



DATE: **March 20, 2023**

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

FROM: Corey Garberolio, Finance Director/Deputy City Manager

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 2023 budget that was adopted by the City Council in June of 2022. At that time the combined ending General Fund and Measure U Fund Unassigned Reserve balance at June 30, 2022 was projected to be \$0k, with revenues equaling expenditures. That balance was projected to remain at this level through June 30, 2028.

Updating the Five-Year Financial Forecast

The forecasting process and model are constantly in a state of improvement, and in 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.

The five-year forecast has been updated as of mid-year 2022-23. All budget adjustments that have been approved by Council since the 2022-23 budget was adopted have been included. Those adjustments provide revised FY 2022-23 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

Our revenues are recovering, and we recognized strong growth through June of 2022. Revenues through today, specifically sales tax, one of the largest revenue categories that support the General Fund, remains strong however, 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 possible full recovery by next fiscal year. 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.

The long-term outlook for Sonoma County tourism is positive with steady growth that will rebuild its tourism base. 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 will steadily recover given the renewed confidence in traveling. The county's natural beauty, proximity to strong regional economies, and diverse tourist attractions will aid in recover. In addition to the pandemic, wildfires continue to challenge the travel and tourism industry in Sonoma County. Petaluma did recognize a significant decline in Transient Occupancy Tax during the pandemic, however revenues have improved and the expectation is this recovery trend will continue.

Petaluma's overall economic outlook is stable however the unstable nature of 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 vacancy 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 2022-23 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 22-23 are projected to be up \$1,617,638 from budgeted amounts.

Revenue Category	Budget FY 22-23	Revised FY 22-23	Change	Change %
Property Taxes	12,363,947	12,363,947	\$ -	0.0%
Sales and Use Taxes	14,708,400	15,958,400	1,250,000	8.5%
Business License Taxes	1,194,168	1,194,168	-	0.0%
Property Transfer Taxes	1,202,220	1,202,220	-	0.0%
Franchise Fees	3,294,376	3,294,376	-	0.0%
Permits and Fees	1,133,254	1,133,254	-	0.0%
Fines and Penalties	485,000	485,000	-	0.0%
Investment Earnings and Rent	406,663	406,663	-	0.0%
Intergovernmental Revenue	7,175,444	7,175,444	-	0.0%
Charges for Services	8,803,068	8,803,068	-	0.0%
Other Revenues	14,000	14,000	-	0.0%
TOT Transfer	2,123,000	2,123,000	-	0.0%
Other Transfers	394,500	394,500	-	0.0%
Measure U Transfer	10,658,794	9,926,432	(732,362)	-6.9%
Funds from Designated Reserves	1,110,000	2,210,000	1,100,000	99.1%
Total Revenues	\$ 65,066,834	\$ 66,684,472	\$ 1,617,638	2.5%

The following are revenue adjustments for FY 2022-23:

- Sales Tax – This category is increasing \$1,250,000 due to sooner than anticipated and stronger than expected recovery and associated increased sales tax revenues expected through June 30, 2023
- Funds from Designated Reserves – This category is increased due to one-time transfers in from reserves for the Turning Basin Dredging and Dock Upgrades capital project. This is directly offset by increased expenditures.
- Measure U Transfer – This category is reduced due to less funds needed in the General Fund to balance the budget. As there are changes to General Fund revenues and expenditures throughout the fiscal year, the transfer in from Measure U will be adjusted.

General Fund Expenditures

Fiscal year 2022-23 expenditures are projected to be \$1,617,638 higher than the adopted budget during the current fiscal year.

Expenditure Category	Budget FY 22-23	Revised FY 22-23	Change	Change %
Salaries and Wages	\$ 31,358,289	\$ 31,388,022	\$ 29,733	0.1%
Benefits	20,768,611	20,771,516	2,905	0.0%
Services & Supplies	6,975,693	7,160,693	185,000	2.7%
Utilities	1,176,444	1,176,444	-	0.0%
Intragovernmental	2,795,290	2,795,290	-	0.0%
Fixed Assets and Capital Outlay	219,000	219,000	-	100.0%
Transfers Out	1,773,507	3,173,507	1,400,000	78.9%
Total Expenditures	\$ 65,066,834	\$ 66,684,472	\$ 1,617,638	2.5%

The following are expenditure adjustments for FY 2022-23:

- Salary and wage expenditures have been adjusted for compensation adjusted during the year and approved by Council. This category, together with Benefits, is increased by \$32,638.
- Services and supplies are increasing by \$185,000 due to increased costs related to Healthy Democracy and associated professional services.
- Transfers out are increasing by \$1,400,000 due to a transfer to the Vehicle Replacement Fund approved by Council and the offsetting expenditure as noted above for the Turning Basin Dredging and Dock Upgrades capital project.

Revenue and Expenditure Summary

The following 2022-23 summary shows the impacts of the above-mentioned changes:

General Fund

Revenue Categories	Budget 2023	Revised 2023
Property Taxes	12,363,947	12,363,947
Sales and Use Taxes	14,708,400	15,958,400
Business License Tax	1,194,168	1,194,168
Property Transfer Tax	1,202,220	1,202,220
Franchise Fees	3,294,376	3,294,376
Permits and Fees	1,133,254	1,133,254
Fines and Penalties	485,000	485,000
Investment Earnings and Rent	406,663	406,663
Intergovernmental Revenues	7,175,444	7,175,444
Charges for Services	8,803,068	8,803,068
Other Revenues	14,000	14,000
Transfers from Transient Occupancy Tax	2,123,000	2,123,000
Transfers from Measure U Sales Tax Fund	10,658,794	9,926,432
Other Transfers and Sources	1,504,500	2,604,500
Total Revenues	\$ 65,066,834	\$ 66,684,472
Expenditure Categories		
Salaries and Wages	31,358,289	31,388,022
Benefits	20,768,611	20,771,516
Services & Supplies	6,975,693	7,160,693
Utilities	1,176,444	1,176,444
Intragovernmental	2,795,290	2,795,290
Fixed Assets & Cap. Outlay	219,000	219,000
Stormwater transfer	592,053	592,053
Transfers Out	1,181,454	2,581,454
Total Expenditures	\$ 65,066,834	\$ 66,684,472
Rev. Over (Under) Exp.	\$ -	\$ -
Total Unassigned Bal. Beg. of Yr	\$ -	\$ -
Total Unassigned Bal. End of Yr	\$ -	\$ -

As previously mentioned, revenues and expenditures are anticipated to be up \$1,617,638. Those adjustments, in addition to a slightly lower beginning unassigned fund balance, results in no change to the General Fund balance. 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.

Like the General Fund, Measure U sales tax revenues have also shown signs of recovery occurring sooner than expected and thus revenues have been increased by \$1,300,000. Transfers Out of the Measure U fund are expected to be decreased by \$732,362 due to less needed in the General Fund. Those adjustments, in addition to a higher beginning fund balance, results in an increase to the Measure U ending fund balance by \$4,460,384.

Measure U Fund

Revenue Categories	Budget 2023	Revised 2023
Sales and Use Taxes	13,581,750	14,881,750
Total Revenues	\$ 13,581,750	\$ 14,881,750
Expenditure Categories		
General Fund Deficit - Maintain Service Level	6,527,604	5,795,241
Workforce Stabilization	3,987,190	3,987,191
Infrastructure Investment/Bonding/Debt Service	3,701,135	3,701,135
Priority Initiatives	1,498,000	1,498,000
Total Expenditures	\$ 15,713,929	\$ 14,981,567
Rev. Over (Under) Exp.	\$ (2,132,179)	\$ (99,817)
Beginning Fund Balance	\$ 2,149,633	\$ 4,577,655
Ending Fund Balance	\$ 17,454	\$ 4,477,838

This change, in addition to the revenue and expenditure changes mentioned above for both funds, results in a projected estimated unassigned General Fund and Measure U Fund balance of \$4.47 million at June 30, 2023.

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 85% 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 3.0% during FY 23-24; and 3.0% 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 recovering sooner than anticipated and are projected to increase by approximately 4% next fiscal year and continue their moderate growth into the out years of the forecast. The City’s sales tax consultant has revised their forecast to include a slight increase to incorporate business changes and growth in the food products, construction and transportation categories. Moderate growth in business to business, retail and the miscellaneous sectors are included. Overall sales tax revenue growth is projected at about 3% 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 \$400k annually in Transient Occupancy Tax when fully operational. This new revenue has been budgeted for beginning in FY 23-24.
- Transfers in – One-time transfers in during FY 22-23 have been removed in subsequent years. 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 beginning in FY 23-24 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 2022 which includes the CalPERS discount rate reduction reflecting the full

impact of this reduction as well as savings from investment returns earned during FY 21 and the continued savings from the partial paydown of the PERS Unfunded Liability.

- Worker's Compensation costs are projected to increase at a minimum of 8% annually.
- Health care insurance cost increases are included at 7% annually for most miscellaneous and safety employees.

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

- FY 23-24 Services and Supplies expenditures are projected to be relatively flat from the current year. This is due to non-recurring expenditures and carryover encumbrances that were included in FY 22-23. 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 \$592,053 annually to fund Storm Water operations until a funding source is identified.
- FY 23-24 Transfers Out are projected to be down due to non-recurring transfers that were included in FY 22-23 and removed in subsequent years. 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 2023	Revised 2023	Forecast 2024	Forecast 2025	Forecast 2026	Forecast 2027	Forecast 2028
Property Taxes	12,363,947	12,363,947	12,734,865	13,116,911	13,510,419	13,915,731	14,333,203
Sales and Use Taxes	14,708,400	15,958,400	16,530,500	17,085,800	17,691,900	18,276,400	18,839,500
Business License Tax	1,194,168	1,194,168	1,229,993	1,266,893	1,304,900	1,344,047	1,384,368
Property Transfer Tax	1,202,220	1,202,220	1,238,287	1,275,435	1,313,698	1,353,109	1,393,702
Franchise Fees	3,294,376	3,294,376	3,393,207	3,495,003	3,599,854	3,707,849	3,819,085
Permits and Fees	1,133,254	1,133,254	1,167,252	1,202,269	1,238,337	1,275,487	1,313,752
Fines and Penalties	485,000	485,000	494,700	504,594	514,686	524,980	535,479
Investment Earnings and Rent	406,663	406,663	418,863	431,429	444,372	457,703	471,434
Intergovernmental Revenues	7,175,444	7,175,444	7,390,707	7,612,429	7,840,801	8,076,025	8,318,306
Charges for Services	8,803,068	8,803,068	9,067,160	9,339,175	9,619,350	9,907,931	10,205,169
Other Revenues	14,000	14,000	14,420	14,853	15,298	15,757	16,230
Transfers from Transient Occupancy Tax	2,123,000	2,123,000	2,294,000	2,294,000	2,294,000	2,294,000	2,294,000
Transfers from Measure U Sales Tax Fund	10,658,794	9,926,432	11,719,232	13,401,975	14,583,284	15,799,333	16,983,549
Other Transfers and Sources	1,504,500	2,604,500	486,500	486,500	486,500	486,500	486,500
Total Revenues	\$ 65,066,834	\$ 66,684,472	\$ 68,179,686	\$ 71,527,266	\$ 74,457,399	\$ 77,434,852	\$ 80,394,277
Expenditure Categories							
Salaries and Wages	31,358,289	31,388,022	33,018,161	34,478,818	35,856,252	37,109,718	38,407,055
Benefits	20,768,611	20,771,516	21,834,697	23,245,052	24,401,188	25,611,186	26,737,501
Services & Supplies	6,975,693	7,160,693	7,167,285	7,418,140	7,677,775	7,946,497	8,224,625
Utilities	1,176,444	1,176,444	1,352,911	1,447,614	1,548,947	1,657,374	1,773,390
Intragovernmental	2,795,290	2,795,290	3,543,125	3,667,135	3,695,484	3,824,826	3,958,695
Fixed Assets & Cap. Outlay	219,000	219,000	200,000	207,000	214,245	221,744	229,505
Storm water transfer	592,053	592,053	592,053	592,053	592,053	592,053	592,053
Transfers Out	1,181,454	2,581,454	471,454	471,454	471,454	471,454	471,454
Total Expenditures	\$ 65,066,834	\$ 66,684,472	\$ 68,179,686	\$ 71,527,266	\$ 74,457,399	\$ 77,434,852	\$ 80,394,277
Rev. Over (Under) Exp.	\$ -	\$ -	\$ 0	\$ (0)	\$ (0)	\$ 0	\$ (0)
Total Unassigned Bal. Beg. of Yr	\$ -	\$ -	\$ -	\$ 0	\$ (0)	\$ (0)	\$ 0
Total Unassigned Bal. End of Yr	\$ -	\$ -	\$ 0	\$ (0)	\$ (0)	\$ 0	\$ 0

The Mid-Year revised unassigned general fund balance is projected to be \$0 at the end of FY 2022-23. 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 \$9.8m 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 4% 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 2023	Revised 2023	Forecast 2024	Forecast 2025	Forecast 2026	Forecast 2027	Forecast 2028
Sales and Use Taxes	13,581,750	14,881,750	15,762,700	16,508,500	17,197,700	17,860,900	18,498,100
Total Revenues	\$ 13,581,750	\$ 14,881,750	\$ 15,762,700	\$ 16,508,500	\$ 17,197,700	\$ 17,860,900	\$ 18,498,100
Expenditure Categories							
General Fund Deficit - Maintain Service Level	6,527,604	5,795,241	7,181,802	8,300,762	8,904,412	9,528,583	10,106,351
Workforce Stabilization	3,987,190	3,987,191	4,537,430	5,101,213	5,678,872	6,270,750	6,877,198
Infrastructure Investment/Bonding/Debt Service	3,701,135	3,701,135	3,743,468	2,806,525	2,314,416	1,761,567	1,214,551
Priority Initiatives	1,498,000	1,498,000	300,000	300,000	300,000	300,000	300,000
Total Expenditures	\$ 15,713,929	\$ 14,981,567	\$ 15,762,700	\$ 16,508,500	\$ 17,197,700	\$ 17,860,900	\$ 18,498,100
Rev. Over (Under) Exp.	\$ (2,132,179)	\$ (99,817)	\$ 0	\$ (0)	\$ (0)	\$ 0	\$ (0)
Beginning Fund Balance	\$ 2,149,633	\$ 4,577,655	\$ 4,477,838	\$ 4,477,838	\$ 4,477,838	\$ 4,477,838	\$ 4,477,838
Ending Fund Balance	\$ 17,454	\$ 4,477,838	\$ 4,477,838	\$ 4,477,838	\$ 4,477,838	\$ 4,477,838	\$ 4,477,838

As of this forecast, this balance is projected to remain at \$4.47m through the end of the forecasting period FY 27-28. It is anticipated that this balance will be programmed in the upcoming FY 23-24 budget process.

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 23-24 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 2022 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, 2021 were strong and have resulted in savings beginning in FY 25 of the forecast, however investment losses for the year ended June 30, 2022 have resulted in increased costs which have been included and nearly offset any earlier reductions. Investment returns fluctuate from year to year thus changes to contributions are expected into the future. If rates

fall below PERS target rate, a reduction to the discount rate will be implemented by PERS furthering increasing rates. As mentioned, prior, upcoming fiscal years will require significantly more in the way of PERS contributions due to the lower discount rate implement 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 only minimally built into the forecast.
- Economists warn of the possibility of a recession in the near term which is not built into the forecast and could have serious implications should it occur.

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 the tourism industry continues
- Some 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 out of the pandemic. 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 producing a balanced and fiscally responsible budget for Fiscal Year 2023-24. Over the next few months, next year's budget will be developed, 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.