



DATE: **March 3, 2025**

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 General Fund five-year financial forecast is periodically updated to provide the Council with a long-term financial planning tool. City staff typically provides an updated forecast twice annually; at mid-year and year-end. The most recent forecast update was included in the 2025 budget that was adopted by the City Council in June of 2024. At that time the combined ending General Fund and Measure U Fund Unassigned Reserve balance at June 30, 2024 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 been included.

The five-year forecast has been updated as of mid-year 2024-25. All budget adjustments that have been approved by Council from July through December of 2024 have been included. Those adjustments provide revised FY 2024-25 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

Uncertainty at the Federal level, from potential tariffs to possible tax cuts, makes it difficult to predict Petaluma's economic future. GDP estimates for 2025 range from 1.5% to 3.0% growth, and the federal budget deficit is estimated to remain around 6% of GDP for the foreseeable future. The Fed reduced interest rates in 2024, reducing the rate to 4.25%-4.5%. The Fed is now pausing on rate cuts while they monitor inflation.

California is also facing budget deficits, with a \$68 billion deficit forecast for the current fiscal year. Revenues have declined, leading the state to consider spending cuts or use of reserves. As of December 2024, California's unemployment rate of 5.5% was higher than the nationwide rate of 4.1%.

Annual inflation has dropped, but the cumulative impacts of inflation over the past few years as increased prices in the West by about 21% from December 2020 to December 2024. Looking forward, inflation is expected to continue at 2.2%-2.5% per year.

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 find ways to bring in additional revenues and/or reduce expenditures over the coming years or face an ongoing structural deficit. While we have not experienced a repeat of the steep inflation that occurred during the pandemic, the US has not had any deflation since that time. For the Western US, prices were 21% higher in December 2024 as compared to December 2020. This pressure is now being felt in changes in consumer spending habits.

According to the Sonoma County Economic Development Board the long-term outlook for Sonoma County tourism is positive the county's natural beauty, proximity to strong regional economies, and diverse tourist attractions. We will need to monitor this revenue source closely, as reduced consumer spending will likely also have some impact on travel. In the current fiscal year, Transient Occupancy Tax (TOT) revenues are trending at 87% of budgeted as of December 2024.

Petaluma has the second-highest number of businesses of all cities in Sonoma County at 5,308. The total number of business establishments operating in Petaluma has continuously increased year over year since 2013. With inflationary pressure reducing consumer spending, we anticipate some negative impacts over the next 18 months to our local business community.

Home values and prices for Sonoma County and Petaluma have held strong, with Petaluma's median price for an existing single family residence at \$1.03 million as of December 2024. Unsurprisingly, just 35% of households in Sonoma County can afford to buy a home in the county. These strong property values bring in property tax revenue for the City, but impact our community.

The anticipated dip in sales tax revenues is considered to be temporary, and we anticipate Petaluma to hold strong in future years thanks to our diverse population, business community, and natural beauty.

General Fund Revenues

Fiscal Year 2024-25 General Fund revenues have been analyzed and projected amounts for the remainder of the current fiscal year have been developed. As shown in the table below, total revenues during FY 24-25 are projected to be approximately \$1.8 million higher than originally budgeted amounts.

The FY 2024-25 Mid-Year Budget Adjustment requests an increase of \$1.2 million for Fire Strike Team reimbursements, and an increase of \$1.3 million for funding from the Ground Emergency Medical Transport (GEMT) Intergovernmental Transfer (IGT) Program. This funding has already been received this fiscal year in excess of what was originally budgeted. Expenditure budget adjustments are included in the adjustment request for the additional expenditures related to these programs. These increases, along with increases to Permits and Fees, Investment Earnings, and transfers in, help to offset anticipated reductions in Sales Tax, Business License Tax, and Property Transfer Tax. Based on analysis from our sales tax consultants, reductions in revenues are anticipated in the current fiscal year and FY 2025-26. This slight dip in sales will also impact anticipated Business License Tax, which is based on gross sales. Adjustments are being requested based on current economic factors, as well as our actuals for the FY 2023-24 fiscal year.

Revenue Categories	Budget FY 24-25	Revised FY 24-25	Change in \$	Change in %
Property Taxes	14,393,500	14,393,500	-	0%
Sales and Use Taxes	16,000,000	14,199,700	(1,800,300)	-11%
Business License Tax	1,376,800	1,297,200	(79,600)	-6%
Property Transfer Tax	1,572,200	1,300,000	(272,200)	-17%
Franchise Fees	3,515,000	3,515,000	-	0%
Permits and Fees	1,403,800	1,587,100	183,300	13%
Fines and Penalties	362,900	362,900	-	0%
Investment Earnings and Rent	1,039,870	1,081,070	41,200	4%
Intergovernmental Revenues	8,044,400	9,384,555	1,340,155	17%
Charges for Services	12,449,910	14,369,418	1,919,508	15%
Other Revenues	73,700	73,700	-	0%
Transfers from Transient Occupancy Tax	2,000,000	2,339,045	339,045	17%
Transfers from Measure U Transactions and Use Tax	13,614,247	13,614,247	-	0%
Other Transfers and Sources	1,230,000	1,325,642	95,642	8%
Total Revenues	77,076,327	78,843,077	1,766,750	2%

General Fund Expenditures

Fiscal year 2024-25 expenditures are currently projected to be \$1.5 million higher than the current adopted budget based on the costs from strike team deployments and the additional spending capacity from the GEMT IGT dollars.

Expenditure Categories	Budget FY 24-25	Revised FY 24-25	Change in \$	Change in %
Salaries & Wages	36,707,479	37,922,387	1,214,908	3%
Employee Benefits	24,191,147	24,191,147	-	0%
Services & Supplies	8,898,852	9,563,852	665,000	7%
Utilities	1,434,303	1,434,303	-	0%
Intragovernmental Charges	4,749,235	4,204,235	(545,000)	-11%
Fixed Assets & Capital Outlay	-	154,004	154,004	n/a
Storm Water Transfer	622,053	622,053	-	0%
Transfers Out	785,454	785,454	-	0%
Total Expenditures	77,388,523	78,877,435	1,488,912	2%

The following are expenditure adjustments for FY 2024-25:

- Strike Team Reimbursements:
 - Salaries & Wages: increase of \$1,214,908 for deployments; this funding covers both overtime and related benefits
- Ground Emergency Medical Transport (GEMT) Intergovernmental Transfer (IGT) Program:
 - Services & Supplies: increase of \$665,000
 - Fixed Assets & Capital Outlay: increase of \$125,155
 - Total change of \$154,004 shown includes \$28,849 adjustment from the first quarter budget adjustments
- Intragovernmental Charges:
 - Reduction of charges to Risk Management Fund; fund has sufficient fund balance for the current fiscal year.

Revenue and Expenditure Summary

The following 2024-25 summary shows the impacts of the above-mentioned changes:

General Fund

Revenue Categories	Budget FY 24-25	Projected FY 24-25
Property Taxes	14,393,500	14,393,500
Sales and Use Taxes	16,000,000	14,199,700
Business License Tax	1,376,800	1,297,200
Property Transfer Tax	1,572,200	1,300,000
Franchise Fees	3,515,000	3,515,000
Permits and Fees	1,403,800	1,587,100
Fines and Penalties	362,900	362,900
Investment Earnings and Rent	1,039,870	1,081,070
Intergovernmental Revenues	8,044,400	9,384,555
Charges for Services	12,449,910	14,369,418
Other Revenues	73,700	73,700
Transfers from Transient Occupancy Tax	2,000,000	2,339,045
Transfers from Measure U Transactions and Use Tax	13,614,247	13,614,247
Other Transfers and Sources	1,230,000	1,325,642
Total Revenues	77,076,327	78,843,077
Expenditure Categories		
Salaries & Wages	36,707,479	37,922,387
Employee Benefits	24,191,147	24,191,147
Services & Supplies	8,898,852	9,563,852
Utilities	1,434,303	1,434,303
Intragovernmental Charges	4,749,235	4,204,235
Fixed Assets & Capital Outlay	-	154,004
Storm Water Transfer	622,053	622,053
Transfers Out	785,454	785,454
Total Expenditures	77,388,523	78,877,435
Net Impact	(312,196)	(34,358)
Unassigned Fund Balance at 7/1/24	34,358	34,358
Projected Unassigned Fund Balance at 6/30/25	(277,838)	(0)

The net impact to the General Fund is projected to be a decrease of fund balance of \$34,358.

The Measure U fund is also projected to be impacted by the expected downtown in City sales tax revenues. This impact has been offset by reducing transfers out of the fund in order to balance the fund for FY 2024-25.

Measure U Fund

Revenue Categories	Budget FY 24-25	Projected FY 24-25	Change in \$	Change in %
Transaction and Use Taxes	16,200,000	15,615,000	(585,000)	-4%
Total Revenues	16,200,000	15,615,000	(585,000)	
Expenditure Categories				
General Fund Support	13,614,247	13,614,247	-	0%
Infrastructure Investment/Future Needs	1,950,542	1,427,052	(523,490)	-27%
Priority Initiatives	642,000	642,000	-	0%
Total Expenditures	16,206,789	15,683,299	(523,490)	-3%
Net Impact	(6,789)	(68,299)		
Unassigned Fund Balance at 7/1/24	68,299	68,299		
Projected Unassigned Fund Balance at 6/30/25	61,510	-		

Methodology used to Revise Five-Year Financial Forecast

The five-year financial forecast has 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%, are expected to dip in the current fiscal year and essentially plateau over the forecast period, with very slow growth over the five years shown.
- 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. The Transfer In from Measure U is shown to steadily increase over the life of the forecast to

support General Fund operations, including funding community facing positions, supplies for parks and other facilities, and public safety.

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 2024.
- 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 \$500,000 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 such as the contribution to vehicle replacement represent placeholder dollars 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 Five-Year Forecast

Revenue Categories	Revised 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	14,393,500	15,005,100	15,643,000	16,308,000	17,001,000	17,723,000
Sales and Use Taxes	14,199,700	14,280,000	14,539,000	14,704,000	14,826,000	14,898,000
Business License Tax	1,297,200	1,379,000	1,420,370	1,462,981	1,506,870	1,552,076
Property Transfer Tax	1,300,000	1,326,000	1,365,780	1,406,753	1,448,956	1,492,425
Franchise Fees	3,515,000	3,585,400	3,692,962	3,803,751	3,917,864	4,035,400
Permits and Fees	1,587,100	1,556,700	1,603,401	1,651,503	1,701,048	1,752,079
Fines and Penalties	362,900	435,500	444,210	453,094	462,156	471,399
Investment Earnings and Rent	1,081,070	1,072,300	1,104,469	1,137,603	1,171,731	1,206,883
Intergovernmental Revenues	9,384,555	9,125,000	9,444,375	9,774,928	10,117,050	10,471,147
Charges for Services	14,369,418	13,946,997	14,365,407	14,796,369	15,240,260	15,697,468
Other Revenues	73,700	79,000	81,370	83,811	86,325	88,915
Transfers from Transient Occupancy Tax	2,339,045	2,350,000	2,350,000	3,800,000	3,800,000	4,350,000
Transfers from Measure U Transactions and Use Tax	13,614,247	14,691,329	16,178,817	16,274,635	18,499,431	19,570,310
Other Transfers and Sources	1,325,642	1,434,651	1,286,500	1,286,500	1,286,500	1,286,500
Total Revenues	78,843,077	80,266,977	83,519,661	86,943,928	91,065,191	94,595,602
Expenditure Categories						
Salaries & Wages	37,922,387	38,135,453	39,398,153	40,785,593	42,221,594	43,707,855
Employee Benefits	24,191,147	26,083,702	27,509,499	28,958,832	31,032,229	32,439,022
Services & Supplies	9,563,852	8,397,629	8,691,546	8,995,750	9,310,601	9,636,472
Utilities	1,434,303	1,453,268	1,554,997	1,663,847	1,780,316	1,904,938
Intragovernmental Charges	4,204,235	4,815,458	4,983,999	5,158,439	5,338,984	5,525,848
Fixed Assets & Capital Outlay	154,004	-	-	-	-	-
Storm Water Transfer	622,053	622,053	622,053	622,053	622,053	622,053
Transfers Out	785,454	759,414	759,414	759,414	759,414	759,414
Total Expenditures	78,877,435	80,266,977	83,519,661	86,943,928	91,065,191	94,595,602
Net Impact	(34,358)	-	-	-	-	-
Unassigned Fund Balance at July 1	34,358	(0)	(0)	(0)	(0)	(0)
Projected Unassigned Fund Balance at June 30	(0)	(0)	(0)	(0)	(0)	(0)

This forecast shows a scenario where revenues largely grow as anticipated, including a slight dip in sales tax and related revenues in FY 2024-25 and FY 2025-26 and then slowly increase over time. Expenditures are growing faster than operating revenues, necessitating increasing transfers in from other funds over the course of the forecast period to balance the General Fund. The Measure U forecast balances General Fund support with the use of reserve funds. This approach will be considered more closely with the preparation and adoption of each budget.

Measure U Fund Five-Year Forecast

Revenue Categories	Revised FY 24-25	Forecast FY 25-26	Forecast FY 26-27	Forecast FY 27-28	Forecast FY 28-29	Forecast FY 29-30
Transaction and Use Taxes	15,615,000	15,458,000	15,688,000	16,044,000	16,366,000	16,647,000
Use of Reserve Funds		547,048	2,560,786	2,744,354	4,647,150	5,437,029
Total Revenues	15,615,000	16,005,048	18,248,786	18,788,354	21,013,150	22,084,029
Expenditure Categories						
General Fund Support	13,614,247	14,691,329	16,178,817	16,274,635	18,499,431	19,570,310
Infrastructure Investment/Future Needs	1,427,052	913,719	1,944,969	2,413,719	2,413,719	2,413,719
Priority Initiatives	642,000	400,000	125,000	100,000	100,000	100,000
Total Expenditures	15,683,299	16,005,048	18,248,786	18,788,354	21,013,150	22,084,029
Net Impact	(68,299)	-	-	-	-	-
Unassigned Fund Balance at July 1	68,299	-	-	-	-	-
Projected Unassigned Fund Balance at June 30	-	-	-	-	-	-

Risks and Opportunities

It is important to note that the amounts contained in the forecast are estimates based on our current information. 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 25-26 budget process. There are multiple risks associated with the forecast, such as:

- Sales and use tax revenues are expected to dip in the current year and show very slow growth during the forecast period. This impacts the General Fund, Measure U Fund, Measure H Fund, and the Measure M Fund.
- 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 9.3%, stronger than the prior year’s 6.1% and higher 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. 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. The strong investment returns of 2023-24 should hopefully defray those costs slightly; we should see the impact in the next set of actuarial reports.
- Workers’ Compensation costs could be greater than forecasted.
- 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.
- The forecast 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 and to explore new opportunities.
- 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.

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.

Although the forecast provides a look ahead to plan for our future, the immediate focus is ensuring that our current fiscal year is balanced and producing a balanced and fiscally responsible budget for Fiscal Year 2025-26. 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.