

MEMORANDUM

TO: City Council

FROM: Nicole Valentine, Director of Administrative Services

SUBJECT: Five-Year Financial Forecast

DATE: January 28, 2025

RECOMMENDATION:

Review and discuss the Five-Year Financial Forecast ("Forecast").

IMPACT ON FINANCIAL AND PERSONNEL RESOURCES:

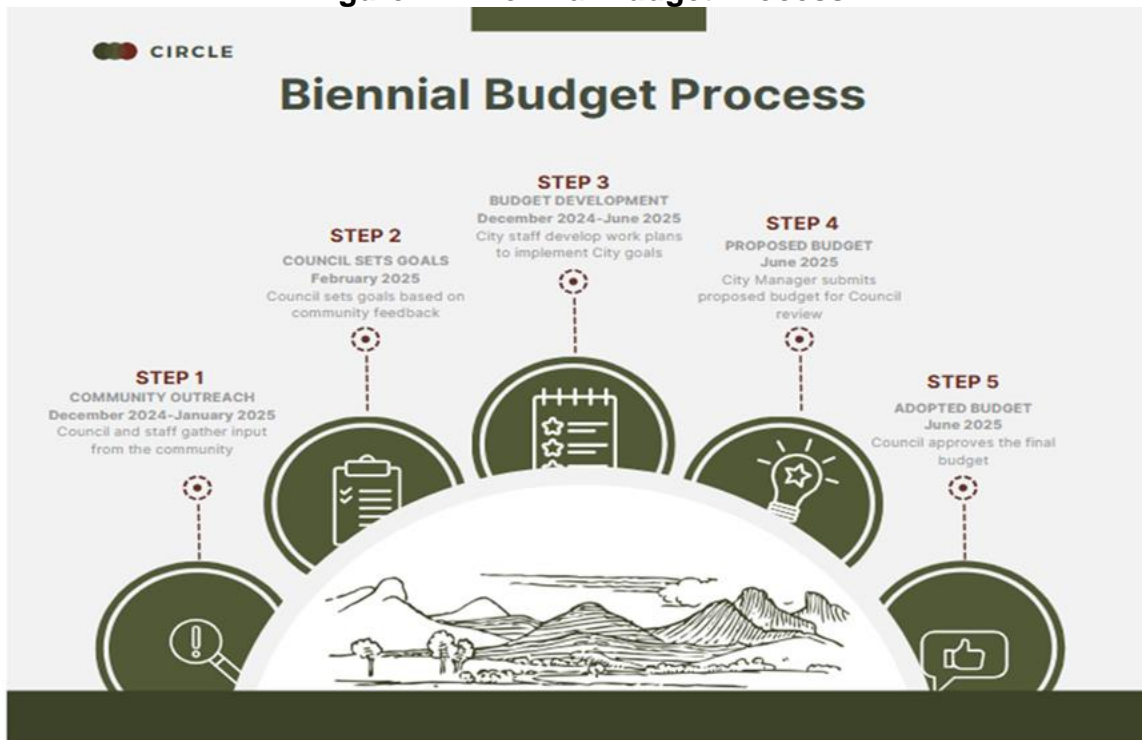
The forecast provides an analysis of the financial impact of revenue and expenditure changes in the current fiscal year and the following five years. Preparation of the forecast required several hours of staff time, with additional review and input provided by the City's financial consultant.

BACKGROUND:

As shown in Figure 1, Step 1 in the Biennial Budget Process, the focus is on providing information to the City Council and community on the state of the City's finances. This background sets the stage for goal-setting and budget development that will occur over the next several months. Accordingly, this report provides an updated Five-Year Forecast of General Fund operations, along with information on revenues and expenditures from the recently approved local sales tax, Measure E-24, as well as Measure O-06. Here are some key points regarding this Forecast:

- Forecast is not a budget proposal, but rather a planning tool to facilitate a discussion for the creation of the upcoming FY 2025-27 Biennial Budget;
- Focuses on the General Fund and Measures E & O;
- Assumes no enhancements to current service levels or increases in staffing (Status Quo); and
- Contains estimates based on the best information available at the time it is prepared.

Figure 1 – Biennial Budget Process



On June 11, 2024, City staff presented a [2024-25 Mid-Cycle Budget Update¹](https://pub-arroyogrande.escribemeetings.com/filestream.ashx?DocumentId=11090) to the City Council that showed a General Fund that was balanced overall with the use of an excess available fund balance. The largest use of the fund balance in the FY 2024-25 budget was for a \$2.36 million transfer to the [Capital Improvement Program²](https://pub-arroyogrande.escribemeetings.com/filestream.ashx?DocumentId=10770) for pavement improvement. Repairing and maintaining the City’s 73 miles of roads was one of [three top priorities³](https://pub-arroyogrande.escribemeetings.com/filestream.ashx?DocumentId=10915) identified by Arroyo Grande residents in 2024, and City staff believes that community priority contributed to the passage of Measure E-24 in November of 2024.

Given this high priority identified by the community, in addition to the one-time General Fund dollars included in the FY 2024-25 budget, this Forecast assumes all \$6+ million received annually from Measure E will be allocated to road infrastructure improvements. Note that this is not a proposal from City staff at this time. The City Manager will make a recommendation on the allocation of this funding to the City Council as part of the upcoming budget process. However, as a starting point for purposes of forecasting the City’s future finances, staff has assumed Measure E would be used to fund the large infrastructure needs. It is also important to note that while this allocation would give a

¹ <https://pub-arroyogrande.escribemeetings.com/filestream.ashx?DocumentId=11090>

² <https://pub-arroyogrande.escribemeetings.com/filestream.ashx?DocumentId=10770>

³ <https://pub-arroyogrande.escribemeetings.com/filestream.ashx?DocumentId=10915>

**City Council
Five-Year Financial Forecast
January 28, 2025
Page 3**

significant boost to the City’s road improvement program, it will not directly pay for City services paid for by the General Fund in an ongoing manner.

ANALYSIS OF ISSUES:

As previously prefaced, below are some highlights of this Forecast:

- Projected beginning fund balance of \$7.7 million for FY 2025-26;
 - \$1.6 million higher beginning fund balance than the FY 2024-25 mid-cycle budget update, primarily due to:
 - FY 2023-24:
 - Revenues higher than estimate by \$0.6 million;
 - Expenditures lower than estimate by \$0.5 million;
 - FY 2024-25:
 - Revenues expected to be \$0.5 million higher;
- General Fund shortfall projected to an average of \$1.4 million annually throughout Forecast;
 - Note: this shortfall does not include any impact from Measure E since that new funding is allocated to only road improvement projects in this Forecast;
- Fund balance drops below 15% minimum target by FY 2027-28 and to only 2% by FY 2029-30 as shown in Table 1.

Table 1: Status Quo Financial Forecast

General Fund Financial Forecast (In thousands)							
	FY 2023-24 Actual	FY 2024-25 Budget	FY 2025-26 Projection	FY 2026-27 Projection	FY 2027-28 Projection	FY 2028-29 Projection	FY 2029-30 Projection
Beginning Fund Balance	\$11,511	\$11,124	\$7,687	\$6,619	\$4,493	\$3,209	\$1,755
Total Revenue	22,659	22,753	23,472	24,228	25,012	25,823	26,663
Total Expenditures	23,045	26,190	24,539	26,355	26,295	27,277	27,821
Surplus or (Deficit)	(387)	(3,437)	(1,068)	(2,127)	(1,284)	(1,454)	(1,158)
Ending Fund Balance	\$11,124	\$7,687	\$6,619	\$4,493	\$3,209	\$1,755	\$596
Fund Balance %	48.3%	29.4%	27.0%	17.0%	12.2%	6.4%	2.1%

For discussion and information only, staff made two adjustments to the above Forecast scenario to give an example of how a portion of the \$1.4 million annual shortfall could be addressed. Currently, the General Fund pays for 75% of the cost of the Five Cities Fire Authority (FCFA) contract and the Measure O Local Sales Tax Fund pays for 25%. In addition, Measure O currently pays for one police officer position. The following table includes two changes to these two safety budget items:

1. Change percentage split of FCFA contract from 75% General Fund/25% Measure O to 65%/35%

**City Council
Five-Year Financial Forecast
January 28, 2025
Page 4**

2. Add funding for one additional police officer position to Measure O, for a total of two positions.

Table 2: Scenario - Increased Measure O Contributions to Public Safety

General Fund Financial Forecast (In thousands)							
	FY 2023-24 Actual	FY 2024-25 Budget	FY 2025-26 Projection	FY 2026-27 Projection	FY 2027-28 Projection	FY 2028-29 Projection	FY 2029-30 Projection
Beginning Fund Balance	\$11,511	\$11,124	\$7,687	\$7,252	\$5,779	\$5,172	\$4,419
Total Revenue	22,659	22,753	23,472	24,228	25,012	25,823	26,663
Total Expenditures	23,045	26,190	23,907	25,701	25,618	26,576	27,096
Surplus or (Deficit)	(387)	(3,437)	(436)	(1,473)	(607)	(753)	(433)
Ending Fund Balance	\$11,124	\$7,687	\$7,252	\$5,779	\$5,172	\$4,419	\$3,986
Fund Balance %	48.3%	29.4%	30.3%	22.5%	20.2%	16.6%	14.7%

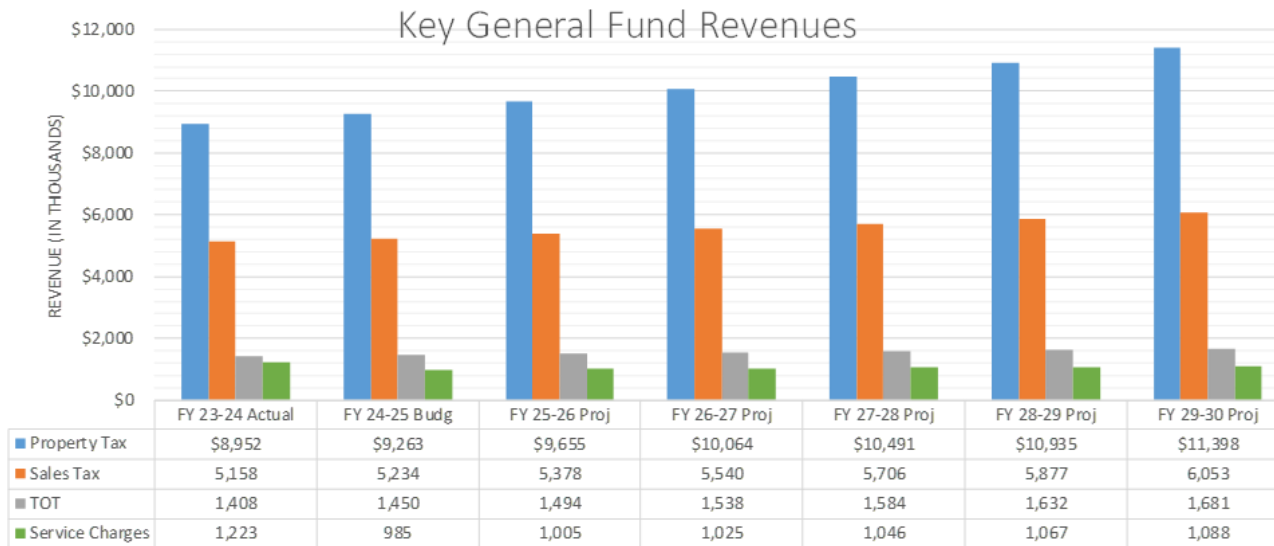
With the above two budgetary shifts in public safety funding, the average General Fund shortfall for the Forecast period (FY 2025-26 through FY 2029-30) drops from \$1.4 million annually to approximately \$740,000 annually over the same period. This is shown in Table 2 by a larger fund balance at the end of the five-year period.

Again, this is not a budget proposal but is presented to the City Council for the purpose of discussion. Of course, shifting even more public safety costs from the General Fund to Measure O would change the budget picture further. For example, a 50/50 split of FCFA costs between the General Fund and the Measure O Fund would result in an almost \$700,000 annual savings to the General Fund, bringing the average shortfall to almost zero. This would limit what the Measure O Fund could spend on infrastructure improvements. However, with the funding from the new Measure E, most of the road improvement costs would be budgeted using that source.

Analysis of Major Revenues and Expenditures in Forecast

After an expected modest increase of 0.4% projected for FY 2024-25, revenues are projected to increase 3.2% annually thereafter. Chart 1 shows major revenue projections in the Forecast.

Chart 1 – Major Revenue Projections



Property Tax

- 40% of General Fund revenue.
- Key drivers: annual increase assessed by the County of up to 2%, home sales, and home prices.
- County Auditor-Controller’s office provided property tax estimates for FY 2024-25 and FY 2025-26.
- Forecast includes growth of 4.25% annually.

Sales Tax

- 24% of General Fund revenue.
- Key drivers: consumer confidence, unemployment, consumer spending, business retention and development.
- City’s sales tax consultant provided estimates of 1.5% in FY 2024-25 and 2.8% in FY 2025-26.
- Sales tax is projected to grow approximately 3% per year for remaining years of the Forecast.

Transient Occupancy Tax (TOT)

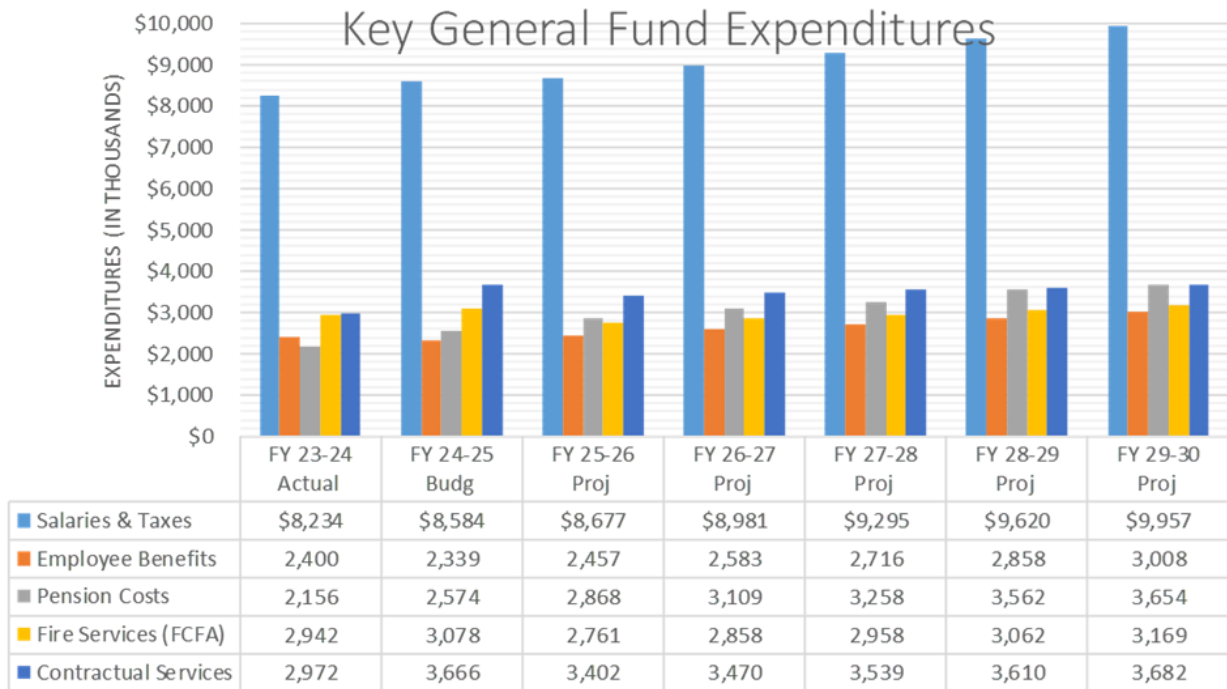
- 7% of General Fund revenue.
- Key drivers: lodging capacity, room rates, and occupancy rates.
- TOT is forecasted to grow 3% annually throughout this Five-Year Forecast.
- Forecast does not factor in any increase in room capacity.

Expenditures

Chart 2 shows the major expenditure categories and projected costs throughout the Forecast period. This assumes the two changes in public safety funding discussed above.

Since cities are largely service agencies that provide general government services, personnel-related costs represent the majority of expenditures.

Chart 2 – Major Expenditure Projections



Under the scenario noted above, that funding for public safety be allocated from the General Fund to Measure O, an 8.7% decrease in General Fund expenditures would be expected in FY 2025-26. This is primarily due to:

- Moving some public safety costs (greater FCFA funding and one additional police officer funding) to the Measure O Fund;
- One-time expenditures in FY 2024-25 budget for pavement maintenance that are not present in the FY 2025-26 Forecast;
- For the remainder of the Forecast period, expenditures are projected to increase 3.7% on average annually thereafter.

Salary and payroll taxes are forecasted to increase 4.3% in FY 2024-25 and 3.5% in FY 2025-26. The increase in FY 2025-26 would be 1.1% under the scenario that moved the cost of one additional police officer to Measure O Local Sales Tax funding. For the remainder of the Forecast salaries and taxes are projected to increase 3.5% per year.

The City’s unfunded accrued liability (UAL) is expected to increase 9% annually on average according to projections from CalPERS. Employee benefits are projected to increase on average 4.6% over the Forecast period. Health insurance costs alone account for 85% of all employee benefit costs. Workers’ compensation costs are forecasted to increase 8% per year over the Forecast period.

After an expected 7.2% decrease in contractual and professional service costs in FY 2025-26, due to the completion of the General Plan update, these costs are expected to increase 2% per year for the remainder of the Forecast. During the period of the Forecast, the cost of services provided by Five Cities Fire Authority is projected to average \$4.5 million annually.

General Fund, Measure O, and Measure E Consolidated Five-Year Forecast

Sales tax revenue received from Measures O and E are deposited into separate funds in the City's financial accounting system. This enhances transparency and allows for more efficient reporting on how these voter-approved tax sources are being spent. However, since sales tax funding from these two measures are designed to be used for programs that are also funded by the General Fund (e.g. public safety and street and road improvements), their budgets should be looked at as a whole when allocation decisions are being made. Table 3 below is a consolidation of all three funds (General, Measure O, Measure E) so the budgetary connection between the funds can be seen more clearly.

The numbers in Table 3 for the General Fund are the same as shown earlier in Table 2. This can be seen most clearly in the FCFA expenditure line when the cost increases from \$995,000 in FY 2024-25 to \$1,487,000 in FY 2025-26.

The impact of allocating all Measure E funding to pavement improvement can be seen most clearly in the ending fund balance line for that fund, that shows a zero balance for the entire five-year forecast. Note that this assumption (like the assumption moving public safety costs to Measure O) has not been approved by the City Council. It is only a starting point for discussion of the General Fund's shortfall throughout the Forecast.

**Table 3 – General Fund, Measure O, and Measure E
Consolidated Five-Year Forecast**

General Fund & Measures E & O Financial Forecast							
(In thousands)							
	FY 2023-24	FY 2024-25	FY 2025-26	FY 2026-27	FY 2027-28	FY 2028-29	FY 2029-30
	Actual	Budget	Projection	Projection	Projection	Projection	Projection
Beginning Fund Balance							
General Fund	\$ 11,511	\$ 11,124	\$ 7,687	\$ 7,252	\$ 5,779	\$ 5,172	\$ 4,419
Measure E Sales Tax Fund	-	-	1,483	-	-	-	-
Measure O Sales Tax Fund	7,685	4,815	3,728	3,366	2,668	3,256	3,494
Total Beginning Fund Balance	19,196	15,940	12,899	10,617	8,447	8,428	7,913
Revenue							
General Fund	22,659	22,753	23,472	24,228	25,012	25,823	26,663
Measure E Sales Tax Fund	-	1,483	6,092	6,275	6,463	6,657	6,857
Measure O Sales Tax Fund	3,283	2,966	3,046	3,138	3,232	3,329	3,429
Total Revenue	25,942	27,202	32,610	33,641	34,707	35,809	36,948
Expenditures							
General Fund	23,045	26,190	23,907	25,701	25,618	26,576	27,096
Measure E Sales Tax Fund							
CIP - Pavement Improvement			7,575	6,275	6,463	6,657	6,857
Measure O Sales Tax Fund							
Five Cities Fire Authority	949	995	1,487	1,539	1,593	1,649	1,706
Police Services	208	200	415	429	444	460	476
Supplies/Services	8	57	57	57	57	57	57
Animal Control Services	49	60	60	60	60	60	60
Capital Improvement Program	4,918	2,721	1,370	1,730	470	845	1,100
USDA City Hall loan	20	20	20	20	20	20	20
Total Expenditures	29,198	30,243	34,891	35,811	34,726	36,324	37,372
Surplus or (Deficit)							
General Fund	(387)	(3,437)	(436)	(1,473)	(607)	(753)	(433)
Measure E Sales Tax Fund	-	1,483	6,092	6,275	6,463	6,657	6,857
Measure O Sales Tax Fund	(2,869)	(1,087)	(363)	(698)	588	238	9
Total Surplus or (Deficit)	(3,256)	(3,041)	5,294	4,105	6,445	6,142	6,433
Ending Fund Balance							
General Fund	11,124	7,687	7,252	5,779	5,172	4,419	3,986
Measure E Sales Tax Fund	-	1,483	-	-	-	-	-
Measure O Sales Tax Fund	4,815	3,728	3,366	2,668	3,256	3,494	3,503
Total Ending Fund Balance	\$ 15,940	\$ 12,899	\$ 10,617	\$ 8,447	\$ 8,428	\$ 7,913	\$ 7,490

ALTERNATIVES:

The following alternatives are provided for the Council’s consideration:

1. Review and discuss the Five-Year Financial Forecast “Forecast” and determine that the Five-Year Financial Forecast is not a project subject to the California Environmental Quality Act (“CEQA”) because it has no potential to result in either a direct, or reasonably foreseeable indirect, physical change in the environment. (State CEQA Guidelines, §§ 15060, subd. (c)(2)-(3), 15378); or
2. Provide other direction to staff.

ADVANTAGES:

Receiving and discussing the Five-Year Financial Forecast Report will assist in informed discussions between the community, City Council, and staff about budgetary priorities as the City develops the upcoming FY 2023-25 Biennial Budget. In future budget cycles, this Report will be provided prior to the City Council’s goal-setting process.

DISADVANTAGES:

There are no disadvantages in relation to the recommended action.

ENVIRONMENTAL REVIEW:

No environmental review is required for this item. Review and discussion of the Five-Year Financial Forecast is not a project subject to the California Environmental Quality Act (“CEQA”) because it has no potential to result in either a direct, or reasonably foreseeable indirect, physical change in the environment. (State CEQA Guidelines, §§ 15060, subd. (c)(2)-(3), 15378.)

PUBLIC NOTIFICATION AND COMMENTS:

The Agenda was posted at City Hall and on the City’s website in accordance with Government Code Section 54954.2.