



DATE: **March 18, 2024**

TO: Honorable Mayor and Members of the City Council through City Manager

FROM: Jessie Gooch, Finance Director
Corey Garberolio, Assistant Director of Finance

SUBJECT: Mid-Year General Fund Financial Forecast Update

The five-year financial forecast is periodically updated to provide the Council with a long-term financial planning tool. It has been the practice that updates occur twice annually; at mid-year and year-end. The most recent forecast update was included in the 2024 budget that was adopted by the City Council in June of 2023. At that time the combined ending General Fund and Measure U Fund Unassigned Reserve balance at June 30, 2023 was projected to be \$0k, with revenues equaling expenditures. That balance was projected to remain at this level through June 30, 2029.

Updating the Five-Year Financial Forecast

The forecasting process and model are constantly being improved, and while developing the forecast updates the following items are considered:

- Year-end results from the prior fiscal year are updated and included in the forecast.
- Current year revenues and expenditures are updated. As actual amounts are realized during the year projected amounts are analyzed and validated or revised.
- An economic update is included.
- Model assumptions for revenues and expenditures are analyzed and revised as necessary.
- Any ongoing structural deficit is identified.
- The City Council's direction regarding the establishment of reserves is benchmarked against actual results.
- Measure H revenue and expenditure impacts have not yet been included – these will be added to the next forecast update.

The five-year forecast has been updated as of mid-year 2023-24. All budget adjustments that have been approved by Council since the 2023-24 budget was adopted have been included. Those adjustments provide revised FY 2023-24 year-end projections of revenues, expenditures and fund balance. This helps provide a base for calculation of the forecasted amounts over the next five years.

The Economy

Revenues have recovered from the pandemic lows, but the nature of the economy – from high inflation, supply chain issues and ongoing world events – remains unstable.

We remain cautiously optimistic regarding financial trends that show a continued growth to our major sources of revenue. There continues to be concern countywide about businesses and the long-lasting impacts related to the pandemic. Sonoma County's near-term outlook has improved as the economy shows signs of recovery. Growth is expected to continue, barring any setbacks from a recession. Tourism is recovering but will undoubtedly depend on the continued abatement of COVID-19 cases nationally and consumers' willingness to travel. The unemployment rate in Sonoma County has returned to pre pandemic levels, slightly below the State and National rates, however this is primarily because of the weak labor force.

Inflationary pressure has impacted the City in multiple ways, from increasing the cost of needed supplies and service vendors, to pushing cost of living increases for employees in recent negotiations. With costs rising faster than most revenue sources, the City will need to use increased amounts of transient occupancy tax and Measure U district tax each year of the forecast to balance the General Fund.

The long-term outlook for Sonoma County tourism is positive with steady growth. Occupancy rates remain below pre pandemic levels but have improved due to increased confidence and pent-up travel demand. According to the Sonoma County Economic Development Board the long-term outlook for Sonoma County tourism is positive given the renewed confidence in traveling. The county's natural beauty, proximity to strong regional economies, and diverse tourist attractions will aid in continued visitor growth. In addition to the pandemic, wildfires continue to challenge the travel and tourism industry in Sonoma County.

Petaluma's overall economic outlook is stable however the current economic environment remains a concern. The areas of home price stability, jobs, and real estate vacancies are challenged as Petaluma's median home price continues to rise year over year due to shortage of inventory relative to demand. Petaluma's commercial vacancy rates remained relatively unchanged with retail and industrial hovering around 5% to 6% and office vacancies slightly increasing to 14%. Petaluma has the second-highest number of businesses of all cities in Sonoma County at 4,969. The total number of business establishments operating in Petaluma has continuously increased year over year since 2013.

Sonoma County's diverse economic drivers – wineries, breweries, food manufacturing, travel and tourism are holding strong. Construction, Tourism and Winemaking industries are expected to propel the County through the next expansion. Petaluma continues to have a strong food and beverage cluster that is expected to continue to push nondurable goods manufacturing and service sector employment higher. All these drivers will continue to make a large contribution to job and income growth in the county as well as in Petaluma.

General Fund Revenues

Fiscal year 2023-24 General Fund revenues have been analyzed and projected amounts for the remainder of the current fiscal year have been developed. As can be seen in the table below, total revenues during FY 23-24 are projected to be approximately \$3.3 million higher than originally budgeted amounts.

Revenue Categories	Budget FY 23-24	Revised FY 23-24	Change in \$	Change %
Property Taxes	12,977,564	12,977,564	-	0%
Sales and Use Taxes	16,530,500	16,530,500	-	0%
Business License Tax	1,241,935	1,241,935	-	0%
Property Transfer Tax	1,367,331	1,367,331	-	0%
Franchise Fees	3,336,507	3,336,507	-	0%
Permits and Fees	1,174,478	1,174,478	-	0%
Fines and Penalties	464,500	464,500	-	0%
Investment Earnings and Rent	581,770	581,770	-	0%
Intergovernmental Revenues	7,508,097	7,508,097	-	0%
Charges for Services	9,534,712	10,266,488	731,776	8%
Other Revenues	84,000	84,000	-	0%
Transfers from Transient Occupancy Tax	2,123,000	2,123,000	-	0%
Transfers from Measure U Sales Tax Fund	13,819,174	13,819,174	-	0%
Other Transfers and Sources	1,108,520	3,686,434	2,577,914	233%
Total Revenues	\$71,852,088	\$75,161,778	\$ 3,309,690	5%

The following are revenue adjustments for FY 2023-24:

- Charges for Services – increase of \$731,776 for adjustments to Fire ambulance revenue and to record firefighter deployment reimbursements.
- Other Transfers and Sources – increase of \$2,577,914 includes the use of designated reserves to fund the increased transfers out for CIP projects, as well as anticipated salary savings from vacant and/or underfilled positions.

General Fund Expenditures

Fiscal year 2023-24 expenditures are projected to be \$3.1 million higher than the adopted budget during the current fiscal year.

Expenditure Categories	Budget FY 23-24	Revised FY 23-24	Change in \$	Change %
Salaries and Wages	33,528,055	35,278,923	1,750,868	5%
Benefits	22,085,232	21,986,140	(99,092)	0%
Services & Supplies	8,198,327	8,198,327	-	0%
Utilities	1,401,085	1,401,085	-	0%
Intragovernmental	4,291,667	4,291,667	-	0%
Fixed Assets & Cap. Outlay	170,000	170,000	-	0%
Storm water transfer	622,053	622,053	-	0%
Transfers Out	1,555,669	3,033,583	1,477,914	95%
Total Expenditures	\$71,852,088	\$74,981,778	\$ 3,129,690	4%

The following are expenditure adjustments for FY 2022-23:

- Salary and wage expenditures, along with benefits, have been adjusted for compensation adjusted during the year and approved by Council, including a limited-term EMS Coordinator and increases to Fire department pay due to deployments.
- Transfers Out are increasing by \$1,477,914 due to additional CIP transfers approved with the first quarter adjustments, as well as a decrease from shifting a transfer into FY 2024-25.

Revenue and Expenditure Summary

The following 2023-24 summary shows the impacts of the above-mentioned changes:

General Fund

Revenue Categories	Budget FY 23-24	Revised FY 23-24
Property Taxes	12,977,564	12,977,564
Sales and Use Taxes	16,530,500	16,530,500
Business License Tax	1,241,935	1,241,935
Property Transfer Tax	1,367,331	1,367,331
Franchise Fees	3,336,507	3,336,507
Permits and Fees	1,174,478	1,174,478
Fines and Penalties	464,500	464,500
Investment Earnings and Rent	581,770	581,770
Intergovernmental Revenues	7,508,097	7,508,097
Charges for Services	9,534,712	10,266,488
Other Revenues	84,000	84,000
Transfers from Transient Occupancy Tax	2,123,000	2,123,000
Transfers from Measure U Sales Tax Fund	13,819,174	13,819,174
Other Transfers and Sources	1,108,520	3,686,434
Total Revenues	\$71,852,088	\$75,161,778

Expenditure Categories	Budget FY 23-24	Revised FY 23-24
Salaries and Wages	33,528,055	35,278,923
Benefits	22,085,232	21,986,140
Services & Supplies	8,198,327	8,198,327
Utilities	1,401,085	1,401,085
Intragovernmental	4,291,667	4,291,667
Fixed Assets & Cap. Outlay	170,000	170,000
Storm water transfer	622,053	622,053
Transfers Out	1,555,669	3,033,583
Total Expenditures	\$71,852,088	\$74,981,778

Rev. Over (Under) Exp.	\$ -	\$ 180,000
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Total Unassigned Bal. Beg. of Yr	\$ -	\$ -
Total Unassigned Bal. End of Yr	\$ -	\$ 180,000

As previously mentioned, revenues and expenditures are anticipated to be \$3 million higher than originally budgeted. Those adjustments, in addition to a slightly lower beginning unassigned fund balance, results in a small increase to the General Fund balance. This fund balance will be used in FY 2024-25, for the Free Fare transit program as originally budgeted. As a reminder, Measure U funds provide resources to balance the General Fund budget. As changes to General Fund revenues and expenditures occur throughout the fiscal year, the associated transfer into the General Fund from Measure U will be adjusted and the resulting impacts on overall fund balance will be presented in the Measure U fund.

The Measure U fund is expected to perform as originally budgeted. The First Quarter Adjustments included an increase of \$950,000 in the Priority Initiatives line, increasing funding for the Turning Basin CIP project.

Measure U Fund

Revenue Categories	Budget FY 23-24	Revised FY 23-24
Sales and Use Taxes	15,762,700	15,762,700
Total Revenues	\$15,762,700	\$15,762,700

Expenditure Categories		
General Fund Support	12,897,174	12,897,174
Infrastructure Investment/Future Needs	2,684,221	2,684,221
Priority Initiatives	4,604,000	5,554,000
Total Expenditures	\$20,185,395	\$21,135,395

Rev. Over (Under) Exp.	\$ (4,422,695)	\$ (5,372,695)
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Beginning Fund Balance	\$ 5,379,484	\$ 5,379,484
Ending Fund Balance	\$ 956,789	\$ 6,789

The revenue and expenditure changes mentioned above for both funds result in a projected estimated unassigned General Fund and Measure U Fund balance of \$186,789 on June 30, 2024.

Methodology used to Revise Five-Year Financial Forecast

The five-year financial forecast has also been revised in conjunction with the mid-year update. As mentioned earlier in this report, the forecasting model and process are both constantly evolving. An integrated salary and benefit forecasting model continue to be utilized and updated in conjunction with the annual budgeting process. Salaries and benefits represent approximately 78% of total General Fund expenditures so it is extremely important to focus significant energy on this component of the forecasting exercise. This model allows the results of each forecast year to roll forward to the subsequent year and provides for increasingly accurate forecasting.

Revenue Assumptions

- Property taxes – Property Taxes are projected to increase 4.0% annually through the remainder of the forecast period. Collaboration with the Sonoma County Tax Collector's office was critical during the formulation of this projection. Over the next few months we will be refining the projections based on anticipated residential and commercial development.
- Sales Tax – Sales taxes including the Bradley Burns 1% in addition to the Measure U district sales tax of 1%, have fully recovered and are projected to continue to grow throughout the forecast. The City's sales tax consultant has updated their forecast to include increases to incorporate business changes and growth in the food products, construction, and county pool categories. Moderate growth in business to business, retail and the miscellaneous sectors are included. Transportation is expected to decrease slightly from the highs of prior years. Overall sales tax revenue growth is projected at about 2% annually for the remaining years of the forecast.
- Other Revenue Categories – With the exception of Intergovernmental Revenues, other revenue categories are growing between 2.5% and 3.5% annually throughout the life of the forecast. These small increases are mainly driven by anticipated inflation increases over time. Intergovernmental Revenues are made up predominantly of Motor Vehicle In-Lieu fees and revenue growth is tied to changes in assessed property valuation.
- Transient Occupancy Tax Transfer – One newer hotel is expected to generate approximately \$800k annually in Transient Occupancy Tax when fully operational. This new revenue has been budgeted for beginning in FY 27-28.
- Transfers in –Transfers in from SLESF and Prince Park Trust will continue to provide support for Police operations and CAD as well as funding for park maintenance.

Expenditure Assumptions

Expenditure assumptions have also been evaluated and revised. As mentioned earlier, the salary and benefit model provide for increasingly accurate forecasting. In conjunction with that update, positions, payroll rates, allocations, and current benefits for each employee were verified. Benefits and retirement expenses were also verified, and calculations were reconciled with the payroll module. Salaries and benefits for full-time equivalent positions were also reconciled with the budgeted authorized positions.

There have been several salary and benefit assumptions incorporated into the updated forecast. They are as follows:

- Negotiated adjustments have been included in the forecast and anticipated future salary adjustments are included as well.
- Employee step increases continue to be included.
- Future Cost of Living Increases are included.
- It is assumed that there are no additional employees, other than the funded and authorized positions that currently exist.
- Comp time payout and separation cost estimates have been updated and are included.
- PERS contribution rates have been updated based on CalPERS actuarial study information received in July 2023.
- Worker's Compensation costs and Health Care insurance costs are projected to increase at a minimum of 8% annually.

Other expenditure assumptions have also been included in the forecast. They are included in the appropriate expenditure category and are as follows:

- Services and Supplies are projected to increase 3.5% annually. This could change as needs are identified for annual operations to occur.
- Storm Water Transfer continues to be included at \$622,053 annually to fund Storm Water operations until a funding source is identified.
- Transfers out include \$400,000 to the Vehicle Replacement Fund to fund the cost of replacing vehicles and equipment. Also included is the payback of an interfund loan for the LED streetlight project. Amounts included like the contribution to vehicle replacement represents a placeholder and are insufficient to have a significant impact.

The assumptions previously noted have all been included in the five-year forecasting model and the results are illustrated in the General Fund Long Term Operating Forecast below.

General Fund Long-Term Operating Forecast

Revenue Categories	Budget FY 23-24	Revised FY 23-24	Forecast FY 24-25	Forecast FY 25-26	Forecast FY 26-27	Forecast FY 27-28	Forecast FY 28-29	Forecast FY 29-30
Property Taxes	12,977,564	12,977,564	14,393,500	14,969,240	15,568,010	16,190,730	16,838,359	17,511,893
Sales and Use Taxes	16,530,500	16,530,500	16,122,100	16,475,000	16,811,700	17,132,200	17,436,500	17,724,600
Business License Tax	1,241,935	1,241,935	1,376,800	1,418,104	1,460,647	1,504,466	1,549,600	1,596,088
Property Transfer Tax	1,367,331	1,367,331	1,572,200	1,619,366	1,667,947	1,717,985	1,769,525	1,822,611
Franchise Fees	3,336,507	3,336,507	3,515,000	3,620,450	3,729,064	3,840,936	3,956,164	4,074,849
Permits and Fees	1,174,478	1,174,478	1,403,800	1,445,914	1,489,291	1,533,970	1,579,989	1,627,389
Fines and Penalties	464,500	464,500	362,900	370,158	377,561	385,112	392,814	400,670
Investment Earnings and Rent	581,770	581,770	982,690	1,012,171	1,042,536	1,073,812	1,106,026	1,139,207
Intergovernmental Revenues	7,508,097	7,508,097	8,044,400	8,285,732	8,534,304	8,790,333	9,054,043	9,325,664
Charges for Services	9,534,712	10,266,488	11,871,020	12,227,151	12,593,966	12,971,785	13,360,939	13,761,767
Other Revenues	84,000	84,000	73,700	75,911	78,188	80,534	82,950	85,439
Transfers from Transient Occupancy Tax	2,123,000	2,123,000	2,000,000	2,123,000	2,123,000	2,723,000	4,223,000	4,423,000
Transfers from Measure U Sales Tax Fund	13,819,174	13,819,174	13,744,550	14,743,134	16,365,707	17,369,699	18,472,266	19,892,988
Other Transfers and Sources	1,108,520	3,686,434	1,060,000	936,500	936,500	936,500	936,500	936,500
Total Revenues	\$71,852,088	\$75,161,778	\$76,522,660	\$79,321,831	\$82,778,421	\$86,251,062	\$90,758,675	\$94,322,665
Expenditure Categories								
Salaries and Wages	33,528,055	35,278,923	35,992,114	37,260,343	38,572,960	39,931,519	41,337,627	42,792,949
Benefits	22,085,232	21,986,140	23,930,347	25,413,304	26,966,551	28,465,471	30,926,259	32,367,482
Services & Supplies	8,198,327	8,198,327	9,022,337	8,871,494	9,181,996	9,503,366	9,835,984	10,180,243
Utilities	1,401,085	1,401,085	1,434,303	1,534,704	1,642,133	1,757,082	1,880,078	2,011,683
Intragovernmental	4,291,667	4,291,667	4,650,052	4,812,804	4,981,252	5,155,596	5,336,042	5,522,803
Fixed Assets & Cap. Outlay	170,000	170,000	120,000	124,200	128,547	133,046	137,703	142,523
Storm water transfer	622,053	622,053	622,053	622,053	622,053	622,053	622,053	622,053
Transfers Out	1,555,669	3,033,583	751,454	682,929	682,929	682,929	682,929	682,929
Total Expenditures	\$71,852,088	\$74,981,778	\$76,522,660	\$79,321,831	\$82,778,421	\$86,251,062	\$90,758,675	\$94,322,665
Rev. Over (Under) Exp.	\$ -	\$ 180,000	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Total Unassigned Bal. Beg. of Yr	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Total Unassigned Bal. End of Yr	\$ -	\$ 180,000	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -

The Mid-Year revised unassigned general fund balance is projected to be \$0 at the end of FY 2023-24. This balance is expected to remain at this level throughout the duration of the 5-year forecast. As a reminder, Measure U resources provide funding to balance the General Fund, thus any changes in fund balance that occur during the year, will be presented in the Measure U Fund. Please note that the General Fund has designated reserves, not shown here, of \$10.4 million available in the event of an emergency or downturn in the economy. This is currently 15% of operating expenditures and will be maintained at this level per Council policy.

Assumptions included in the Measure U Fund include sales tax growth of approximately 3% annually throughout the duration of the 5-year forecast. These estimates were developed in conjunction with the City's sales tax consultant. Expenditure assumptions are largely based on the anticipated General Fund Deficit which includes workforce stabilization. Estimates are updated twice per year and as new information is provided, such as new PERS rates, etc., updates could result in significant changes to the projected General Fund deficit.

Measure U Fund Long-Term Operating Forecast

Revenue Categories	Budget FY 23-24	Revised FY 23-24	Forecast FY 24-25	Forecast FY 25-26	Forecast FY 26-27	Forecast FY 27-28	Forecast FY 28-29	Forecast FY 29-30
Sales and Use Taxes	15,762,700	15,762,700	16,538,000	17,055,000	17,558,000	18,045,000	18,517,000	18,972,500
Use of Reserve Funds	-	-	-	-	-	-	-	920,488
Total Revenues	\$ 15,762,700	\$ 15,762,700	\$ 16,538,000	\$ 17,055,000	\$ 17,558,000	\$ 18,045,000	\$ 18,517,000	\$ 19,892,988
Expenditure Categories								
General Fund Support	12,897,174	12,897,174	13,744,550	14,743,134	16,365,707	17,369,699	18,472,266	19,892,988
Infrastructure Investment/Future Needs	2,684,221	2,684,221	2,151,450	1,811,866	1,067,293	575,301	14,734	-
Priority Initiatives	4,604,000	5,554,000	642,000	500,000	125,000	100,000	30,000	-
Total Expenditures	\$ 20,185,395	\$ 21,135,395	\$ 16,538,000	\$ 17,055,000	\$ 17,558,000	\$ 18,045,000	\$ 18,517,000	\$ 19,892,988
Rev. Over (Under) Exp.	\$ (4,422,695)	\$ (5,372,695)	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Beginning Fund Balance	\$ 5,379,484	\$ 5,379,484	\$ 6,789	\$ 6,789	\$ 6,789	\$ 6,789	\$ 6,789	\$ 6,789
Ending Fund Balance	\$ 956,789	\$ 6,789	\$ 6,789	\$ 6,789	\$ 6,789	\$ 6,789	\$ 6,789	\$ 6,789

As of this forecast, this balance is projected to remain near zero through the end of the forecasting period FY 29-30.

Risks and Opportunities

It is important to note that the amounts contained in the forecast are estimates. While a “most likely” estimate has been presented, the amounts will change. Most immediately, they will be refined over the next few months in conjunction with the FY 24-25 budget process. There are multiple risks associated with the forecast, such as:

- PERS rates have been revised to reflect the most up to date actuarial report dated July 2023 but could increase more than forecasted from factors including, but not limited to, underperforming investments and assumption changes. Investment returns for the year ended June 30, 2023, were 6.1%, stronger than the prior year's -7.5% but still lower than the discount rate of 6.8%. Investment returns fluctuate from year to year thus changes to contributions are expected into the future. When rates fall below PERS' target rate, a reduction to the discount rate can be implemented by PERS, further increasing rates. As mentioned prior, upcoming fiscal years will require significantly more in the way of PERS contributions due to the lower discount rate implemented by PERS several years ago.
- Workers' Compensation costs could be greater than forecasted amounts due to an increase in injury claims.
- The costs associated with storm water maintenance could surpass the forecasted estimates.
- General Fund capital or infrastructure costs are only minimally built into the forecast.
- Economists continue to have differing views on the possibility of a recession in the near term; the forecast does is based on current expected economic growth and a recession would profoundly impact the City's revenues and spending ability.

There are also opportunities associated with the forecast, such as:

- Revenues will be analyzed over the next two months to determine any available ongoing resources.
- Growth in tourism and sales tax continues to increase.
- New housing development is occurring which will result in increased property tax revenues into the future.
- Sonoma County will hopefully continue as a desirable destination and one of the fastest growing areas for job growth.
- New revenue opportunities will be explored.

Conclusion

We continue to work closely with our partners in the community as well as the City's sales tax consultant and County, State and Federal agencies as we navigate our way into this new normal. The nature of the current economy remains a concern. Any decrease or change in forecasted revenues will be communicated as soon as possible and any adjustments deemed necessary will be brought forward in conjunction with quarterly budget adjustments as the year progresses.

The forecast is a tool that illustrates how the City's financial situation could change over time based on economic assumptions for revenue growth and anticipated expenditure growth. The forecast does not include future management decisions that could impact the income statement, such as proposed new revenues or how to reduce expenditures. These decisions are part of budget discussions and incorporated into budget adoption each year.

Although the forecast provides a look ahead to plan for our future, the immediate focus is producing a balanced and fiscally responsible budget for Fiscal Year 2024-25. Over the next few months, next year's budget will be finalized, and a balanced budget brought forward for Council consideration. The forecast presented here, along with future updates, will provide financial perspective as we progress into the future.