Agenda Item #4.1
For Council Meeting of: April 15, 2025

CITY OF SANTA ROSA
CITY COUNCIL

TO: MAYOR AND CITY COUNCIL
FROM: ALAN ALTON, CHIEF FINANCIAL OFFICER, FINANCE DEPARTMENT
SUBJECT: GENERAL FUND BUDGET REDUCTIONS FY 2025-26

AGENDA ACTION: NO ACTION REQUIRED

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.

EXECUTIVE SUMMARY

This Study Session will provide the City Council with an update of the condition of the General Fund and present reductions to the budget that have been identified that could become effective as part of the Fiscal Year (FY) 2025-26 budget.

BACKGROUND

The City's General Fund structural deficit reflects a broader issue affecting cities in California, where expenditures related to staffing costs, labor and supplies, and the growing cost of CalPERS pension Unfunded Actuarial Liabilities (UAL) are increasing. Additionally, new service levels in the community, coupled with a deceleration in the growth of pivotal revenue streams such as sales tax, further contribute to this imbalance where expenditures across the state frequently exceed revenues.

On October 22, 2024, staff identified ongoing and one-time reductions to the current year (FY 2024-25) budget. On January 28, 2025, the City Council approved ongoing reductions totaling $4 million, which helped to close the budget gap in FY 2024-25, but did not have a significant effect on the forecasted deficit in the next 5 years. The council also re-allocated $9.2 million in PG&E settlement funding previously directed to one-time projects to reserves. Even with these moves, the budget deficit for FY 2025-26 is $19.9 million, and the additional reserves, while helpful, have been dwarfed by the projected deficits.

Prior to the FY 2025-26 budget development process, staff contracted with a firm, Alvarez & Marsal (A&M), to provide an independent validation of the City Long-Range Financial Forecast for the General Fund, and to evaluate the City's annual budget process to provide insights on opportunities for improvement and options for engaging zero-based budgeting.

A&M's review found that City's General Fund financial model is a best practice and is more advanced than those used in other jurisdictions they have studied. Overall, the forecast methodology is sound; however, they noted that revenue forecasting should better align with actuals, notably that the City should lower its sales tax estimate to align with actual sales tax revenue. In addition, the report noted that the City could refine its method of forecasting vacant position costs to better align with the impact of the actual number of vacant positions annually, but that change would have a low impact on the overall outcome of the model.

The review also recommended a redesign of the budget infrastructure towards a program-based approach rather than relying on object codes. The City's current line-item budgeting structure inherently supports existing staffing levels and maintaining the status quo. Moving to a program-based budget would allow the City to evaluate department programs to determine which ones are most aligned with legislative mandates and/or City strategic initiatives and to prioritize spending and identify opportunities to right-size spending at the programmatic level. This redesign will take the 2025-26 year complete with the goal of implementation in FY 2026-27.

City departments have completed budget development for FY 2025-26, with General Fund departments instructed to submit a budget that maintains the same level of funding as the previous year for services, supplies and other controllable expenses. In this year's budget process, staff is actively reviewing the administrative operations within each department to maximize efficiency. This effort includes reducing spending linked to management planning and support services. Additionally, in response to the significant General Fund budget deficit, departments were required to identify potential budget cuts amounting to 8% of their total budget.

PRIOR CITY COUNCIL REVIEW

October 22, 2024 – City Council Study Session, "General Fund Budget Reductions"

January 28, 2025 – Report Item, "Mid-Year Budget Adjustment"

ANALYSIS

The City's largest revenue source in the General Fund is Sales Tax. During the pandemic, Sale Tax revenues temporarily increased as consumers remained at home, spent stimulus funds and disposable income. However, with a shift in consumer spending towards non-taxable travel, experiences, and increased online purchases, the

City’s collected Sales Tax has declined. This decrease is constraining the resources available within the General Fund.

In 2024, labor contracts were settled, offering generous cost of living raises, equity adjustments, and specialty pays to General Fund employees. Salaries and Benefits make up over 75% of the General Fund expenses, and these costs are rising faster than revenue grows, creating a structural deficit. The reserves are currently bridging this gap while we plan necessary budget cuts, but those reserves are dwindling quickly. It's vital that the next round of budget reductions effectively slows the use of reserves before they're completely used up.

The General Fund has three categories of reserves to fund operations during deficits, fiscal stability reserves, available reserves, and mandated reserves.

- **Mandated reserves** are the baseline of funding mandated through City Council policy to maintain 17% of expenditures, these funds are intended to cover deficits created through unforeseen events like disasters or recessions. During both the Great Recession and 2017 wildfires this reserve was stressed to remain positive. Available reserves are any amount above the mandated reserve, these funds are strained across many needs of the City which are unbudgeted.
- **Available reserves** are required to fund deferred maintenance on City facilities, capital improvement projects, infrastructure, and one-time services.
- **Fiscal stability** reserves were established by the City Council to specifically address budgeted deficits and provide a period for the City to adjust to changing financial conditions.

General Fund reserves have declined substantially and are projected to be exhausted in the near term without correcting the deficit. Governmental accounting standards require reserving for adopted deficits against the prior year’s balances and therefore deficits have an immediate impact. Further impacting reserves is that the FY 2023-24 deficit of $3.3M came to fruition once closing out the City’s financials, the projected budgetary deficit was proved accurate. It is anticipated that the FY 2024-25 budgetary deficit of $13.3M will be realized and likely surpassed, this is primarily due to labor contracts being finalized after projections were made into the adopted budget. Remaining Financial Stability reserves of $10.7M project to be fully exhausted by the end of the current fiscal year, FY2024-25. This would leave $22.0M of available reserves which would be fully exhausted by the end of FY2025-26, the budget year currently under development. Additionally, the City would fall below its mandated reserve levels in FY2025-26 with all reserves having no remaining funding during FY2026-27. The levels of deficits being projected are unsustainable in the short term and require immediate corrective actions.

Department Reductions

Departments were tasked with proposing ongoing budget reductions with a programmatic focus where possible. These proposals and their impacts were evaluated

by the City Manager and discussed at length prior to being brought to Council. The final administrative and operational departments budget reductions proposals are below:

Dept	2025-26 Proposed Budget	8% Target	January 2025 Reductions	Proposed Reductions
City Manager	3,163,274	253,062	359,900	485,000
City Attorney	4,593,236	367,459	2,500	293,550
HR/Risk	4,642,756	371,420	202,435	-
Finance	8,003,655	640,292	10,000	1,744,902
Fire Department	55,866,080	4,469,286	900,000	3,929,000
Planning & Econ Development	17,503,262	1,400,261	457,590	1,052,600
Recreation & Parks	17,120,134	1,369,611	375,000	550,000
Transportation & Public Works	25,753,151	2,060,252	1,191,605	687,000
Police Department	77,779,139	6,222,331	160,502	2,777,500
Comms & Intergovt. Relations	1,819,748	145,580	211,368	233,000
Total	**216,244,435**	**17,299,555**	**3,870,900**	**11,752,552**

The department cuts listed above include the elimination of both filled and vacant positions.

Included in the Finance Department's reductions are the realized savings from restructuring funding to post-employment medical health care benefits (PEMHCA) resulting from the creation of a section 115 trust. The City Council approved this strategy and funded the trust on May 21, 2024, with $12,300,000 of funding already dedicated solely to this purpose. This action was anticipated to significantly address unfunded liability and create budgetary savings going forward. The City has subsequently received an actuary study showing our unfunded liability for PEMHCA increasing from 0% to 69% funded and reducing the City's unfunded liability from $24,964,000 to $5,467,000. Additionally, this strategy provides the City a path forward for PEMHCA becoming fully funded and the ability to remove established annual General Fund appropriations creating an ongoing savings of $1,545,000 per year.

In Public Safety, Police and Fire brought forth options for reducing their operations that would have significant impacts on the community. Instead of recommending a specific option for Public Safety departments, staff will present all options and allow Council to provide feedback.

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

Pursuant to CEQA Guidelines Section 15378, the recommended action is not a "project" subject to the California Environmental Quality Act (CEQA) because it does not have a potential for resulting in either a direct physical change in the environment or a

reasonably foreseeable indirect physical change in the environment. In the alternative, the recommended action is exempt from CEQA pursuant to CEQA Guidelines section 15061(b)(3) because it can be seen with certainty that there is no possibility that the project may have a significant effect on the environment. In addition, 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