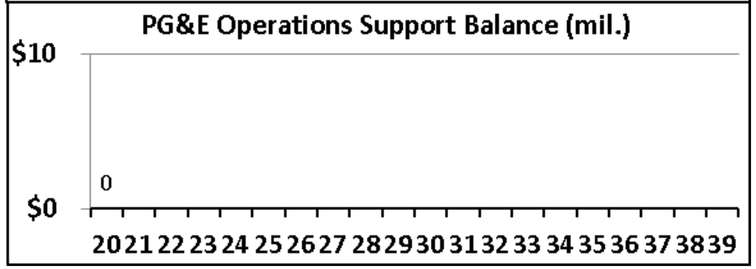
Baseline Forecast

10-Year Forecast

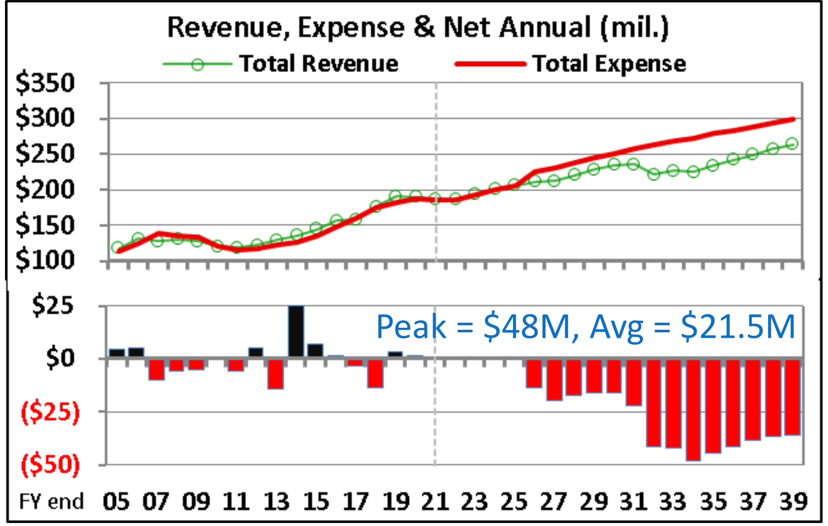


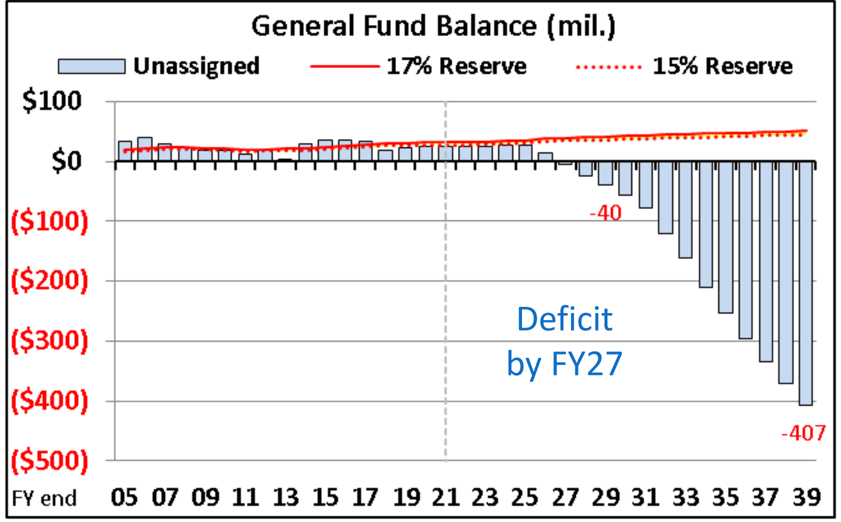


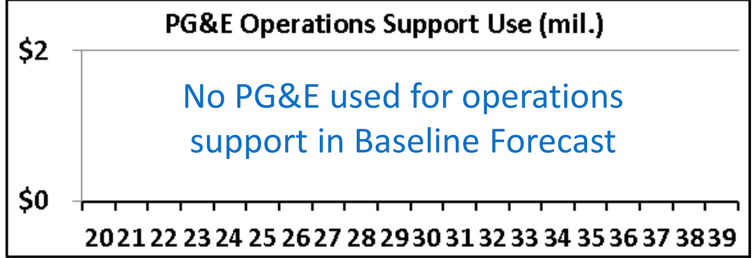


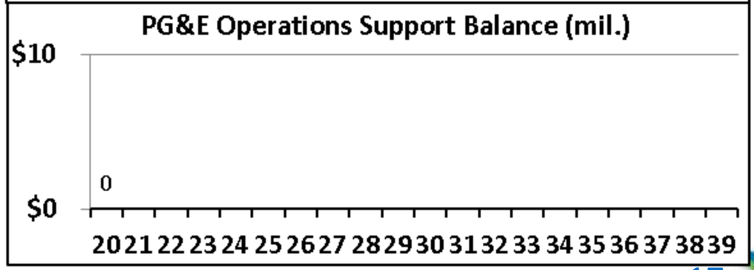


20-Year Forecast









Major Forecast Variables

- **Vacancies**
  - Will be most likely reason for lower expense in near-term
- **Pay & Benefits**
  - Wage adjustments are subject to the meet & confer process, and if wage adjustments exceed the 2% in the forecast, these costs will compound into future years
- **Pension Costs**
  - Forecast assumes more conservative than CalPERS's current 7% returns and discount rate, but this is a realistic outcome; returns will be higher or lower every year, making pension forecast volatile in any event
- **Growth Related to Workload Increases**
  - Additions of 2 FTE and $4M for CIP annually are budget decisions, and can be eliminated at City discretion, but are recommended for long-term sustainability of City services and infrastructure
- **One-Time Funding**
  - FEMA reimbursements not included in the forecast could be significant over the next few years, depending on the timing and level of payments approved
  - Pending ARPA legislation could add $26M, but only amounts added to the GF to augment reserves should be included in the forecast (if new programs/projects are funded, this reduces net benefit to GF)
  - FEMA & ARPA together could equal the $40M discussed as PG&E use by GF

Alternative Scenarios for Meeting Reserve Goal Using 20-Year Forecasts

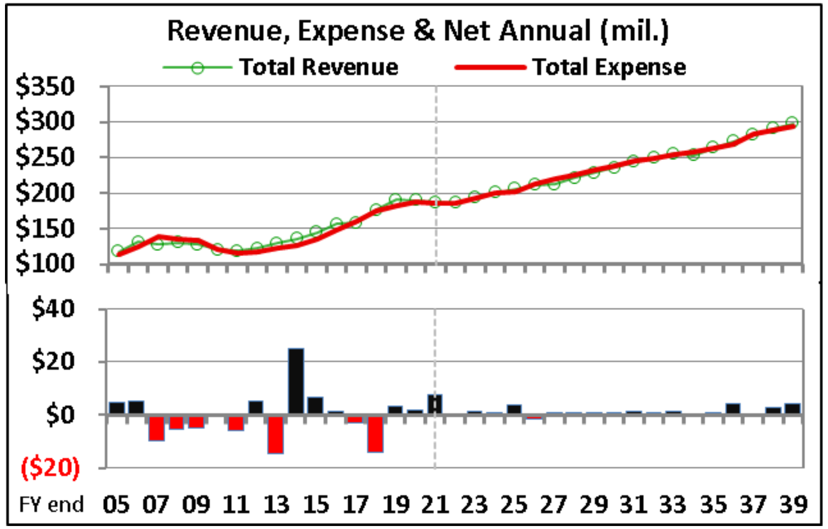
Summary of Alternative Scenarios

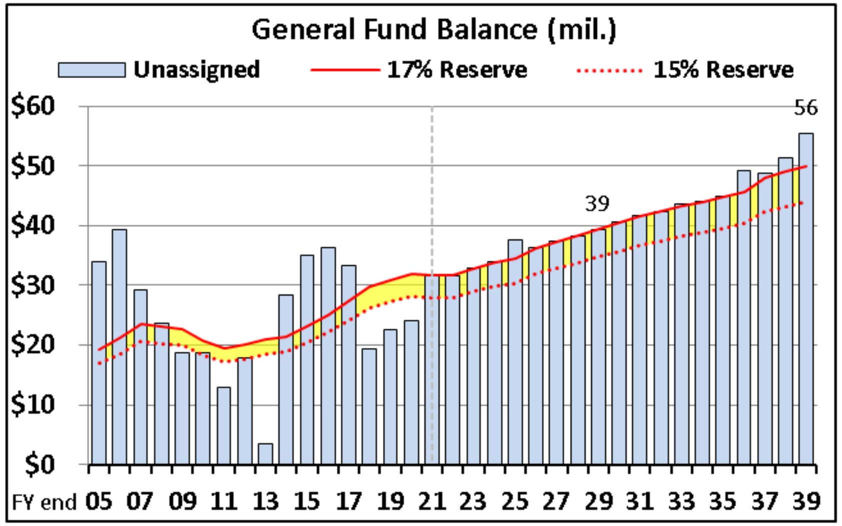
Budget Action	Baseline Forecast	Scenario A	Scenario B	Scenario C	Scenario D	Scenario E	Scenario F
PG&E settlement to support GF operations*	none	$40M	$40M	$40M	none	none	none
FY22 Expense=FY20 for O&M/PT/OT	yes	yes	yes	no	yes	yes	no
Frozen FTE in effect	5 years	5 years	5 years	10 years	10 years	10 years	10 years
2 FTE growth/year	yes	yes	yes	no	no	no	no
Measures N & Q sales taxes (requires voter approval)	N & Q both expire	N & Q renewed	N expires, Q renewed	N & Q renewed	N & Q renewed	N expires, Q renewed	N expires, Q renewed
Ongoing expense <u>decreases</u> (and/or revenue increases)	none	none	$11M in FY26	$5M in FY27	none	$12M in FY36	$7M in FY22 & $11M in FY25**
Ongoing expense <u>increases</u>	none	$10M in FY37	$6M in FY38	$8M in FY37	$12M in FY36	$11M in FY36	$10M in FY36

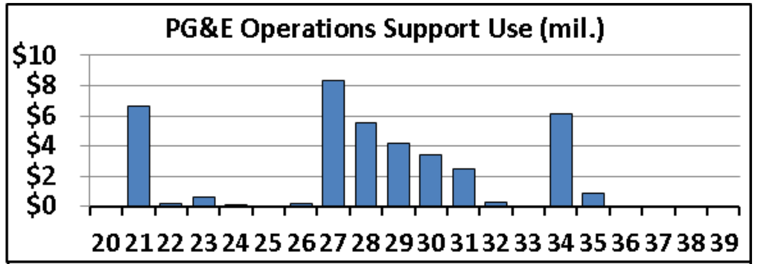
*drawdown from settlement proceeds as needed to maintain GF reserve goal

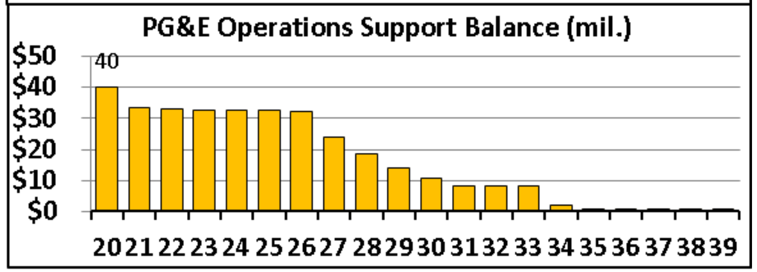
**both phased-in over 2 years

Scenario A
$40M PG&E, FY22 Exp=FY20, Renew Both Taxes



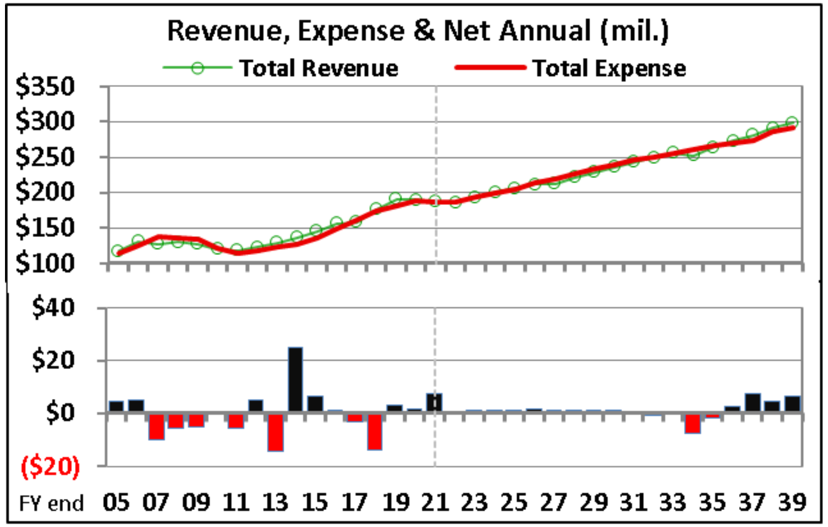


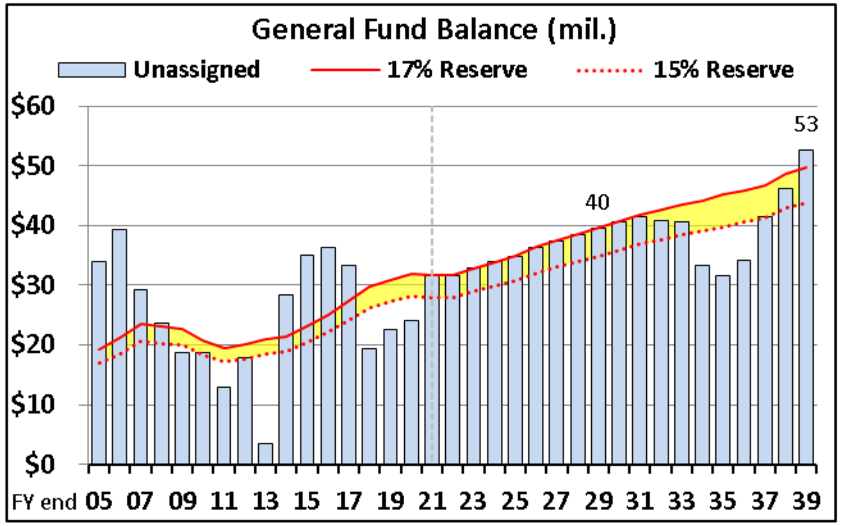


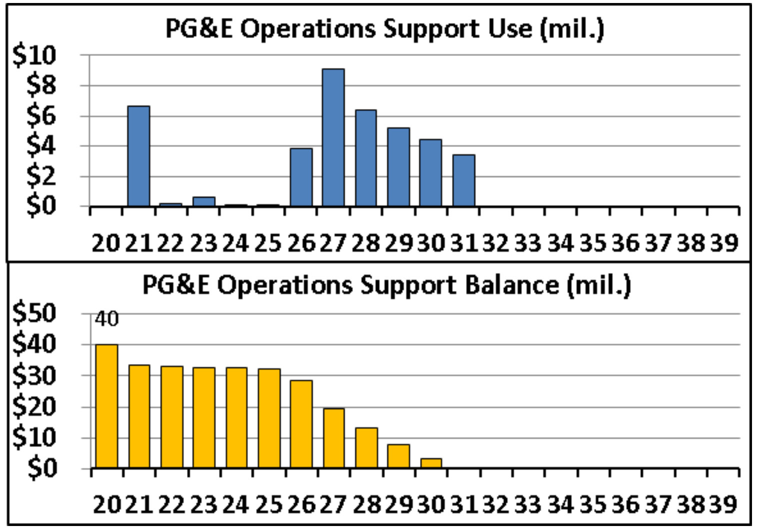


- Revised Assumptions from Baseline:
  - Measure N (public safety) and Measure Q (general tax) are both renewed
- Budget actions required:
  - $40M of PG&E settlement set aside to support operations, drawn down as needed to maintain GF reserve goal until funds are depleted
  - $10M in ongoing expense increase starting FY37 (restored/augmented services)

Scenario B
$40M PG&E, FY22 Exp=FY20, Renew Q/Lose N

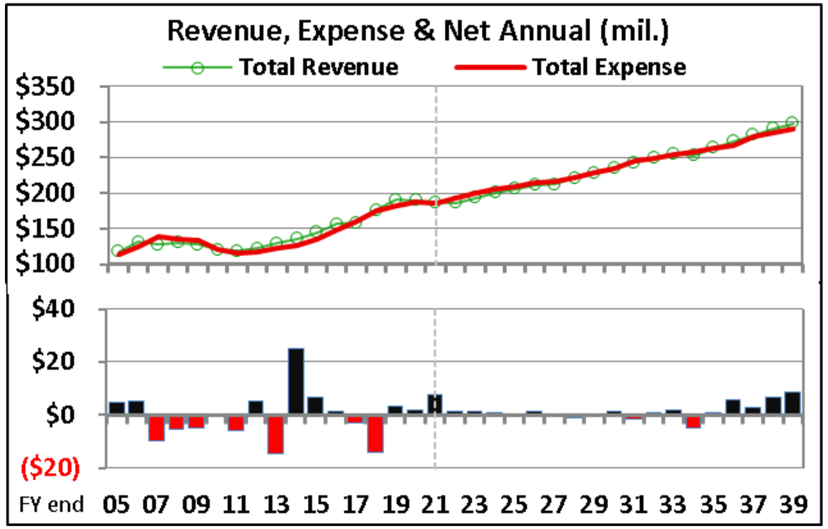


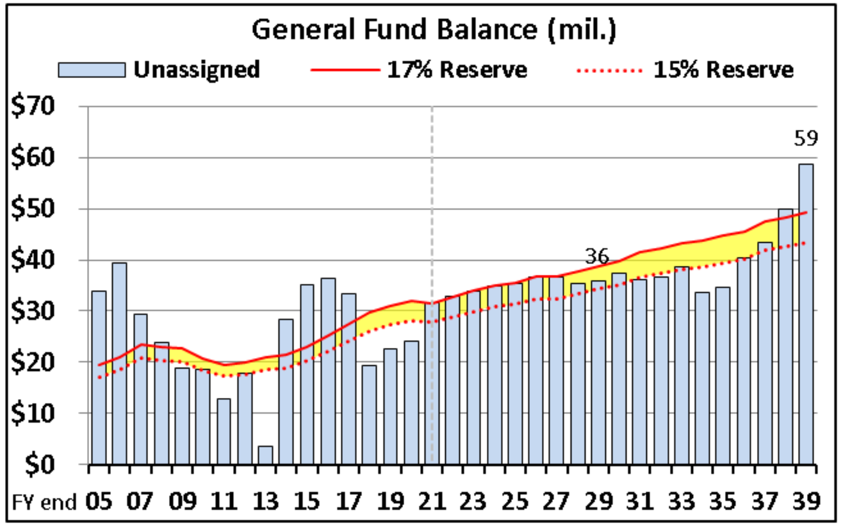


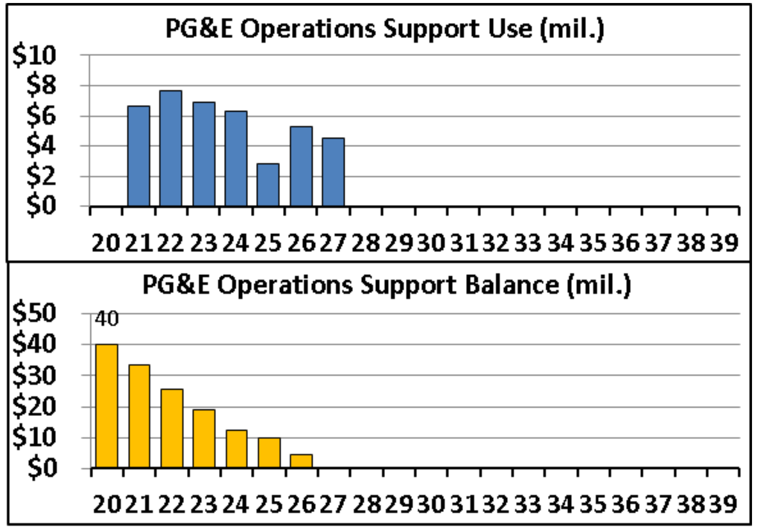


- Revised Assumptions from Baseline:
  - Measure Q (general tax) is renewed, but Measure N (public safety) expires
- Budget actions required:
  - $40M of PG&E settlement set aside to support operations, drawn down as needed to maintain GF reserve goal until funds are depleted
  - $11M in ongoing budget reduction (or revenue increase) starting FY26, and $6M in ongoing expense increase starting FY38 (restoration of services)

Scenario C
$40M PG&E, No FY22 Exp=FY20, Both Taxes Renewed

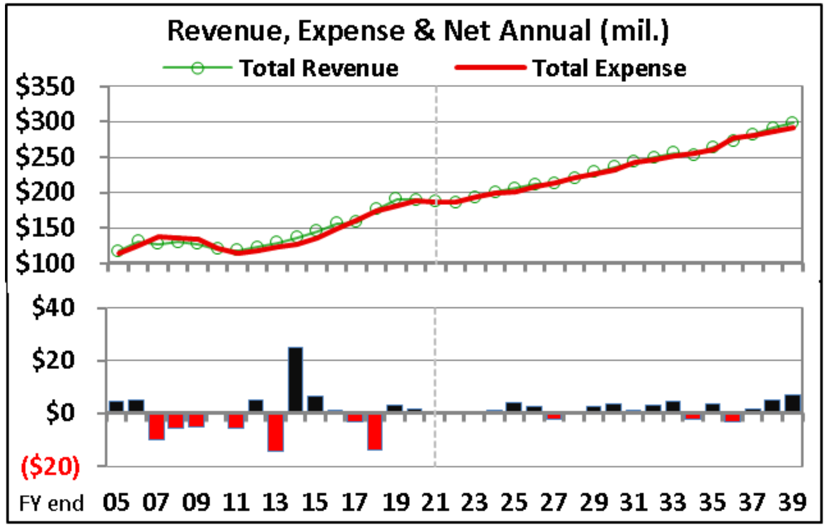


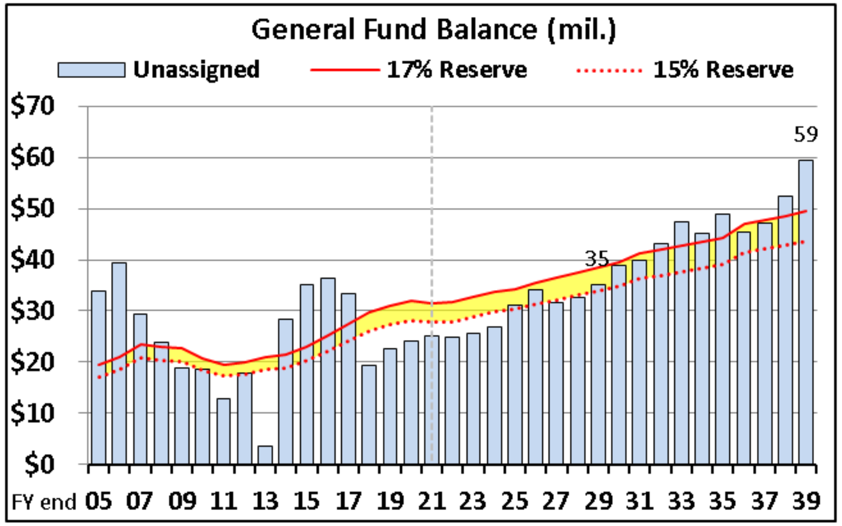


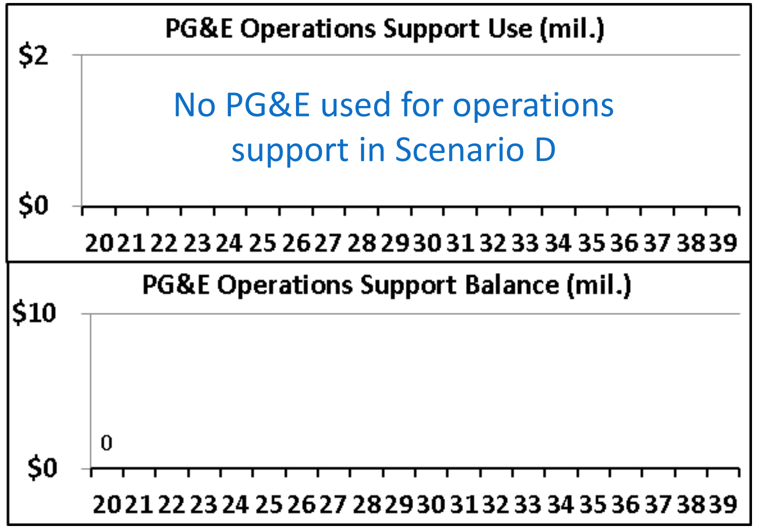


- Revised Assumptions from Baseline:
  - FY22 O&M/PT/OT expense not held to FY20 levels
  - Measure N (public safety) and Measure Q (general tax) are both renewed
- Budget actions required:
  - $40M of PG&E settlement set aside to support operations, drawn down as needed to maintain GF reserve goal until funds are depleted
  - Frozen FTE for 10 years and no annual FTE growth
  - $5M in ongoing budget reduction and/or revenue increase starting FY27, and $8M in ongoing expense increase starting FY37 (restoration/augmentation of services)

Scenario D
No PG&E, FY22 Exp=FY20, Both Taxes Renewed

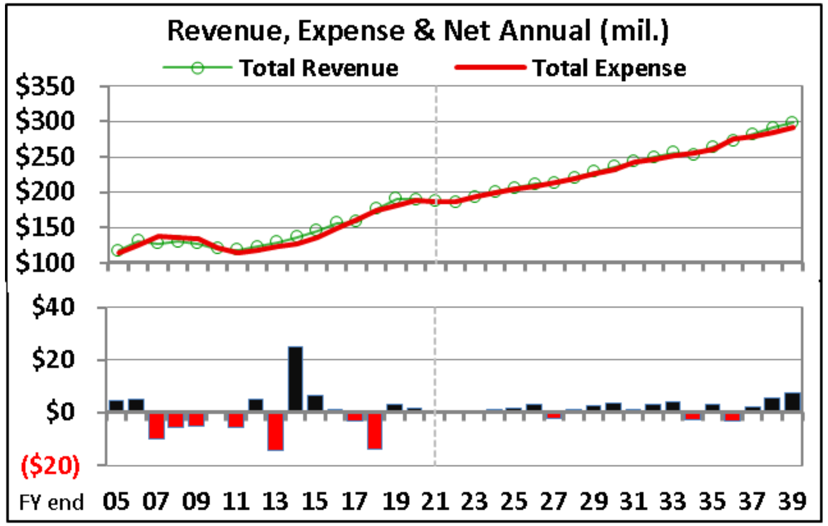


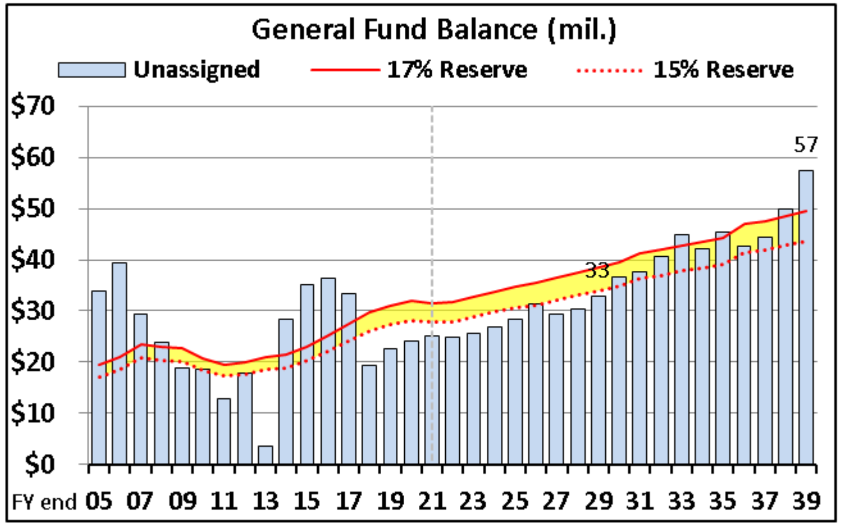


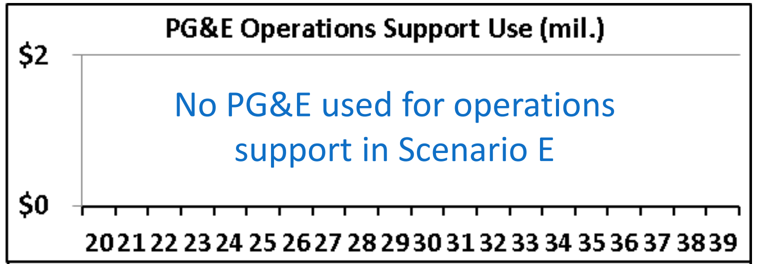


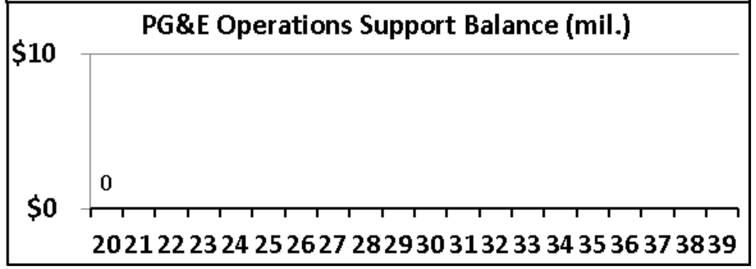
- Revised Assumptions from Baseline:
  - Measure N (public safety) and Measure Q (general tax) are both renewed
- Budget Actions Required:
  - Frozen FTE for 10 years and no annual FTE growth
  - $12M in ongoing budget increase starting FY36 (augmented services)

Scenario E
No PG&E, FY22 Exp=FY20, Keep Q/Lose N



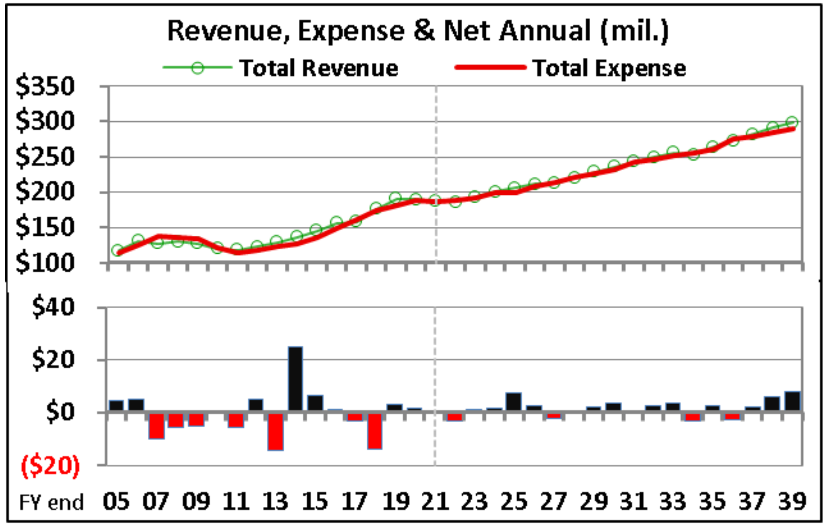


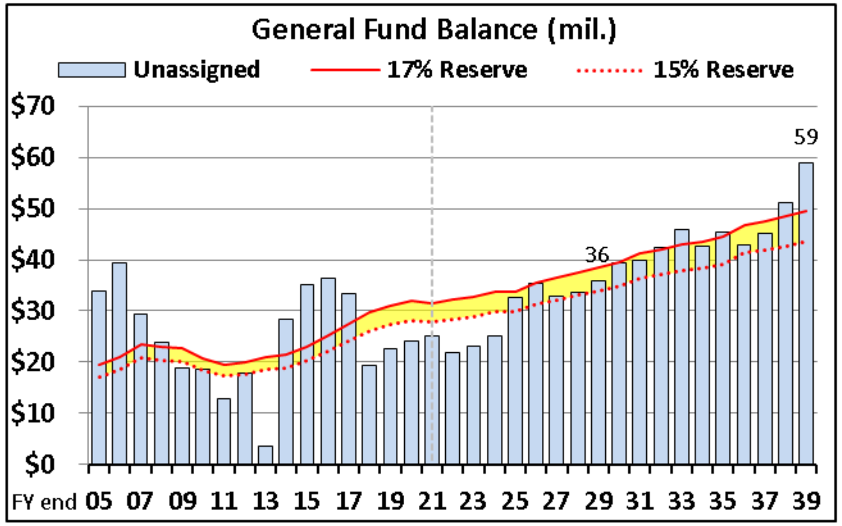


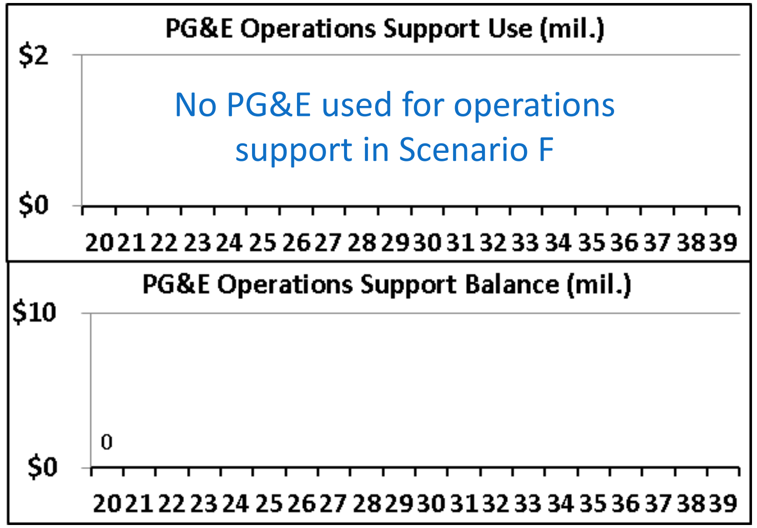


- Revised Assumptions from Baseline:
  - Measure Q (general tax) renewed, <u>but Measure N (public safety) expires</u>
- Actions Required:
  - Frozen FTE for <u>10 years</u> and <u>no</u> annual FTE growth
  - $12M in ongoing budget <u>decrease</u> starts FY26, and $11M in ongoing expense <u>increase</u> starts FY36 (restoration of services)

Scenario F
No PG&E, No FY22=FY20, Keep Q/Lose N







- Revised Assumptions from Baseline:
  - FY22 O&M/PT/OT expense not held to FY20 levels
  - Measure Q (general tax) renewed, but Measure N (public safety) expires
- Actions Required:
  - Frozen FTE for 10 years and no annual FTE growth
  - $7M in ongoing expense reduction starting FY22 & $11M additional expense reduction starting FY25 (both phased over 2 years), and $10M in ongoing expense increase starting FY36 (restoration of services)

Long-Term Financial Policies

- Determine policy for use of one-time revenues:
  - PG&E settlement
  - FEMA reimbursements
  - ARPA aid
- Determine course of action and timing for Measure N public safety sales tax renewal
- Determine policies regarding timing/magnitude of early expense reductions to conserve GF reserves:
  - Term of position freeze
  - Whether new positions will be added over time
  - Holding O&M, part-time and overtime costs to lesser of FY20 actual levels or growth on FY21 budget

Thank You! Questions?

Contact Information:
Bob Leland
rleland@managementpartners.com
530-219-5812