General Fund Five-Year Fiscal Analysis and Long-Term Financial Plan: 2024-29

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OVERVIEW

Background

This report is in response to the City of South Pasadena's interest in preparing a General Fund fiscal analysis and long-term financial plan (Plan) in assessing its ability over the next five years – on an "order of magnitude" basis – to:

- Continue current services in the aftermath of global pandemic (as well as other recently surfaced economic challenges).
- Address long-term liabilities.
- Achieve capital improvement plan (CIP) goals.
- And if the forecast projects a negative gap between revenues and expenditures, identify realistic options for the City's consideration in closing the gap.

Short and Long-Term Decision-Making Consequences. Making good resource decisions in the short term as part of the budget process requires considering their impact on the City's fiscal condition down the road. Developing good solutions requires knowing the size of the problem the City is trying to solve. In short, the City cannot fix a problem it hasn't defined. And in this economic and fiscal environment, looking only one year ahead has the strong potential to misstate the size and nature of the fiscal challenges – and opportunities – ahead of the City.

For those local agencies that have prepared long-term forecasts and financial plans, this did not magically make their fiscal problems disappear they still had tough decisions to make. However, it allowed them to better assess their longer-term outlook, more closely define the size and duration of the fiscal challenges facing them, and then make better decisions accordingly for both the short and long run. This will be true for the City as well.

Forecast Purpose and Approach

The purpose of the forecast is to identify the General Fund's ability over the next five years – on an "order of magnitude" basis – to continue current services in the aftermath of the global pandemic (as well as other recently surfaced economic challenges), address long-term liabilities and achieve CIP goals.

The forecast does this by projecting ongoing revenues and subtracting from them likely operating and CIP costs in continuing current service levels. If positive, the balance remaining is available to fund "new initiatives" such as implementing CIP goals, addressing unfunded liabilities or improving service levels. On the other hand, if negative, it shows the likely "forecast gap" if the City continues current service levels or funds CIP projects without corrective action.

The forecast builds on the *General Fiscal Outlook and Key Assumptions* report presented to the Finance Commission in September 2023. It prefaced this forecast report by discussing key economic, demographic and fiscal factors that are likely to affect the General Fund's fiscal future, which ultimately translate into key assumptions that drive forecast results.

It is important to stress that this forecast is not the budget.

Budgets are based on program review, priorities and affordability. The forecast on the other hand is based on assumptions. It doesn't make expenditure decisions; it doesn't make revenue decisions. As noted above, its sole purpose is to provide an "order of magnitude" feel for the General Fund's ability to continue current service levels and achieve CIP goals.

Can the City Afford New Initiatives?

This is a basic question of priorities, not of financial capacity per se. But the forecast assesses how difficult answering this question will be.

Ultimately, this forecast cannot answer the question: "Can the City afford new initiatives?" This is a basic question of priorities, not of financial capacity per se. However, making trade-offs is what the budget process is all about: determining the highest priority uses of the City's limited resources. And by identifying and analyzing key factors affecting the City's long-term fiscal health, the forecast can help assess how difficult making these priority decisions will be.

Stated simply, the forecast is not the budget. Rather, it sets forth the challenges – and opportunities – ahead of the City in adopting a balanced budget, next year and beyond.

FORECAST FINDINGS

The Short Story

- The General Fund is in good shape in funding operating expenditures.

- However, subsidies to other funds also play a key role in funding day-to-day services. When these likely ongoing transfers are included, it appears that the General Fund will experience a small gap (about 0.7% of revenues) in 2024-25. However, after that for each of the next four years, General Fund revenues will exceed operating costs and subsidy transfers to other funds.

- On the other hand, challenges are ahead in funding CIP projects (let alone improving service levels or addressing long-term liabilities).

The following presents results for these three assessments.

Table 1. General Fund Resource Availability: Operating Costs

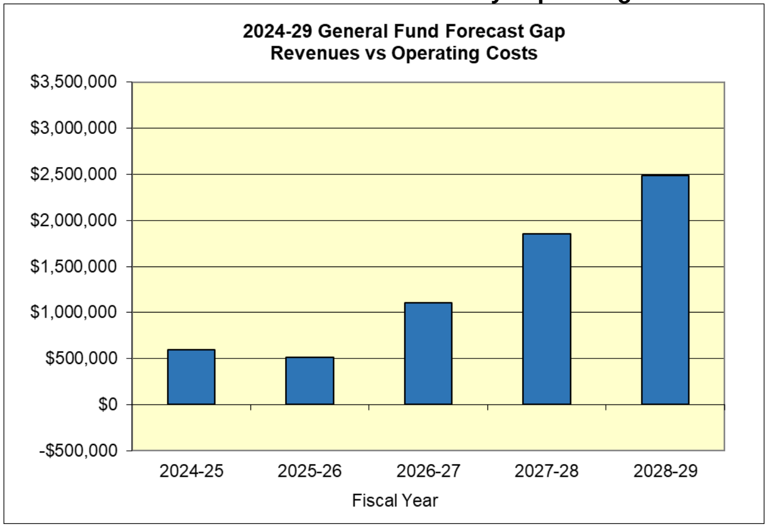


Table 2. General Fund Resource Availability: Operating Costs and Fund Subsidies

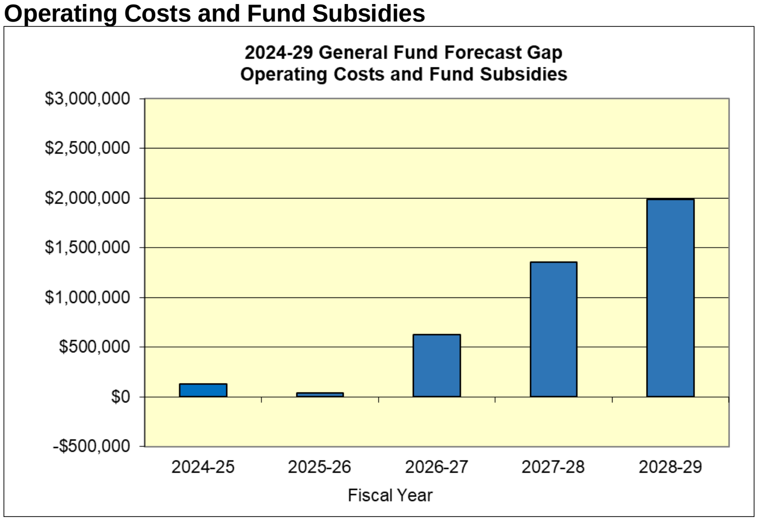
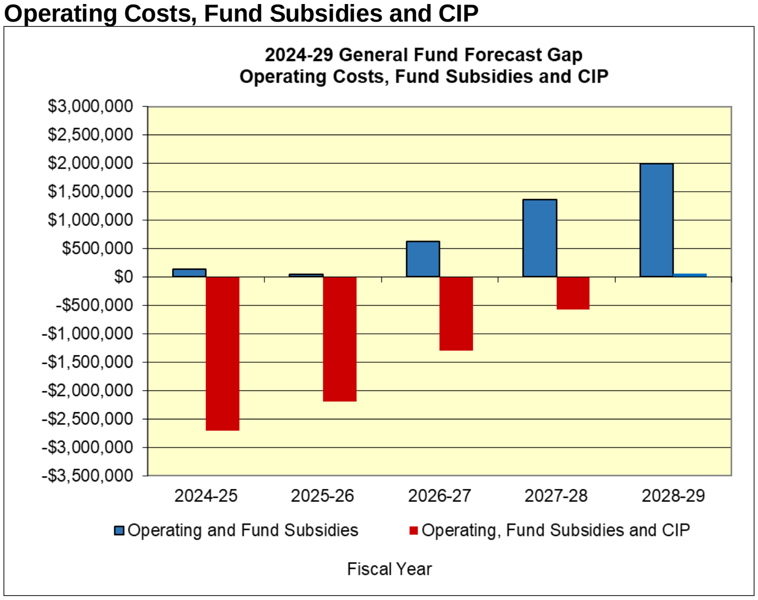


Table 3. General Fund Resource Availability: Operating Costs, Fund Subsidies and CIP



Funding Operating Costs. As shown in Table 1, forecast revenues exceed *operating expenditures* in every year. More importantly, resource availability stays stable or grows each year, rather than declining, with resource availability growing to $2.5 million in 2028-29.

Including Fund Subsidies. That said, subsidies to two funds (Lighting/Landscape Maintenance and Business Improvement) also play a key role in funding day-to-day services. When these likely ongoing transfers are included, Table 2 shows that that the General Fund will still show resource availability in each year, growing to $2.0 million 2028-29.

Funding with Transfers and CIP. Table 3 compares forecast results for operating costs and fund subsidies (Table 2) with what happens if CIP projects (five-year CIP of about $2.2 million annually) are included in the forecast. In this case, in the first four years, there are declining gaps. By year five (2028-29), the gap is eliminated, but by a very modest amount (just $60,600).

What does this mean and why does the General Fund's resource availability grow? As noted above, regardless of whether the gap is positive or negative, the most important finding is that resource availability stays stable or improves each year under either of the three assessments. As discussed in greater detail below regarding key forecast assumptions, this results because the General Fund's top revenues are projected to grow faster (albeit modestly) than operating costs and fund subsidies in each year of the forecast.

The Path Forward. As discussed below, there are several options available in funding CIP projects in all years while meeting minimum policy levels, including:

- Use reserves that are above policy target minimum.
- Scale back CIP projects.
- Reduce CalPERS unfunded actuarial liabilities (UAL).
- Consider focused revenue options and improved indirect cost recovery from enterprise funds.
- Combination of options.

Key Forecast Drivers

Assumptions drive the forecast results, which are detailed on pages 22 to 26. Simply stated, if the assumptions change, the results will change. As prefaced in the *General Fiscal Outlook and Key Assumptions* presented to the Finance Commission on September 28, 2023, there are eight key drivers underlying the forecast results:

- General economic trends and outlook
- State budget situation
- Current financial condition
- Key revenues
- Operating cost drivers, including approved Memorandums of Understanding (MOU's), insurance and pension costs
- General Fund subsidies to other funds
- Population growth and development
- Capital improvement plan

➊ *General Economic Trends and Outlook*

Where's the Recession? The shut-down of the economy in responding to the Covid-19 public health threat was immediate and severe, especially impacting employment and retail sales. However, even with continued peaks and valleys in some cases, the economy has seen significant improvements over the past two years in spite of rises in inflation.

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With the Federal Reserve (Fed) raising its prime interest rate in combatting inflation, the consensus view of many leading economists was that we would experience a recession. However, it appears that the hopeful “soft landing” is happening.

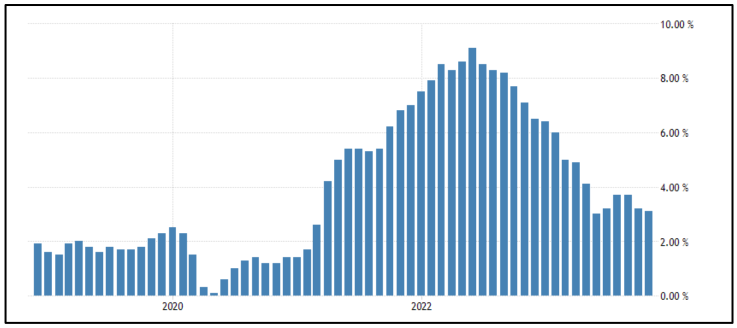
Taming Rising Inflation. While initially believed to be short-term by many leading economists, inflation peaked at an annual rate of 9.1% in June 2022 (the highest rate in forty years), following long-term trends of about 2% before Covid-19. This was largely due to high demand (bottled up during Covid-19) for limited supplies arising from supply chain shortages along with surging gasoline prices due to with limited supplies resulting from the war in Ukraine.

This in turn resulted in increasing interest rates by the Fed in addressing this. However, as shown in Table 4, the inflation rate has steadily declined, following to between 3.0% and 3.7% in the last six months (through November 2023), falling to 3.2% in October and 3.1% in November.

Where is this headed? Many economists predict continued inflationary declines. For example, Statista (will decline to pre-Covid-19 levels of about 2% by 2024 (Table 5). Given recent declines and Fed actions and signals as discussed below, these projections seem reasonable.

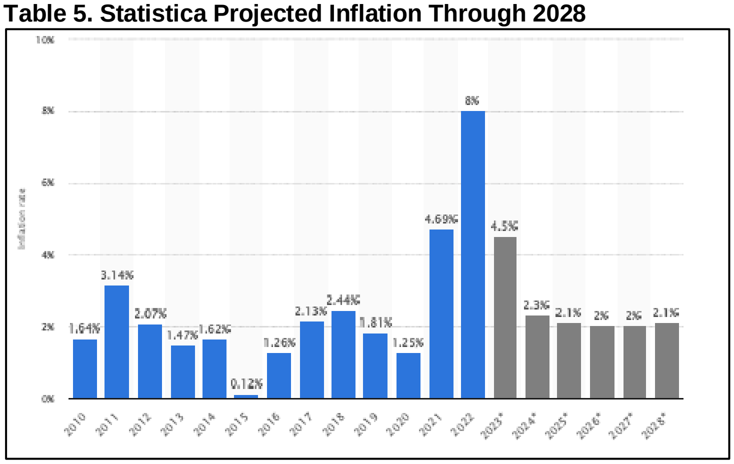
The Fed continues to be concerned about inflation and is committed to returning to its target annual rate of 2%. That said, after eleven consecutive hikes in, the Fed has held its key federal fund rates steady at its last three meetings. At its last meeting in December 2023, it signaled three modest rate cuts of one-quarter percent each in 2024.

Table 4. U.S. Inflation Rate: Last 5 Years



Source: U.S. Bureau of Labor Statistics/TradingEconomics.Com

Table 5. Statistica Projected Inflation Through 2028

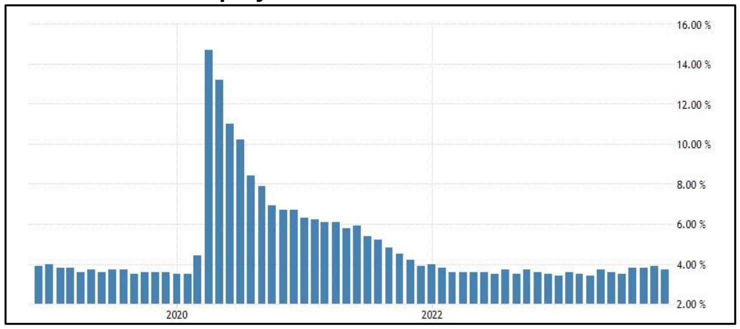


Source: Statistica.Com
Note: Statista is an international company with over 1,100 employes providing statistics and forecasts.

INTRODUCTION

U.S. Unemployment. Table 6 shows an immediate increase in the U.S. unemployment rate following the Covid-19 outbreak. At its peak (14.8% in April 2020), it exceeded the impact of the Great Recession (10.0% in October 2009). Since then, it has declined significantly, ranging from 3.4% to 3.9% in the last 21 months through November 2023. This is the lowest consecutive rate since the 1960s. In short, while the increase in unemployment was steep, so was its decline.

Table 6. U.S. Unemployment Rate: Last 5 Years

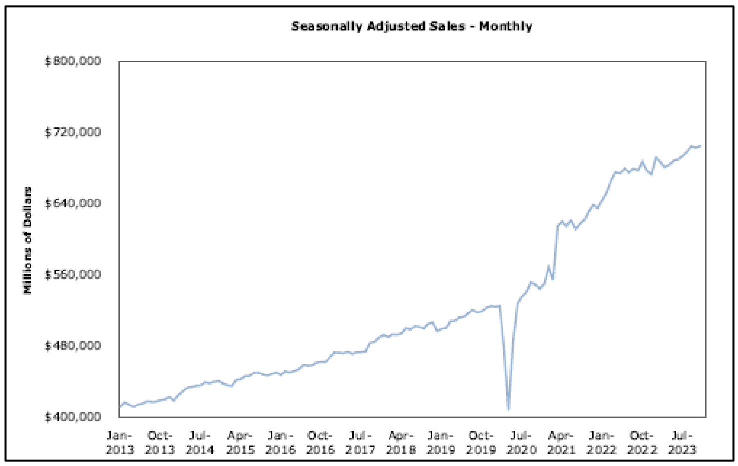


Source: U.S. Bureau of Labor Statistics/TradingEconomics.Com

U.S. Retail Sales. Trends in retail sales tell a similar story: the sharp drop in retail sales beginning in February 2020 is deeper than the Great Recession; but its recovery from Covid-19 is also faster.

By November 2023, retail sales are at their highest level ever (Table 7).

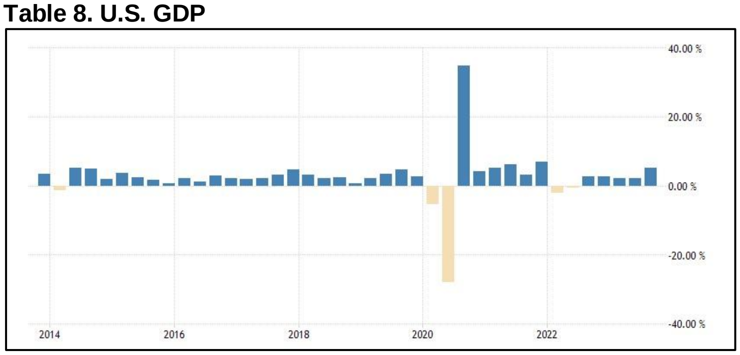
Table 7. U.S. Retail Sales



Source: U.S. Census Bureau

U.S. Gross Domestic Product (GDP). As reflected in Table 8, GDP has also shown consistent recovery since sharp declines during Covid-19, growing by 5.1% in the last (third) quarter of 2023. ***In short, where is the recession?***

Table 8. U.S. GDP



Source: U.S. Bureau of Labor Statistics/TradingEconomics.Com

Standard & Poors (S&P) 500. As shown in Table 9, the S&P 500 Index (a widely accepted broad measure of stock market performance) has been on a roller coaster ride lately. However, it has strongly recovered from its lowest point following Covid-19 impacts.

- Its peak before Covid-19 was 3,380.
- It fell to its lowest point of 2,305 in March 2020, increasing to its peak of 4,766 in December 2021.
- There have been mixed results since then. However, at 4,768 as of December 19, 2023, it has recovered from its pre-Covid peak.

Table 9. S&P 500 Index: Last 5 Years

Source: Macrotrends.com

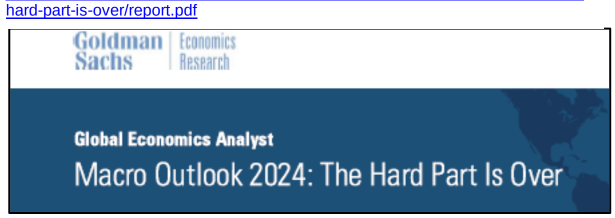
Where We're Headed. Most economists foresee continued strengthening of the economy. The Congressional Budget Office (non-partisan and widely accepted, credible source) projects nominal (unadjusted for inflation) GDP growth rates of 3.8% in 2023, 3.9% in 2024 and 4.5% in 2025.

The long awaited recession in 2023 is postponed, and perhaps even cancelled.

California Economic Forecast
https://californiaforecast.com/september-2023

What does this mean for the City? The top four General Fund revenues – property tax, sales tax, utility users tax (UUT) and franchise fees, which account for almost 80% of total revenues - are driven by the performance of the local economy, which in turn is driven by the interrelated performance of regional, state and national economies.

www.goldmansachs.com/intelligence/pages/gs-research/macro-outlook-2024-the-hard-part-is-over/report.pdf



The forecast revenue and cost drivers reflect cautious optimism that these positive trends will continue. This means that no significant economic downturns that will impact key General Fund revenues are projected in the forecast.

❷ *State Budget Outlook*

Over the past thirty five years, the greatest fiscal threat to cities in California has not been economic downturns, dotcom meltdowns, corporate scandals or Covid-19, but rather, State takeaways. These included 20% reductions in property tax revenues in transferring revenues to schools via the Education Revenue Augmentation Fund (which the State used to reduce its funding to schools by a corresponding amount); property tax administration fees; unfunded State mandates; and more recently dissolution of redevelopment agencies. These takeaways were on top of the fiscal challenges facing cities in light of their own revenue declines and cost pressures.

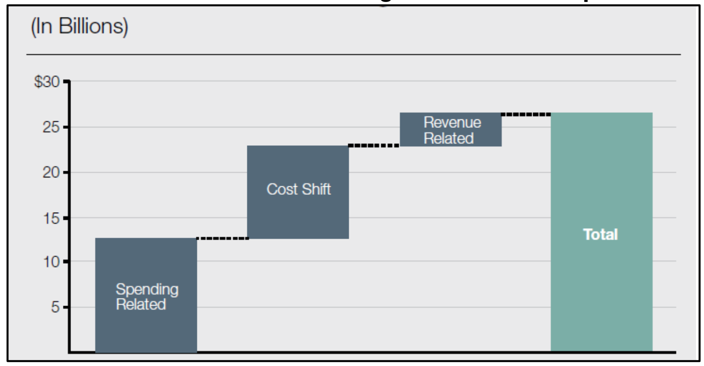
Fortunately, prior to Covid-19 impacts, the State was in its best financial condition in many years. However, for 2023-24, the State was facing a $27 billion General Fund gap. As shown in Table 10, the State resolved this gap through a combination of spending cuts, cost shifts and revenue increases.

In prior years, local government would have been a "usual suspect" for takeaways. However, that was not the case in 2023-24.

Table 11 shows the State with a balanced budget and ending reserves of $27 billion. At this point, there are no further takeaways on the horizon (but neither are there any suggested restorations of past takeaways).

That said, the next five years is a long time for the State to leave cities alone.

Table 10. How State 2023-24 Budget Closed the Gap



Source: California LAO, 2034 Budget Overview of the Spending Plan

Table 11. 2023-24 State Budget

General Fund Condition Summary

(In Millions)

	2021-22 Revised	2022-23 Revised	2023-24 Enacted
Prior-year fund balance	$40,057	$55,810	$26,352
Revenues and transfers	232,537	205,134	208,688
Expenditures	216,785	234,592	225,928
Ending fund balance	$55,810	$26,352	$9,112
Encumbrances	$5,272	$5,272	$5,272
SFEU balance	**$50,538**	**$21,080**	**$3,840**
Reserves			
BSA	$21,708	$22,252	$22,252
SFEU	50,538	21,080	3,840
Safety net	900	900	900
Total Reserves	**$73,146**	**$44,232**	**$26,992**

SFEU = Special Fund for Economic Uncertainties and BSA = Budget Stabilization Account.

Source: California LAO, 2034 Budget Overview of the Spending Plan

❸ *Current Strong Financial Condition*

The City has established a clear and prudent General Fund reserve policy that sets the minimum target at an unassigned fund balance of 30% of revenues.

For context, under generally accepted accounting principles (GAAP), General Fund balance is organized into three main categories:

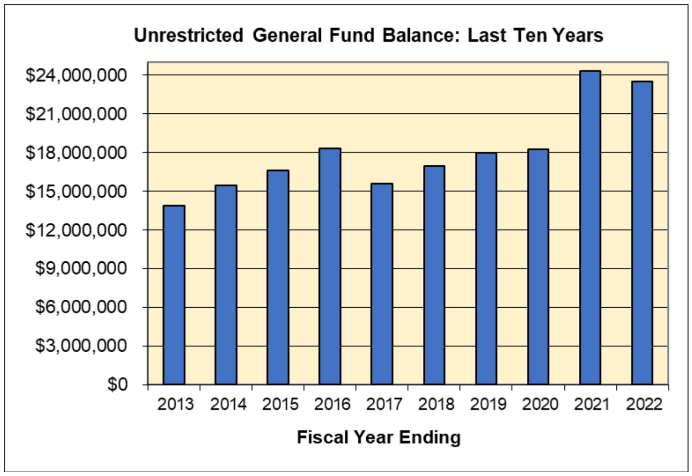
- **Nonspendable.** Not available for appropriation such as prepaid expenses, inventory and long-term advances to other funds.
- **Restricted**. Can only be used for externally restricted purposes and accordingly are not available for discretionary purposes.
- **Unrestricted.** Available for discretionary appropriation and fall into three City policy-designated categories: committed, assigned and unassigned.

Since policy determinations of committed and assigned fund balance can change from year-to-year, the best measure of discretionary resource availability is unrestricted fund balance.

Table 12 shows unrestricted General Fund balance for the last ten years through 2021-22 (last completed audit).

As reflected in this chart, the City has maintained strong General Fund balances over the last ten years, well in excess of the 30% target. As a percentage of revenues, they range from 60% (2012-13) to 69% (2015-16).

Table 12. Unrestricted General Fund Balance



Based on the 2023-24 Budget (with three adjustments: see notes below), Table 12 shows projected ending fund balance at June 30, 2024 of $22.1 million.

With projected revenues of $39.6 million, the unassigned balance of $16.8 million is 42% of revenues compared with the minimum policy target of 30%. This results in an unassigned fund balance that is $4.9 million above the policy minimum target.

Table 12. 2023-24 Projected Ending Fund Balance

General Fund Balance: June 30, 2024	Amount
Nonspendable/Restricted	1,150,800
Committed/Assigned	
Arroyo Golf Course/Bike Trail	600,000
Caltrans Vacant Lot Purchases	392,000
Legal Reserve	500,000
Library Expansion	200,000
Maintenance Yard/Community Center	267,067
Renewable Energy Sources Reserve	700,000
Financial Sustainability Reserve	900,000
Caltrans 626 Prospective Litigation	305,876
Vehicle Replacement Reserve	100,000
Stables CIP Reserve	62,998
Mental Health Reserve	200,000
Total Committed/Assingned	4,227,941
Unassigned	16,768,200
Total General Fund Balance: June 30, 2024	$22,146,941

Notes. *The projected ending fund balance at June 30, 2024 has been adjusted from the 2023-24 Budget as follows:*

1. *Upwards by $625,500 to account the General Fund share (58%) of the retro payment of $1,489,285 to the California Joint Powers Insurance Authority (CJPIA) in 2022-23. The Budget shows all of this amount being charged to the General Fund. However, three other funds (Water, Sewer and Golf) are allocated 42% of insurance costs, and thus should pay their proportionate share of the retro payment.*

2. *Upwards based on estimated results for 2022-23: transfers to the Lighting and Landscape Maintenance Fund are projected to be $370,300 less than budgeted in 2023-24 (see discussion below).*

3. *Downwards based on an assumed one-time transfer to the Mission Meridian Garage Fund of $386,200 in 2023-24 in addressing its negative fund balance (see discussion below).*

Structurally Balanced Budget? Significant concerns surfaced early in this project regarding whether the City's General Fund is "structurally balanced." This can best be measured by the City's Budget policy regarding a balanced budget. Key excerpts are:

> *The City strives to maintain a balanced operating budget for all governmental funds [the General Fund is a "governmental" fund type], with total ongoing revenues equal to or greater than total on-going expenditure …*
>
> *Ongoing operations are funded by recurring revenues …*

With the focus appropriately on operations (all of the balanced budget policies that I am familiar with have a similar "operating" focus), implicit in this policy is that beginning fund balance may be used to fund one-time costs and capital outlay.

Accordingly, a surface analysis shows that the 2023-24 is balanced. Projected revenues are $39.6 million and operating expenditures are $39.1 million. This is a favorable difference of over $400,000.

However, there are other factors that surface beyond these two measures.

Prorated Costs for Vacancies. The City began 2023-24 with significant vacancies: with 135.3 authorized full-time positions in the General Fund, 34 of these were vacant (25%) when the Budget was prepared. (Five of these were new positions; even adjusting for this, this is a 22% vacancy factor.)

To account for recruitment and filling these vacancies, the cost of these positions was prorated from 12 to 4 months depending on the position. This resulted in General Fund costs that are $1.1 million less than if all positions were filled. In arriving at a "baseline" for the forecast, these costs should be added.

Expenditure Savings. On the other hand, even if these positions were filled at the beginning of the year, some level of ongoing cost savings from the budget can be expected; and many cities budget for this. In the City's case, based on past trends, a 2% savings factor is reasonable ($391,000) for 2023-4 and 2024-25, given ramp-up from current vacancies; and 1% for 2025-29 thereafter.

Insurance. For 2023-24, the City has budgeted $3.9 million for general liability and workers compensation costs. Based on past trends, this appears to be reasonable going forward. However, as initially discussed with the Finance Commission at its August 24, 2023 meeting, this does not address the negative Insurance Fund balance of $2.7 million when long-term liabilities are included. At 58%, the General Fund's share is $1.55 million.

That said, as the Finance Commission discussed at their September 28, 2023 meeting, the Management Services Department has identified significant costs that have not been applied in the past to the City's liability self-insurance retention. Based on extensive research, the City has submitted claims to its excess carrier (Prism) of $2.5 million. At this point, this has all been recovered from Prism in cash. This amount will be accrued to 2022-23. Along with cash balances in the Insurance Fund, this should fully fund the long-term obligations of the Insurance Fund and eliminate any deficits going forward.

Accordingly, while the *General Fiscal Outlook and Key Assumptions* report anticipated that covering this deficit would have General Fund operating impacts going forward, this is no longer the case.

One-Time Costs. In arriving at ongoing costs, one-time costs should be omitted. As shown in Table 13, the 2023-24 Budget includes $1.5 million in one-time costs (about 4% of total operating expenditures).

Table 13. 2023-24 General Fund One-Time Costs

Description	Amount
Caltrans consultant - Civic Stone Jul - Oct 2022	30,464
Network hardware replacement	42,000
Temporary staffing services	25,000
End of live servers: rebuild and migrate to Azure Cloud	80,000
Shared command cehicle	132,500
Tenant protections programs analysis, development & implementation	400,000
Removal of racially restrictive covenants from City-owned properties	100,000
Cultural Heritage Ordinance update	200,000
IHO in-lieu fee study (EPS)	23,000
Ballot measure & height limit study	100,000
GP/DTSP Consultant (Rangwalla)	150,000
TruePoint electronic permit system implementation	151,000
New carpet and paint in teen room	6,000
Furniture for teen room	34,000
New exterior book drops	15,000
Mobile senior tables	4,900
Reception area furniture at Senior Center	4,500
Tables and chairs at War Memorial	2,000
Electrical panel at Garfield Park for events	2,500
Park signage	7,650
Painting of Camp Med	10,500
Total General Fund One-Time Appropriations	**$1,521,014**

Operating Transfers Out. As shown in Table 14, these total $2.3 million and are composed of two components: CIP projects and fund subsidies.

Table 14. Transfers Out

2023-24 General Fund Transfers Out	Amount
CIP Projects	
VoIP Phone System Installation	180,000
CD Permit Management Software	125,000
City/Civic EV Charging System	250,000
Agenda Management System	50,000
City web Site System and Design	60,000
City Hall Storm Water Project	300,000
Arroyo Seco San Rafael and San Pascual Projects	300,000
Library Master Plan	150,000
Total CIP Projects	1,415,000
Fund Subsidies	
Landscape and Lighting Maintenance Fund	774,171
Business Improvement Tax Fund	78,109
Total Fund Subsidies	852,280
Total Transfers Out	$2,267,280

CIP projects are appropriately excluded from operating costs ($1.4 million). However, without a clear and committed plan to reduce or eliminate them, fund subsidies should also be considered operating costs for the purpose of the balanced budget policy.

However, estimated actual results for the difference between revenues and operating costs for the *Lighting and Landscape Fund* for 2022-23 show that transfers for 2023-24 can be significant reduced from budget estimates:

Table 15. Lighting and Landscape Maintenance Fund Subsidies

Lighting and Landscape Fund	2022-23	2023-24	
	Est Actual	Revised	Budget
Beginning Fund Balance			36,500
Revenues	902,100	905,100	905,100
Expenditures*	(1,258,700)	(1,309,000)	(1,715,700)
Balance Funded by Transfers	($356,600)	($403,900)	($774,100)

* 2023-24 increased from 2022-23 by 4%

This means that the “baseline” for transfers to this fund going forward will be $403,900.

For the *Business Improvement Fund*, the transfer of $78,100 includes covering a beginning deficit fund balance of $36,400. Accordingly, its “baseline” ongoing transfer is reduced to $41,700.

In total, this results in “baseline” fund subsidies of $445.600.

“Baseline” 2023-24 Forecast Operating Costs. Table 16 summarizes “baseline” operating costs for the forecast. Even with these adjustments, the 2023-24 operating Budget remains structurally balanced: $39.6 million in revenues exceed $38.4 million in “baseline” operating costs by about $1.2 million.

Table 16. Adjusted “Baseline” Operating Costs

2023-24 Budget Operating Costs	39,147,900
Expenditures Adjustments	
Prorated Vacancies	1,067,900
Estimated Expenditure Savings @ 2%*	(783,000)
One-Time Costs	(1,521,000)
Total Expenditure Adjustments	(1,236,100)
Fund Subsidies	445,600
Total "Baseline" Costs	$38,357,400

* Decreases to 1% in 2025-29

❹ *Key Revenues*

The City’s top four economic related revenues – property tax, sales tax, UUT and franchise fees - account for 80% of General Fund revenues. The following are the forecast assumptions for these four revenues based on long and short-term trends for past ten years as detailed on pages 29 and 30; general economic outlook; and guidance from the City’s tax advisor (HdL) for property and sales taxes:

Table 17. Key Revenue Growth Assumptions

Fiscal Year	Property Tax	Sales Tax	UUT	Franchise
2024-25	4.0%	0.3%	4.5%	4.5%
2025-26	4.4%	2.8%	4.5%	4.5%
2026-27	4.7%	2.9%	4.5%	4.5%
2027-28	4.9%	2.9%	4.5%	4.5%
2028-29	5.0%	3.0%	4.5%	4.5%

As reflected above, UUT and franchise fees are expected to closely mirror each other, since the utility revenue bases are similar.

❺ *Operating Cost Expenditures*

There are five key operating cost assumptions reflected in the forecast:

- Operating cost "baseline."
- Labor agreements in place for 2024-25 (Memorandums of Understanding: MOUs).
- Insurance costs.
- CalPERS pension costs
- Inflation assumption for all other costs.

Operating Cost "Baseline." The 2023-24 Budget is the "baseline" for the forecast, with adjustments for prorated vacancies, operating cost savings and one-time costs as discussed above.

MOU Costs. The City has multi-year agreements with its three major employee groups that cover 2022 to 2025: POA (Police), FFA (Fire) and PSEA (most other employees). The last year of the contract covers the first year of the forecast (2024-25), with salary increases as follows:

Table 18. 2024-25 Salary Increases

Group	% Increase
POA	
Sworn	4%
Non-sworn	3%
FFA	4%
PSEA	2%

Insurance Costs. As noted above, insurance costs appear to have stabilized (albeit at high level). The "baseline" operating costs reflect this. (As noted above, no special provisions are required to account for past Insurance Fund deficits: these have been mitigated through cost recovery from the City's excess insurance carrier.)

CalPERS Pension Costs. The City currently provides defined pension benefits to its regular employees through its contract with the California Public Employees Retirement System (CalPERS). Because the City has under 100 employees covered by each of its contracts with CalPERS, it is pooled with other local agencies that offer similar benefits. Further information about the City's participation in CalPERS, factors that affect rates and unfunded actuarial liabilities (UAL) is detailed on pages 31 to 34. Stated simply, based on projections provided by

CalPERS, the City is facing significant increases in funding the City's UAL over the next five years.

Other Operating Costs. After accounting for the cost factors and adjusting for "baseline" costs as discussed above, remaining operating costs are projected to grow by inflation as follows:

Table 18. Inflation Assumtions

2024-25	3.5%
2025-26	2.5%
2026-27	2.0%
2027-28	2.0%
2028-29	2.0%

These assumptions reflect the recent reduction in the inflation rate (which has occurred without significant impacts on the economy in terms of employment, retail sales, gross domestic product (GDP) or the stock market); and likely continued downward trends given the Federal Reserve's actions and ongoing commitment to bringing the rate down to its 2% target.

❻ *General Fund Subsidies*

As summarized above, the General Fund provides significant subsidies to two funds. The following summarizes the "baseline" subsidies for 2023-24:

Table 19. 2023-24 General Fund Subsidies

Fund Subsidies	Cost
Landscape and Lighting Maintenance Fund	403,900
Business Improvement Tax Fund	41,700
Total Fund Subsidies	$445,600

These subsidies are largely due to structural imbalances between revenues – which are largely fixed – while costs increase (even if modestly). The forecast assumes the "baseline" grows by inflation.

Special Revenue Funds. The scope of work for the forecast is the General Fund. Accordingly, other than the three funds (Lighting and Landscape, Business Improvement and CIP) that directly impact the General Fund, other special revenue funds were not addressed in initial work. However, concern surfaced at the September 28 Finance Commission meeting that are several special revenue funds that are projected to have deficit fund balances at the end of 2023-24 (Table 20).

Table 20. Special Revenue Funds with Projected Deficits

MTA Pedestian Improvements	(29,900)
Mission Meridian Garage	(386,200)
County Park Bond	(210,500)
MSRC Grant	(157,500)
Measure W	(93,500)
Measure H	(51,200)
Proposition C Exchange	(181,900)
BTA Grants	(416,900)
Open Streets Grant	(311,800)
CDBG	(2,600)
Homeland Security Grant	(146,400)
HSIP Grant	(475,200)

This concern is a valid one: if these deficits are not otherwise mitigated, the General Fund will become responsible for them.

However, with one notable exception (the Mission Meridian Garage), these are grant-related funds. The Finance Department believes these deficits will be eliminated in most cases or significantly reduced as delayed billings are caught-up; and in other cases where supplemental information is provided as requested by the granting agency.

That said, there is no resolution of the Mission Meridian Garage deficit on the horizon. Accordingly, the forecast assumes that the General Fund will transfer $386,200 to this fund in 2023-24. (Given inactive operations at the garage, it is assumed that this will be a one-time transfer.)

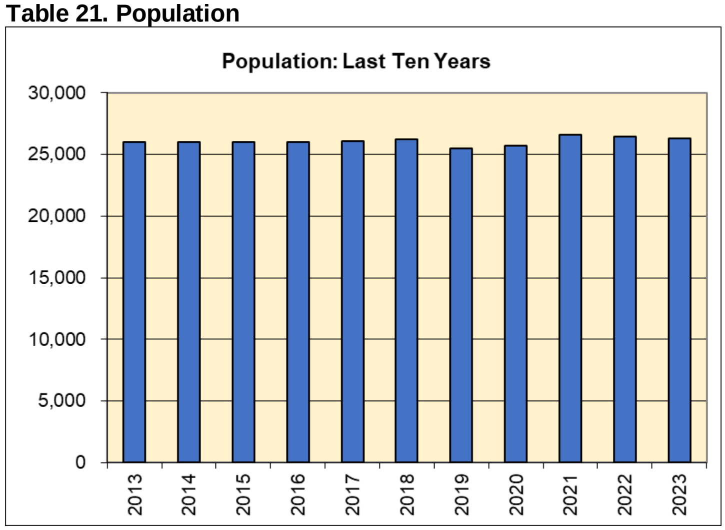
Since these are assumptions, not decisions, it is recommended that the Council consider this issue at the 2023-24 mid-year budget review, when better information about the status of grant billings, actual 2022-23 financial results and the future of the garage will be available.

❼ *Population Growth and Development*

Population growth is not likely to play a significant role in the five-year forecast. As reflected in Table 21, the City's population of about 26,000 has remained virtually unchanged over the past ten years.

However, the new Housing Element results in the potential for added units. But ultimately, the private sector determines this, not the City. Even if added units are possible, it takes time to obtain building permits and then to actually construct the units. Accordingly, a significant increase in population over the next five years is unlikely.

Table 21. Population



Source: City Annual Comprehensive Financial Report; State of California, Department of Finance, Demographic Research Unit

❽ *Capital Improvement Projects*

The forecast CIP is based on the General Fund component of the City's five-year CIP presented with the 2023-24 Budget, summarized as follows:

Table 22. General Fund Five-Year CIP

Project	Adopted 2023-24	Proposed 2024-25	Proposed 2025-26	Proposed 2026-27	Proposed 2027-28
General Buildings & Facilities					
Citywide Facility Repair		500,000	500,000	500,000	500,000
War Memorial Audio/Vis. Equip		50,000	-	-	-
Rec. Facilities Key System		75,000	-	-	-
Citywide Facilities Assessment/ Security Enh.		100,000	-	-	-
Information Technology					
VoiP Phone System Installation	180,000	250,000	-	-	-
CD Permit Management Software	125,000	-	-	-	-
Agenda Management System	50,000	-	-	-	-
City Website System & Design	60,000	-	-	-	-
Customer Care System	-	25,000	-	-	-
Library (General Fund Portion)					
Library ADA Ramp, Light. & Imp		11,414	-	-	-
Library Fire Alarm Control System	-	36,499	-	-	-
Library Electrical Distribution Equipment	-	21,726	-	-	-
Library Security & Safety Improvements	-	68,798	-	-	-
Library Exterior Paint and Protective Coatings	-	-	42,727	-	-
Library Master Plan	150,000	-	-	-	-
Storm Water					
City Hall Stormwater Project	300,000	-	-	-	-
Arroyo Seco San Rafael & San Pascual Projects	300,000	-	-	-	-
Streets (General Fund Portion)					
Street Repairs - 2023	-	1,428,278	1,428,278	1,428,278	1,428,278
Sustainability					
City/Civic EV Charging System	250,000	-	-	-	-
Arroyo Park EV Charging System	-	-	-	-	-
Transportation (General Fund Portion)					
North-South Corridor ITS Deployment		267,387	267,387	-	-
Total	$1,415,000	$2,834,102	$2,238,392	$1,928,278	$1,928,278

In several cases, project costs represent the General Fund's portion of a larger project cost.

It should be noted that the four outyears (2024-25 to 2027-28) reflect a much more aggressive General Fund CIP than the past five years:

Table 23. General Fund Five-Year CIP

2023-24	1,415,000
2022-23	338,500
2021-22	130,700
2020-21	1,294,600
2019-20	1,790,000
Five-Year Average	$993,800

As reflected above, the average General Fund CIP over the past five years (including the adopted budget for 2023-24) is $993,800, compared with an average of $2.2 million in the forecast.

No Project Funding Identified. In addition to projects funded from identified sources, such as General Fund, special revenue funds, grants and enterprise funds, the 2024-28 CIP includes the following projects for which no funding has been identified:

Table 24. Five-Year CIP Projects with No Funding Identified

Project	Adopted 2023-24	Proposed 2024-25	Proposed 2025-26	Proposed 2026-27	Proposed 2027-28
Library					
Radio Freq ID/Auto Mat Hndlng (AMH) Sys	-	160,000	-	-	-
Library Exterior Park Lighting	-	-	169,000	-	-
Library Public Restrooms Expansion/Remodel	-	-	-	450,000	-
Library Emergency Backup & Storage System	-	-	-	-	500,000
Community Services & Parks					
Garfield Park Fitness Equipment	-	100,000	-	-	-
Arroyo Park Fitness Equipment	-	100,000	-	-	-
Eddie Park Restrooms	-	100,000	-	-	-
Orange Grove Gazebo	-	-	150,000	-	-
Orange Grove Park Playground Replacement	-	-	200,000	-	-
Garfield Park Playground Replacement	-	-	200,000	150,000	-
Arroyo Walking Trail	-	-	-	200,000	-
Garfield Gazebo	-	-	-	200,000	-
Eddie Park Playground Replacement	-	-	-	150,000	-
Arroyo Park Sports Complex Renovations	-	-	-	-	750,000
Orange Grove Sports Complex Renovations	-	-	-	-	750,000
Eddie Park House Improvements	-	156,194	156,194	156,194	156,194
Storm Water					
Huntington Drive Green Street	-	595,000	5,570,500	5,570,500	-
Lower Arroyo Seco Projects	-	2,305,000	8,723,362	8,723,362	14,433,362
Camino Verde Pocket Park	-	100,000	600,000	900,000	900,000
Sustainability					
Urban Forest Master Plan	-	150,000	-	-	-
Transportation					
Mission-Merdian-El Centro Bollard System	-	-	50,000	200,000	-
Traffic Signal Controller & Cabinet Replacement	-	-	300,000	300,000	300,000
Total	-	$3,766,194	$16,119,056	$17,000,056	$17,789,556

If any of these are high-priority projects, the General Fund is the likely funding source.

Forecast Gap vs Budget Deficit

In those years where expenditures are greater than revenues due to transfers or CIP projects, this forecast does not project a "budget deficit." Stated simply, a projected "forecast gap" is different from a "budget deficit." The City will have a budget deficit only if it does nothing to take corrective action. However, by looking ahead and making the choices necessary to close any potential *future* gaps, the City will avoid incurring real deficits.

FORECAST FRAMEWORK

Background

There are two basic approaches that can be used in preparing and presenting forecasts: developing one forecast based on one set of assumptions about what is believed to be the most likely outcome; or preparing various "scenarios" based on a combination of possible assumptions for revenues and expenditures. This forecast uses the "one set of assumptions" approach as being the most useful for policy-making purposes. However, the financial model used in preparing this forecast can easily accommodate a broad range of other "what if" scenarios. And in fact, the forecast provides "what ifs" for including transfers and CIP projects.

Demographic and Financial Trends

The past doesn't determine the future. However, if the future won't look like the past, we need to ask ourselves: why not? How will the future be different than the past, and how will that affect the City's fiscal outlook? Accordingly, one of the first steps in preparing the forecast is to take a detailed look at key demographic, economic and fiscal trends over the past ten years.

A summary of key indicators is provided in the *Trends* section of this report beginning on page 27. Areas of particular focus included:

- ***Demographic and Economic Trends.*** Population and inflation as measured by changes in the consumer price index (CPI).
- ***Revenues Trends.*** Focused on the City's top four General Fund revenues – property taxes, sales tax, UUT and franchise fees – which together account for 80% of total General Fund revenues.
- ***Expenditure Trends.*** Overall trends in key expenditure areas, including operating, public safety and pension costs.

Forecast Assumptions

As noted above, assumptions drive the forecast results. Sources used in developing forecast projections include:

- Long and short-term trends in key General Fund revenues and expenditures.
- Economic trends as reported in the national media.
- Statewide and regional economic forecasts prepared by the University of California, Los Angeles, California Economic Forecast and Beacon Economics.
- Economic and fiscal information developed by the State Legislative Analyst Office (LAO), State Department of Finance and State Controller.
- Fiscal and legislative analysis by the League of California Cities.
- Analysis by the City's sales and property tax advisor (HdL Companies).
- Five-year employer contribution rate projections prepared by CalPERS.

Ultimately, working closely with City staff, the forecast projections reflect our best judgment about performance of the local economy during the next five years, and how these will affect General Fund revenues and expenditure. A detailed description of the assumptions used in the forecast and the resulting projections are provided on pages 22 to 26.

What's Not in the Forecast

Grant Revenues. The forecast does not reflect the receipt of any "competitive" grant revenues over the next five years. However, based on past experience, it is likely that the City will be successful in obtaining grants for operating and CIP purposes. However, these are typically for restricted purposes that meet the priorities of the granting agency, which are not necessarily the same as the City's. Moreover, experience shows given federal and state budget challenges, the amount of available grant funding is more likely to decline over the next five years than increase.

Operating Needs Not Funded in the 2023-24 Budget. It is likely that there are General Fund needs that are not reflected in the 2023-24 Budget.

One-Time Operating Costs. Since these are typically reflect significant policy issues, one-time cost assumptions have not been included in the operating cost "baseline." However, it is likely that some level of one-time operating costs in meeting high-priority needs will surface in budget considerations. In this case, as one-time costs, they are candidates for the use of reserves that are above the target policy minimum.

What's Most Likely to Change?

By necessity, the forecast is based on a number of assumptions. The following summarizes key areas where changes from forecast assumptions are most likely over the next five years:

Top Revenue Projections. These are directly tied to the performance of the local economy, which in turn is driven by the interrelated performance of the regional, state and national economies. As noted above, no significant economic downturns that will impact key General Fund revenues are projected in the forecast.

Insurance Costs. The forecast assumes that general liability and workers' compensation insurance costs will grow by inflation. However, in the past this has been a volatile cost for many cities in California (and the City's experience has shown the potential for wide swings as well). While loss experience plays a role, higher costs can also be incurred resulting from volatility in the financial markets. This can often have a far greater impact on insurance costs than actuarial loss experience.

Retirement Costs. The forecast uses CalPERS' rate projections for the next five years. While this is a reasonable assumption, experience has shown the potential for even steeper increases in employer contribution costs.

THE PATH FORWARD

As discussed above, the City is in good fiscal shape in funding General Fund operating expenditures and subsidies to other funds. On the other hand, challenges are ahead in funding CIP projects (let alone improving service levels or addressing long-term liabilities).

As discussed below, there are several options available in closing the forecast gap and funding CIP projects (in full or part) that would result in a balanced budget and reserves at minimum policy levels, including:

Use Reserves Above Policy Target Minimum. The City does not exist to build large fund balances: it exists to make South Pasadena a good place to live, work and visit. Prudent reserves certainly play an important role in assuring adequate fiscal resources to do this. But once reserves achieve a reasonable level (such as the City target minimum of 30% of revenues), then *prudent* consideration of one-time uses of reserves to fund CIP projects and other one-time uses is a reasonable option.

Scale Back CIP Projects. The forecast includes an average annual cost for CIP projects of about $2.2 million. This is significantly higher than the prior five-year average of $993,000.

Reduce CalPERS Unfunded Actuarial Liabilities. The City's pension situation is described on pages 31 to 34. The short story: the City has seen significant increases in annual contributions in amortizing its unfunded actuarial liabilities. With reserves above policy target levels, there are several options available in strategically using these to reduce future costs. These include shortened amortization periods of 10 or 15 years; contributions to a Section 115 Trust; and other options. While these may require higher annual payments initially (which could appropriately be funded from reserves), the long-term cost savings are significant. This requires further analysis in consultation with the City's actuary to further assess the costs and benefits of this approach.

Focused Revenue Options: Higher Cost Recovery and Improved Indirect Cost Recovery from Enterprise Funds. This is one of the few remaining areas where the Council has discretion in balancing funding for the cost of services between general purpose revenues and fees. If fees are set lower than appropriate, this means fewer general purpose revenues are available for services that do not have significant user fee options, like police and fire protection, street maintenance, parks and libraries. Comprehensively analyzing service costs and revenues may present an opportunity for improved cost recovery, that in turn can assist in meeting the City's CIP goals or other service needs. The City has not prepared this type of analysis in many years (if ever). Doing this is on the Finance Department's radar and they plan to bring a proposal forward for the Council's consideration during 2023-24.

Similarly, annual reimbursements from the enterprise funds for support costs like finance, human resources and information technology have remained flat at $483,000 for many years. A comprehensive analysis of indirect cost allocations may also provide added General Fund resources.

Combination of Options. Rather than relying on only one option, the City could use a combination of them.

CONCLUSION

Favorable Outlook in Funding Operating Costs and Fund Subsidies. The City is in good fiscal shape in funding General Fund operating costs and fund subsidies.

Challenges in Funding CIP Projects. On the other hand, challenges are ahead in funding CIP projects (let alone improving service levels or addressing long-term liabilities). included.

The Path Ahead. This report identifies five basic options for funding an expanded CIP or improved services. All of them can be approved by the Council.

KEY ASSUMPTIONS

DEMOGRAPHIC TRENDS

Population. Based on recent trends, no population changes are projected to materially affect revenues or expenditures over the next five years.

Inflation. These assumptions reflect recent reductions in the inflation rate (which have occurred without significant impacts on the economy in terms of employment, retail sales, gross domestic product (GDP) or the stock market); and likely continued downward trends given Federal Reserve's past actions and continued commitment to bringing down inflation to its 2% target. As measured by the consumer price index (CPI), the following summarized inflation assumptions:

2024-25	3.5%
2025-26	2.5%
2026-27	2.0%
2027-28	2.0%
2028-29	2.0%

ECONOMIC OUTLOOK

Based on favorable economic trends, the forecast assumes "cautious optimism" and modest growth. Accordingly, it does not project any significant economic downturns that would impact key General Fund revenues.

EXPENDITURES

Operating Cost "Baseline." The 2023-24 Budget is the "baseline" for the forecast, with adjustments for prorated vacancies, operating cost savings and one-time costs as discussed in the Introduction.

MOU Costs. The City has multi-year agreements that cover 2022 to 2025 with its three major employee groups: POA (Police), FFA (Fire) and PSEA (most other employees). Accordingly, the last year of the contract covers the first year of the forecast (2024-25), with salary increases as follows:

Group	% Increase
POA	
Sworn	4%
Non-sworn	3%
FFA	4%
PSEA	2%

CalPERS Pension Costs. The City currently provides defined pension benefits to its regular employees through its contract with the California Public Employees Retirement System (CalPERS). Further information about the City's participation in CalPERS, factors that affect rates and unfunded actuarial liabilities (UAL) is detailed on pages 31 to 34. Stated simply, based on projections provided by CalPERS, the City is facing significant increases in funding the City's UAL over the next five years.

Other Operating Costs. After accounting for the cost factors above, remaining operating costs are projected to grow with inflation. These remaining costs are largely within the control of the City. For example, staffing costs account for about 70% of operating General Fund operating expenditures. Staffing costs rise (or fall) based on two factors: authorized staffing levels and compensation. Both are within the control of the City. Since this report is a forecast and not the Budget, CPI is a reasonable basis for projecting these other costs.

KEY ASSUMPTIONS

INTERFUND TRANSFERS OUT

Fund Subsidies. The General Fund provides significant subsidies to two funds: Lighting/Landscape Maintenance and Business Improvement. The following summarizes the "baseline" subsidies for 2023-24:

Fund Subsidies	Cost
Landscape and Lighting Maintenance Fund	403,900
Business Improvement Tax Fund	41,700
Total Fund Subsidies	$445,600

These subsidies are largely due to structural imbalances between revenues – which are largely fixed – while costs increase (even if modestly). The forecast assumes the "baseline" grows by inflation.

Capital Improvement Plan (CIP) Projects. Expenditure is based on funding and phasing assessments prepared by City staff. These are presented on page 16. These average about $2.2 million annually, which is significantly more than the prior five-year annual average of $993,000.

STATE BUDGET ACTIONS

The forecast assumes no added cuts nor restoration of past cuts to cities.

REVENUES

Sources used in developing revenue projections for the forecast include:

- Long and short-term trends in key City revenues.
- Economic trends as reported in the national media.
- State and regional economic forecasts prepared by the University of California, Los Angeles; California Economic Forecast; and Beacon Economics.
- Economic and fiscal information developed by the State Legislative Analyst Office (LAO), State Department of Finance and State Controller.
- Fiscal and legislative analysis by the League of California Cities.
- Analysis by the City's sales and property tax advisor (HdL Companies).

Ultimately, however, in close consultation with City staff, the forecast projections reflect our best judgment about the State budget process and the performance of the local economy during the next five years and how these will affect General Fund revenues.

Top Four Revenues. The following summarizes forecast assumptions for the "Top Four" revenues, which account for 80% of total projected General Fund revenues.

Fiscal Year	Property Tax	Sales Tax	UUT	Franchise
2024-25	4.0%	0.3%	4.5%	4.5%
2025-26	4.4%	2.8%	4.5%	4.5%
2026-27	4.7%	2.9%	4.5%	4.5%
2027-28	4.9%	2.9%	4.5%	4.5%
2028-29	5.0%	3.0%	4.5%	4.5%

Other Revenues. These are projected to remain flat or grow modestly by inflation. The forecast "baseline" for most permit and service charges is the average of the three prior years, growing by inflation.

GENERAL FUND FIVE-YEAR FISCAL FORECAST: 2024-2029

	2021-22	2022-23	2023-24		FORECAST				
	Actual	Estimated	Budget	Baseline	2024-25	2025-26	2026-27	2027-28	2028-29
Revenues									
Property Tax	$17,906,100	$18,537,800	$19,700,400	$19,700,400	$20,488,400	$21,389,900	$22,395,200	$23,492,600	$24,667,200
Sales Tax	6,096,600	6,311,300	6,478,000	6,478,000	6,497,400	6,679,300	6,873,000	7,072,300	7,284,500
Utility Users Tax	3,875,300	4,063,100	4,352,500	4,352,500	4,548,400	4,753,100	4,967,000	5,190,500	5,424,100
Franchise Fees	1,289,500	1,217,000	1,271,500	1,271,500	1,328,700	1,388,500	1,451,000	1,516,300	1,584,500
Library Tax	364,200	360,000	375,100	375,100	392,000	409,600	428,000	447,300	467,400
Permit and Service Charges									
Business Licenses	381,400	381,500	391,000	391,000	404,700	414,800	423,100	431,600	440,200
Development Review	1,830,500	1,668,100	1,967,300	1,967,300	1,822,000	1,867,600	1,905,000	1,943,100	1,982,000
Public Safety	1,290,000	1,383,900	1,427,600	1,427,600	1,367,200	1,401,400	1,429,400	1,458,000	1,487,200
Community Services	710,200	601,200	754,900	754,900	688,800	706,000	723,700	741,800	760,300
Other Permit and Service Charges	438,100	354,400	396,900	396,900	396,500	406,400	414,500	422,800	431,300
Use of Money and Property	(495,400)	894,100	1,345,000	1,345,000	1,345,000	1,345,000	1,345,000	1,345,000	1,345,000
Reimbursements from Other Funds	483,400	483,400	483,400	483,400	500,300	512,800	523,100	533,600	544,300
Other Revenues	498,900	332,800	619,600	619,600	483,800	495,900	505,800	515,900	526,200
Total Revenues	**34,668,800**	**36,588,600**	**39,563,200**	**39,563,200**	**40,263,200**	**41,770,300**	**43,383,800**	**45,110,800**	**46,944,200**
Expenditures									
Operating Costs	34,221,500	35,681,200	39,147,900	37,911,800	39,669,900	41,257,900	42,277,000	43,260,500	44,453,600
Revenues Over Expenditures	***447,300***	***907,400***	***415,300***	***1,651,400***	***593,300***	***512,400***	***1,106,800***	***1,850,300***	***2,490,600***
Transfers In (Out)									
Transfers In	-	-	4,700	4,700	-	-	-	-	-
Transfers Out									
Fund Subsidies									
Insurance	-	(863,800)	-	-	-	-	-	-	-
Lighting and Landscape Maint	-	(383,100)	(774,200)	(403,900)	(418,000)	(428,500)	(437,100)	(445,800)	(454,700)
Business Improvement	-	-	(78,100)	(41,700)	(43,200)	(44,300)	(45,200)	(46,100)	(47,000)
Mission Meridian Garage*	-	-	(386,200)	-	-	-	-	-	-
Total Fund Subsidies	-	(1,246,900)	(852,300)	(445,600)	(461,200)	(472,800)	(482,300)	(491,900)	(501,700)
Capital Projects	(130,700)	(338,500)	(1,415,000)	(1,415,000)	(2,834,100)	(2,238,400)	(1,928,300)	(1,928,300)	(1,928,300)
Total Transfers Out	**(130,700)**	**(1,585,400)**	**(2,267,300)**	**(1,860,600)**	**(3,295,300)**	**(2,711,200)**	**(2,410,600)**	**(2,420,200)**	**(2,430,000)**
Sources Over (Under) Uses	***316,600***	***(678,000)***	***(1,847,300)***	***(204,500)***	***(2,702,000)***	***(2,198,800)***	***(1,303,800)***	***(569,900)***	***60,600***
Fund Balance, Beginning of Year	24,355,600	24,672,200	23,994,200		22,146,900	19,444,900	17,246,100	15,942,300	15,372,400
Fund Balance, End of Year	**24,672,200**	**23,994,200**	**22,146,900**		**19,444,900**	**17,246,100**	**15,942,300**	**15,372,400**	**15,433,000**
Nonspendable/Restricted	1,150,800	1,150,800	1,150,800		1,150,800	1,150,800	1,150,800	1,150,800	1,150,800
Available	23,521,400	22,843,400	20,996,100		18,294,100	16,095,300	14,791,500	14,221,600	14,282,200
Committed/Assigned	6,299,900	4,527,900	4,227,900		4,227,900	4,227,900	4,227,900	4,227,900	4,227,900
Unassigned	17,221,500	18,315,500	16,768,200		14,066,200	11,867,400	10,563,600	9,993,700	10,054,300

* This is not in the approved Budget. See page 15 for discussion of this assumption.

ASSUMPTIONS SUMMARY

		2024-25	2025-26	2026-27	2027-28	2028-29
Inflation		3.5%	2.5%	2.0%	2.0%	2.0%
REVENUES & OTHER SOURCES						
Property Tax		4.0%	4.4%	4.7%	4.9%	5.0%
Sales Tax		0.3%	2.8%	2.9%	2.9%	3.0%
Utility Users Tax		4.5%	4.5%	4.5%	4.5%	4.5%
Franchise Fees		4.5%	4.5%	4.5%	4.5%	4.5%
Library Tax		4.0%	4.4%	4.7%	4.9%	5.0%
Permit and Service Charges						
Business Licenses: Grows by inflation		3.5%	2.5%	2.0%	2.0%	2.0%
Development Review						
Average of 3 prior years (2021-22 to 2023-24) as baseline in 2024-25; grows by inflation thereafter		1,822,000	2.5%	2.0%	2.0%	2.0%
Public Safety						
Average of 3 prior years (2021-22 to 2023-24) as baseline in 2024-25; grows by inflation thereafter		1,367,200	2.5%	2.0%	2.0%	2.0%
Community Services						
Average of 3 prior years (2021-22 to 2023-24) as baseline in 2024-25; grows by inflation thereafter		688,800	2.5%	2.5%	2.5%	2.5%
Other Permits and Service Charges						
Average of 3 prior years (2021-22 to 2023-24) as baseline in 2024-25; grows by inflation thereafter		396,500	2.5%	2.0%	2.0%	2.0%
Use of Money and Property: Stays flat from 2023-24		1,345,000	1,345,000	1,345,000	1,345,000	1,345,000
Reimbursements from other funds: grows by inflation form 2023-24		3.5%	2.5%	2.0%	2.0%	2.0%
Other Revenues						
Average of 3 prior years (2021-22 to 2023-24) as baseline in 2024-25; grows by inflation thereafter		483,800	2.5%	2.0%	2.0%	2.0%
EXPENDITURES						
Operating Costs						
Baseline Adjustments						
2023-24 prorated vacancies, adjusted for full year	1,067,900					
Estimated expenditure savings at 2%: 2023-24 and 2024-25; 1% 2025-29 (See below)	(783,000)					
One-time costs	(1,521,000)					
Total Baseline Adjustments	(1,236,100)					
Forecast						
CalPERS Unfunded Actuarial Liability (UAL) Contributions						
Classic Safety Employees		2,617,700	2,810,000	2,997,000	3,148,000	3,478,000
Classic Miscellaneous Employees (65% of total: balance allocated to other funds)		873,300	939,900	1,004,300	1,054,900	1,125,800
PEPRA Police Safety		14,000	21,000	28,000	35,000	39,000
PEPRA Fire Safety		7,600	11,000	14,000	17,000	16,000
PEPRA Miscellaneous (65% of total: balance allocated to other funds)		9,700	16,200	22,800	29,200	35,700
Total CalPERS UAL	2,957,500	3,522,300	3,798,100	4,066,100	4,284,100	4,694,500

ASSUMPTIONS SUMMARY

			2024-25	2025-26	2026-27	2027-28	2028-29
Negotiated Salary Increases (MOU)	% Increase	Comp Base					
POA (police)							
Sworn	4%	3,970,800	4,129,600				
Non-sworn	3%	1,111,900	1,145,300				
FFA (Fire)	4%	2,864,000	2,978,600				
Increases	2%	3,915,900	3,994,200				
Total Negotiated Salary		11,862,600	12,247,700	12,553,900	12,805,000	13,061,100	13,322,300
All other costs grow by inflation		23,091,700	23,899,900	24,497,400	24,987,300	25,487,000	25,996,700
Operating costs before 1% expenditure savings adjustment for 2025-29		37,911,800	39,669,900	40,849,400	41,858,400	42,832,200	44,013,500
Total Operating Costs			39,669,900	41,257,900	42,277,000	43,260,500	44,453,600
TRANSFERS OUT							
Mission Meridian Garage: See discussion on Page 15 for this assumption.	386,200						
Baseline Adjustment: Fund Subsidies							
	2022-23	2023-24					
Lighting and Landscape	Est Actual	Adjusted					
Revenues	902,100	905,100					
Expenditures (Adjusted in 2023-24 by 4%)	1,258,700	1,309,000					
Balance Covered by Transfers	(356,600)	(403,900)					
Business Improvement							
Adjust transfer for elimination of negative beginning fund balance		(36,400)					
Forecast							
Ongoing Fund Subsidies: Grow by Inflation			3.5%	2.5%	2.0%	2.0%	2.0%
Capital Projects							
Five-Year General Fund CIP (2028-29 based on prior year)			2,834,100	2,238,400	1,928,300	1,928,300	1,928,300

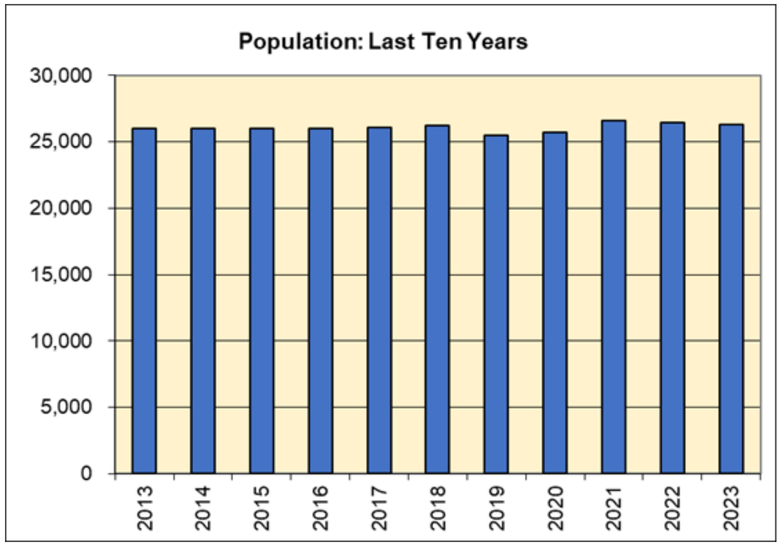
HISTORICAL TRENDS

DEMOGRAPHIC AND ECONOMIC TRENDS

Population. The City's population has remained virtually unchanged at 26,000 for the past ten years.

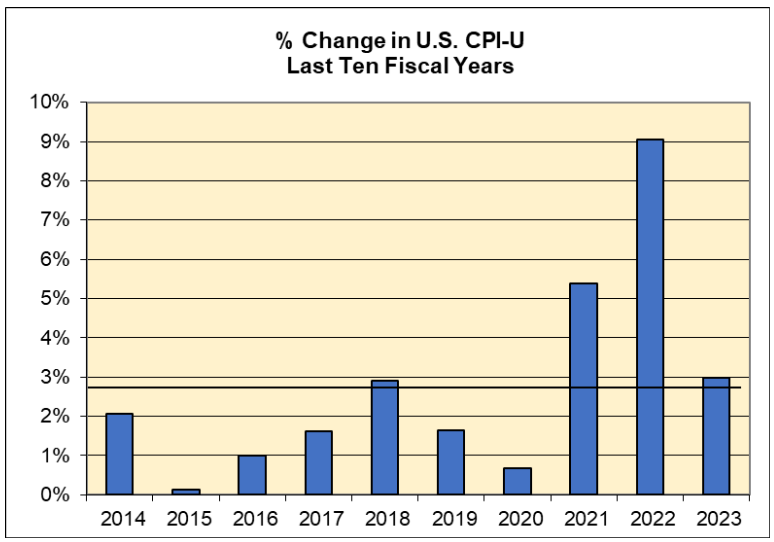
As of January 1 of each year.

Source: City Annual Comprehensive Financial Report; State of California, Department of Finance, Demographic Research Unit



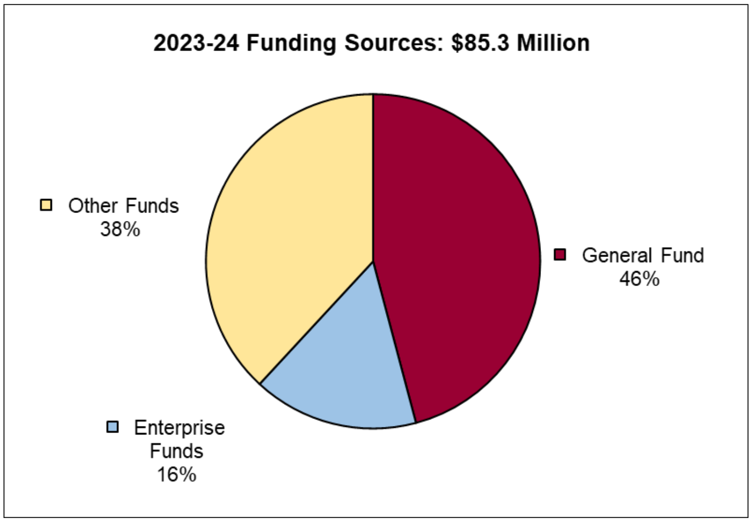
Consumer Price Index. Changes in the U.S. Consumer Price Index for All Urban Consumers (CPI-U) averaged 1.4% for the seven years prior to Covid-19. However, it saw sharp increases in 2020-21 and 2021-22 in the wake of Covid-19, peaking at 9.1%. However, it saw an equally sharp decline to 3% by 2022-23. Even with the Covid-19 increases, the CPI-U averaged 2.7% over the last ten years.

Source: U.S. Bureau of Labor Statistics

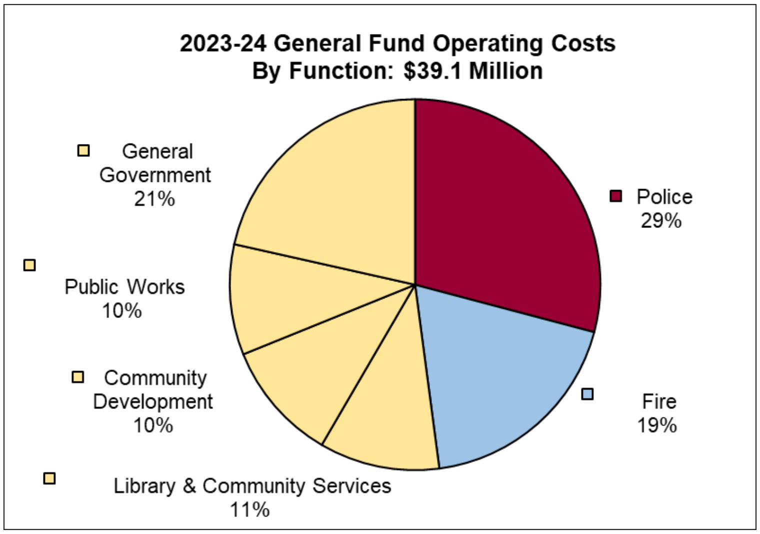


2023-24 EXPENDITURE AND REVENUE SUMMARIES

Funding Sources. The General Fund – which is the focus of this forecast – accounts for about 50% of total City expenditures.



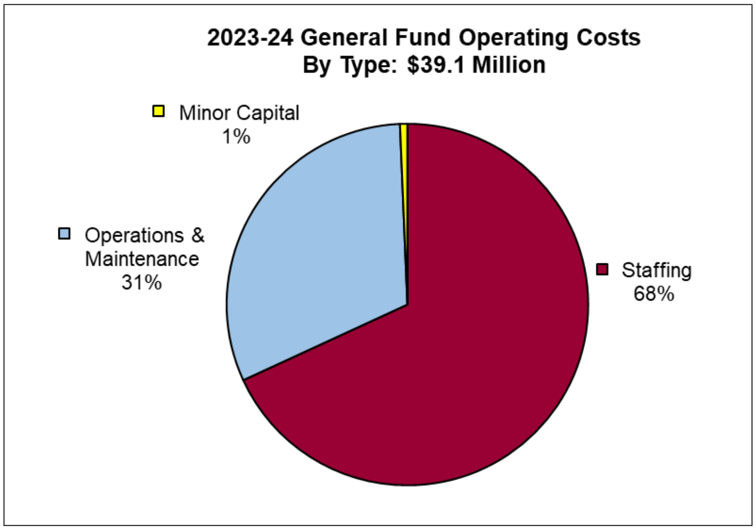
Operating Costs by Function. At about 50%, public safety (Police and Fire) is the largest use of General Fund operating resources.



Operating Costs by Type. This chart shows operating costs by type:

- Staffing: 68%
- Operations and Maintenance: 31%
- Minor Capital: 1%

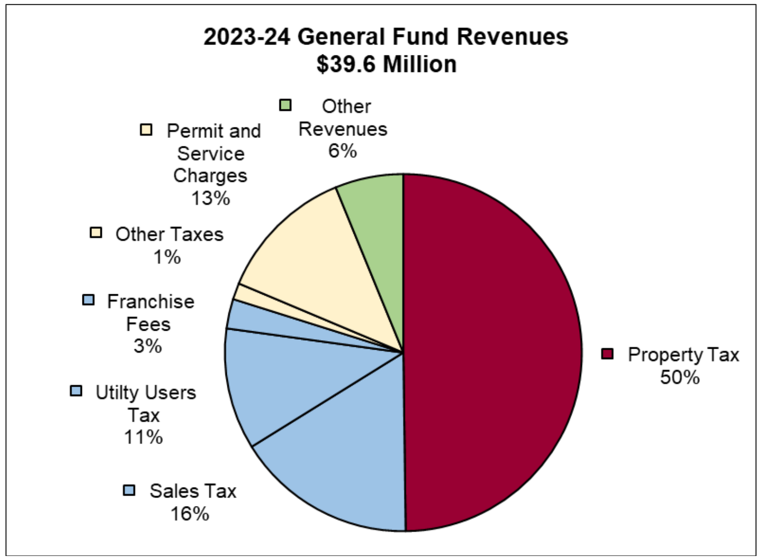
Given the significance of public safety costs, it is not surprising that staffing is the largest cost component by type, since it's police and fire employees that arrest bad guys and put the wet stuff on the red stuff.



HISTORICAL TRENDS

General Fund Revenues. Four revenues account for 80% of total General Fund sources.

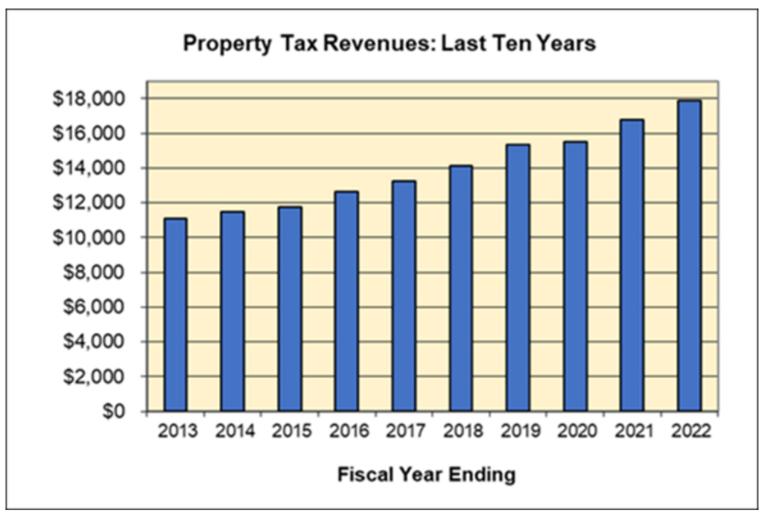
- Property Tax: $19.7 million (50%)
- Sales Tax: $6.5 million (16%)
- Utility Users Tax (UUT): $4.4 million (11%)
- Franchise Fees: $1.1 million (3%)



GENERAL FUND REVENUE TRENDS

The following tables and charts show long-term trends for the General Fund's "Top Four" revenues for the last ten years through 2021-22 (most recent audited year).

Property Tax Revenues. The State controls the allocation of general purpose property taxes between cities, counties, schools and special districts. Nonetheless, these apportionments have remained stable over the past ten years. This has been a very stable source of income for the City, growing by 8% in 2020-21 and 7% in 2021-22.

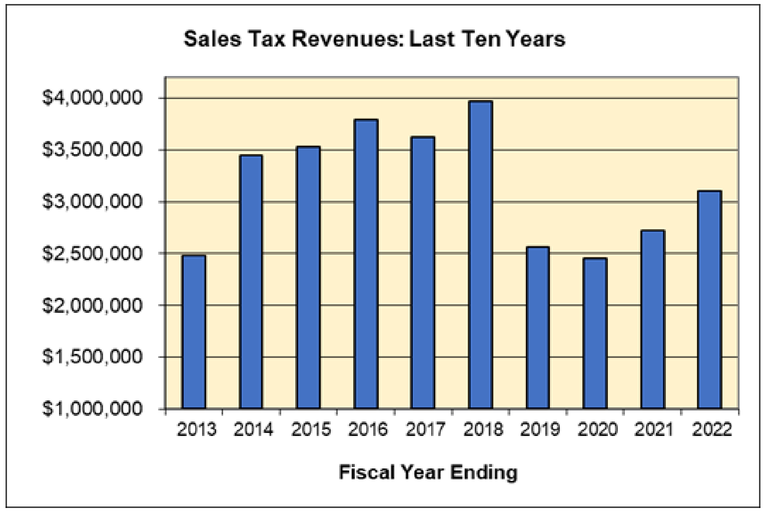


In Thousands

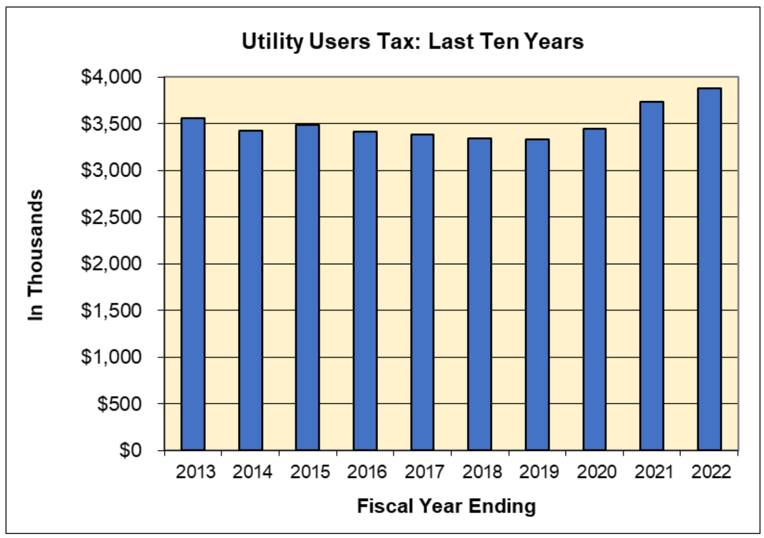
HISTORICAL TRENDS

Sales Tax Revenues. Excluding Measure A revenues (which only began to be partially received in 2019-20 and not fully until 2020-21), the last completed audit years show the impact of Covid-19, where revenues plummeted from $3.9 million in 2017-18 to $2.4 million in 2019-20 (39% decrease in two years), However, revenues recovered strongly in the next two years, growing by 11% in 2020-21 and 14% in 2021-22.

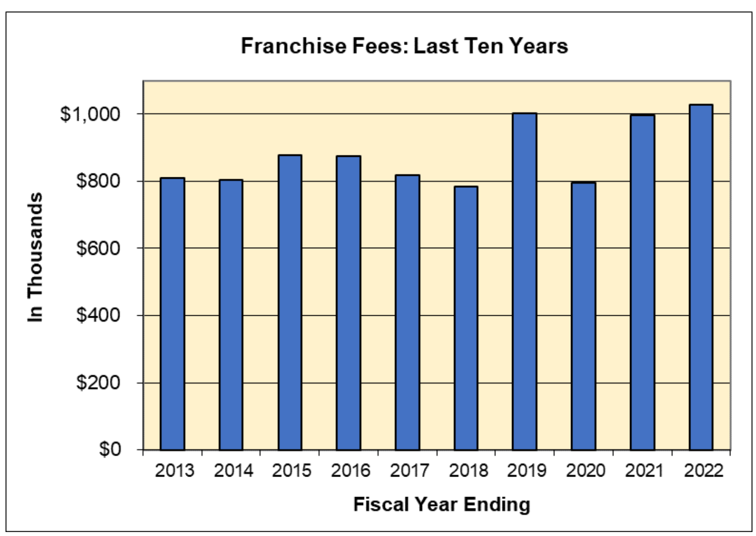
That said, they are 22% lower than the peak in 2017-18; and they are unlikely to recover to this level by the end of the forecast period.



Utility Users Tax. This has been a very stable revenue source. Though flat for most of the early years, it grew by 6.1% on annual basis in the last two years, largely due to rising energy costs.



Franchise Fees. These were relatively stable from 2012-13 through 2017-18, followed by “yoyoing” in 2018-19 and 2019-20. However, they have returned to 2018-19 levels in the last two years. They have grown by an annual average of 14% over the last two years; and 6% over the last five years.



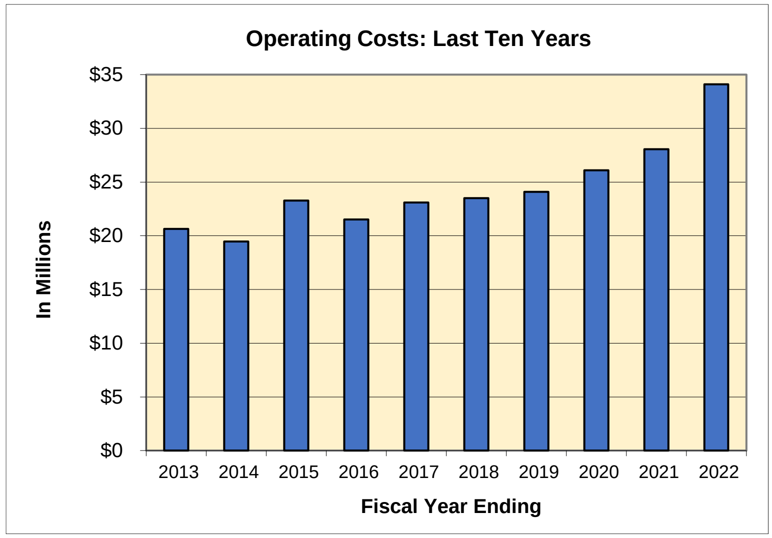
HISTORICAL TRENDS

GENERAL FUND EXPENDITURE TRENDS

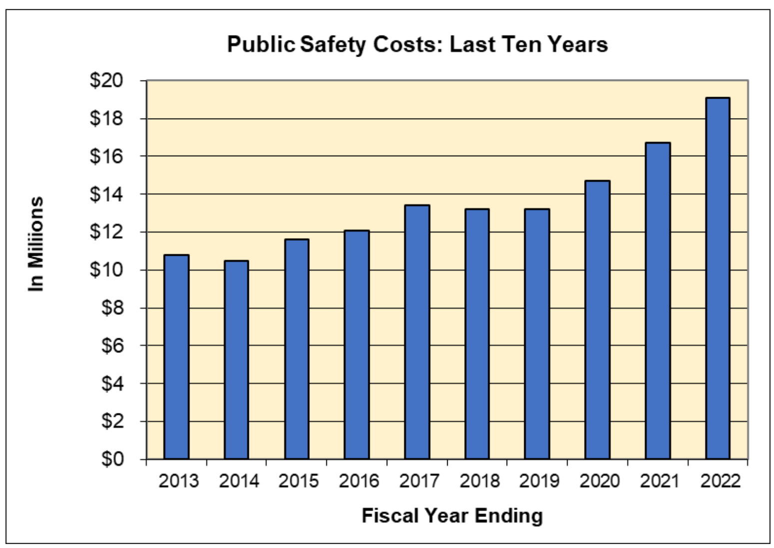
The following charts show long term trends in three key General Fund expenditures:

- Operating costs (last ten fiscal years through 2021-22, most recent audited year).
- Public safety costs (last ten fiscal years through 2021-22, most recent audited year).
- Employer retirement contribution rates to CalPERS as well as projected rates for the next five years.

Operating Costs. These were relatively stable until the onset of Covid-19 beginning in 2019-20. As reflected below, overall operating costs are affected by public safety costs, as they account for about 50% of operating costs.



Public Safey Operating Costs. Police and fire account for about 50% of operating costs, and as such, are a large driver of total operating costs. Again, these were relatively stable until the advent of Covid-19 in 2019-20.



CalPERS Pension Costs. The City currently provides defined pension benefits to its regular employees through its contract with the California Public Employees Retirement System (CalPERS). Because the City has under 100 employees covered by each of its contracts with CalPERS, it is pooled with other local agencies that offer similar benefits.

About CalPERS. While cities, counties, and special districts are free to create their own retirement systems, 460 of California's 482 cities are members of CalPERS. Dating back over 90 years, CalPERS is now the largest pension fund in the United States, providing services to about 2,900 state, city, county and special districts, with over 2 million members and managing $500 billion in assets.

HISTORICAL TRENDS

The City has a two-tier retirement plan resulting from the Public Employees' Pension Reform Act of 2013 (PEPRA).

***"New" (PEPRA) Employees*.** Under PEPRA, "new" system employees hired on January 1, 2013 or after are provided with the with the following plans:

- **Police and Fire sworn employees: "2.7% at 57" plan**. This means that "new" sworn retirees will receive 2.7% of their eligible compensation for each year worked if they retire at age 57. For example, an employee working for 30 years and retiring at age 57 would receive 81% of their eligible compensation (in this case, the average earnings from their three highest years, excluding any overtime pay).

- **Miscellaneous (non-sworn) employees: "2% at 62%" plan**. This means that "new" non-sworn retirees will receive 2% of their eligible compensation for each year worked if they retire at age 62.

"Classic" Employees. This includes employees who worked for the City before January 1, 2013 (CalPERS calls them "classic employees). It also includes new employees with the City who established CalPERS membership with another agency before January 1, 2013, with a break in service of six months or less. Classic employees receive benefits as follows:

- Police and Fire sworn employees: "2% at 50" plan.
- Miscellaneous (non-sworn) employees: "2% at 55%" plan.

Compared with many other agencies, PEPRA plans generally provide lower benefits than "classic plans." Due to a number of factors, most public safety employees before PEPRA were provided "3% at 50" plans by their employers, under which employees would be eligible for 90% of their "PERSable" compensation at age 50 after 30 years.

In the City's case, PEPRA safety benefits are actually better. Thus, relative to the market for "new" employees, the City is no longer at a competitive disadvantage for public safety employees.

This two-tier system by employee group results in five City plans:

Classic Employees	*PEPRA Employees*
Safety (Police and Fire sworn)	Safety: Police
Miscellaneous (non-sworn)	Safety: Fire
	Miscellaneous (non-sworn)

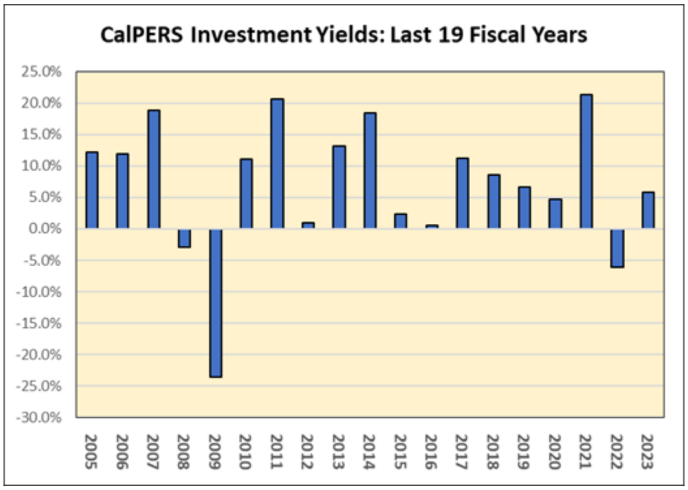
Funding Pension Benefits. There are many actuarial factors that determine contribution rates, including inflation and life expectancy assumptions. However, the assumption for the "discount rate" – the projected long-term yield on investments – is one of the most important. For example, only about one-third of CalPERS retirement benefits are funded by employee and employer contributions: the other two-thirds are funded from investment yields.

As of January 1, 2022, CalPERS current discount rate is 6.8%. Even small changes in this rate – up or down – can significantly affect funding. By comparison, as of June 30, 2022, CalPERS net yield on returns has averaged 6.7% for the last five years; 7.7% for the last 10 years; 6.9% for the last 20 years; and 7.7% over the past 30 years.

As reflected in the chart below, these highly variable results are due to significant swings in investment earnings from year-to-year, ranging from losses of 23.6% in 2009 and gains in 2021 of 21.3%.

HISTORICAL TRENDS

Member and City Contributions. Along with investment earnings, CalPERS pension benefits are funded by contributions from both employees and employers.



The employer share has two components:

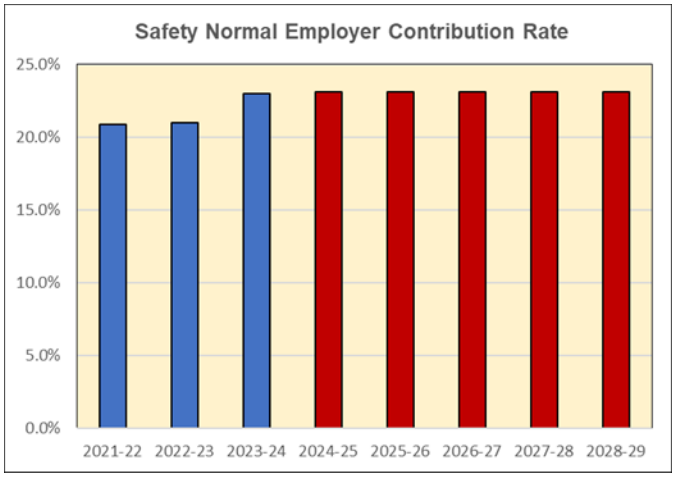
- Normal cost: The rate needed to meet current actuarial obligations.
- Unfunded actuarial liability (UAL): Funding needed to amortize any outstanding unfunded liabilities (typically over 30 years). If there are adverse actuarial results, such as lower investment yields or changes in actuarial assumptions, this will be reflected in the UAL payment.

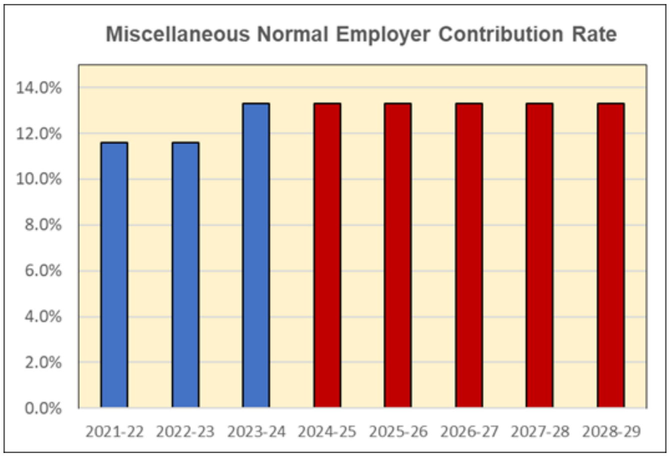
CalPERS Employer Contribution Rates. Over the past five years, CalPERS has phased-in increases in both the normal and UAL employer contribution rates due to actual assumption changes. As reflected in the charts below, normal cost rates have stabilized but UAL payments continue to rise.

The sidebar charts show actual employer contribution rates for the past three years (in blue) for the City's "classic" safety and miscellaneous employees along with projected rates for next five years (in red).

As discussed above, they show how normal rates have generally stabilized.

Note: Trends are provided for "classic" versus "new" (PEPRA) employees for normal and UAL costs, since they are a much larger group and better reflect cost trends. However, over time, PEPRA employees will be a larger share of the City's employees.





HISTORICAL TRENDS

On the other hand, the sidebar charts show how UAL costs for "classic" safety and miscellaneous employees are projected to rise significantly after appearing to stabilize in 2023-24 (actual UAL in blue).

This increase was driven by the investment loss of 6.1% in 2021-22 compared with the target rate of 6.8% (projected costs for the next five years in red).

Most Recent Investment Earnings. For 2022-23, CalPERS investment yield was 5.8%. While this is clearly a better result than the prior year's loss of 6.1% (an improved yield of 11.9%), it is less than the actuarial assumption of 6.8%. This will result in an increase in the UAL and related annual contributions.

The impact will not be known until CalPERS' next actuarial update in Fall 2024. However, the impact on contribution rates will be phased in over five years; and the first year of any increase will be 2025-26.