FOR THE COUNCIL MEETING OF OCTOBER 1, 2024

COUNCIL AGENDA REPORT

TO: City Council

FROM: Interim City Manager Alex Posada

BY: Interim Finance Director Xenia Bradford

SUBJECT: **General Fund Fiscal Forecast Update and Fiscal Year 2024-26 Budget Balancing Analysis**

Description:
The City Council will receive an update on the City's General Fund Forecast, Fiscal Year 2024-26 Budget Balancing Analysis, and overview of Revenue Enhancement Options.

Environmental Notice: The activity is not a "Project" as defined under Section 15378 of the California Environmental Quality Act State Guidelines; therefore, pursuant to State Guidelines Section 15060(c)(3) no environmental review is required.

RECOMMENDATION:

1) Receive General Fund long-term fiscal sustainability forecast update; and

2) Receive staff analysis and recommendations for closing the structural budget gap including revenue enhancement options; and

3) Provide general policy direction to staff.

BACKGROUND:

The Fiscal Year (FY) 2024-26 Biennial Budget, encompassing FY 2024-25 and FY 2025-26 was adopted on June 18, 2024. To develop a City Manager's proposed budget that aligns with the City Council's goals and priorities, this cycle was extended to incorporate a Department Directors forum to discuss Citywide operational priorities, held on November 17th, a Budget Development Kickoff to engage City departments, held on December 19th, and a City Council Goal-Setting Session, held on February 19th. The Preliminary Budget presentation including long-term fiscal forecasts and departmental presentations was presented to the City Council on May 21, 2024.

The budget process encompasses the development, implementation, and evaluation of a plan for the provision of services and capital assets. The goal of the financial plan is to establish desired levels of service while achieving results in the most efficient manner within resource constraints. This requires hard decisions and discipline. The City also must find new revenue sources. The budget process incorporates a long-term perspective, established linkages to broad organizational goals, focuses budget decisions on the results and outcomes, and promotes effective communication with stakeholders.

During the budget adoption on June 18, 2024, the City Council directed staff to return with recommendations to close the ongoing budget deficit in the September timeframe. Staff have updated the General Fund long-term fiscal forecast with the Fiscal Year 2023-24 year-end results. Furthermore, City departments have engaged in an analysis to determine service level impacts if the reductions were taken across the board from all City operations. Revenue options have also been explored. The summary of findings and further recommendations are summarized in the Discussion section of this report.

DISCUSSION:

General Fund Budget Deficit

During the Fiscal Year 2024-26 Biennial budget development, a significant ongoing budget deficit was identified. The cause of the deficit is attributable primarily to growth in salaries and benefits. The primary discretionary revenue sources paying for majority of the general governmental services, including public safety, are growing at a steady but not a rapid pace. These revenue sources are sales tax, property tax, charges for services, and transient occupancy tax. Expenditure growth is outpacing revenue growth in the General Fund and Measure U.

The adopted Fiscal Year 2024-26 Biennial Budget presents shortfalls within the two fiscal years as shows in the graph below.

Overview of the 2024-26 General Fund (Including Measure U)		
	Adopted FY 2024-25	**Adopted FY 2025-26**
Appropriations	$ 139,848,861	$ 140,545,104
Revenues	118,528,588	120,306,714
Projected Deficit	**$ (21,320,273)**	**$ (20,238,390)**

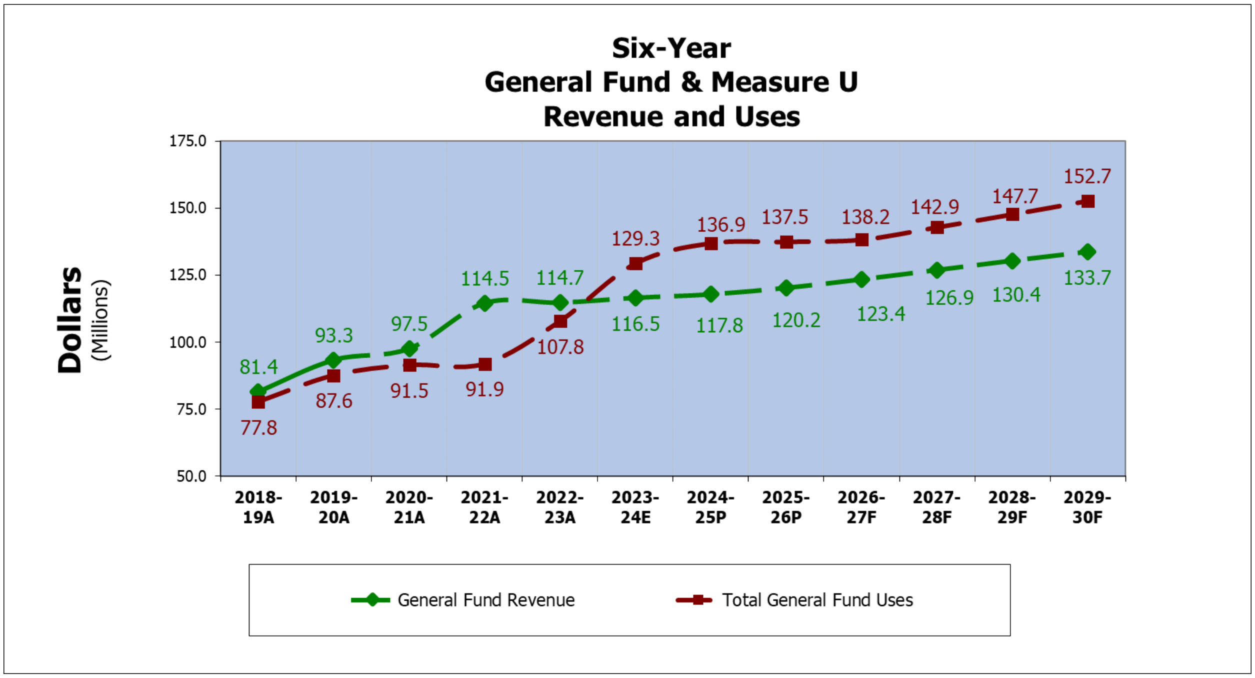
General Fund Fiscal Forecast Update

The General Fund Fiscal Forecast has been updated based on the prior year end trends in revenues and expenditures. The following changes in forecasting methodology have been applied:

- Sales Tax revenue forecast has been updated based on the actual receipts for FY 2023-24 and the City’s Sales Tax consultant, HdL, analysis including economic analysis and local trends by business. Expectations have been slightly lowered.

- Property Tax revenue forecast has been updated based on the actual receipt for FY 2023-24. Expectations have been slightly raised.

- Transient Occupancy Tax expectation have been revised downward based on actuals.
- Based on past trends in salary savings, the updated forecast applies three percent salary and benefits savings reduction per year. It should be noted that this methodology is only applied to the forecast and not the adopted budget. Applying salary savings to the budget is not a conservative approach as the City's staffing levels and level of vacancies may vary from year to year.



As shown in the graph above, the updated forecast continues to show significant shortfall between the discretionary revenues and expenditures. Over the coming months, staff will monitor the forecast, incorporate changes in trends on both revenues and expenditures in preparation for the next update to be presented to the City Council prior to the next Mid-Cycle Budget Update for FY 2025-26.

During the Fiscal Year (FY) 2024-26 Budget development, staff developed fund balance estimates for the General Fund (including Measure U). The unassigned fund balances (funds not set aside for a particular purpose by Council or another law or authority) have been updated based on the FY 2023-24 year-end unaudited actuals as shown below. The General Fund balance resulted in approximately $2.4 million positive variance, while Measure U fund balance shows a variance of approximately $832,000. The unaudited fund balances are net of carryover funds per the City Council adopted policy and accounting principles.

General Fund Fiscal Year 2023-24 Year-End Unassigned Fund Balance Estimates (Budget Development) vs. Year-End Unaudited Actuals			
Unrestricted Fund Balance	**Estimated**	**Actual**	**Variance**
General Fund	$ 8,510,357	$ 11,000,105	$ 2,489,748
Measure U	$ 4,413,648	$ 5,245,747	$ 832,099
FY 2023-24 Year End Positive Impact on Fund Balance			**$ 3,321,847**

The chart above shows the expected positive impact to fund balances based on the FY 2023-24 year-end actuals. Approximately $3.32 million will be the positive impact on fund balances than originally expected.

FY 2024-26 General Fund (Including Measure U) Adopted vs. Estimated Draw on Fund Balance		
		FY 2024-25
Adopted Budget Draw on Fund Balances		$ (21,320,273)
Updated Estimated Draw per Fiscal Forecast		$ (19,100,000)
Forecast Positive Impact to Fund Balance		**$ 2,220,273**

Despite the positive year-end results, a significant budget deficit remains. Based on the updated Fiscal Forecast for the General Fund (including Measure U), approximately $19.1 million is expected to be drawn from the fund balances. This is a forecasted estimate only and the positive variance is attributable to expected salary savings.

Budget Balancing Analysis

To address the ongoing budget deficit, staff engaged in a budget balancing exercise. Finance staff identified the ongoing budget gap at approximately fourteen percent or $16.7 million of the General Fund contribution to the departments for operations. This means that some of the expenditures in Fiscal Year 2024-25 have been classified as one-time in nature that do not directly contribute to the structural deficit. These types of expenditures include appropriations for insurance reserves, which may require further infusion of funds in the future. The departments submitted an analysis of impacts to their programs and services if each department was to absorb a proportional share of the reduction to fully close the structural budget gap.

The City Manager’s Office and the Finance Department reviewed the departmental submissions and developed the following recommendations.

Recommendations

Departmental analysis of potential reductions in operations identified a total of $14.8 million as demonstrated by the sum of the Tier 1, Tier 2, and Tier 3 columns in the second table below. The reduction target was $16.7 million. The identified reductions analysis was divided into three categories, Tier 1, Tier 2, and Tier 3. Tier 1 reductions have only moderate impact to the operations. Tier 2 reductions could significantly impact services offered or lead to departmental inefficiencies. While Tier 3 reductions will result in significant service level impacts including public safety as well as layoffs. Tier 3 reductions are not recommended.

The table below shows the dollar amounts by department in order to achieve the reduction goal.

Reduction by Department	
Department	**General Fund 14% Reduction Target**
City Attorney's Office	263,199
City Manager's Office	1,380,822
Community Development	293,220
Finance	436,790
Fire	3,347,740
Library	705,694
Police	7,649,896
Public Works	557,440
Recreation & Parks	2,103,560
Total Departmental	**$ 16,738,362**

The next chart shows the identified reductions divided into Tiers 1 through 3.

Reduction by Department			
Department	**Tier 1 GF Ongoing Reductions (lease impact)**	**Tier 2 GF Ongoing Reductions**	**Tier 3 GF Ongoing Reductions (significant impact)**
City Attorney's Office	$ 215,000	$ -	$ -
City Manager's Office	238,240	-	-
Community Development	293,650	-	-
Finance	61,800	271,000	124,000
Fire	-	-	2,684,604
Library	103,151	297,091	-
Police	-	-	7,726,080
Public Works	311,154	358,858	-
Recreation & Parks	170,531	1,945,684	-
Total Departmental Reductions	**$ 1,393,526**	**$ 2,872,633**	**$ 10,534,684**

Staff recommends further analyzing actions to be taken to effectuate Tier 1 and Tier 2 reductions and return to Council with specific budget reduction amendments with the Fiscal Year Second Quarter Financial Report slated to be presented to Council in February 2025. In the meantime, the City Manager has placed into effect a “hiring chill” policy requiring justification and analysis before any vacancy can be filled by a department. Through this process, the City will continue to engage in analysis to seek efficiencies in operations and only fill positions identified as critical need to perform essential functions.

Some of the proposed reductions, may be supported by offering retirement incentives. CalPERS has an option for the City to offer up to two years of service credit to employees nearing retirement age. This option would allow some “classic” and “tier two” employees to retire early and provides the City with a five-year window to cover the costs of the two years of service credit. Impacts of this could lead to loss of institutional knowledge, however it offers the opportunity for more PEPRA employees to assume leadership roles at a lesser retirement cost. Potential savings of such a program would need to be researched.

Tier 3 reductions are not currently recommended to move forward pending Council further direction. A significant portion of the General Fund (including Measure U) pays for public safety services. All public safety reductions have been identified as Tier 3. Council may provide staff with direction to further study possibilities to reduce services in public safety or to apply additional reductions to operations in other non-public safety discretionary services.

The City will also continue to seek efficiencies and cost savings citywide. A particular project will be brought forward to reduce electricity costs. The City of Santa Maria currently spends ~$750,000 each year in electricity for facility lighting as well as the significant maintenance burden required to replace failed lamps and ballasts. California Assembly Bill (AB) 2208, which prohibits the purchase of fluorescent lighting, will go into effect January 1, 2025. The lighting project will upgrade ~6,600 fixtures to LED technology in 53 locations throughout the City. The project will reduce annual utility costs by ~$400,000, reduce the associated maintenance costs and bring this lighting into compliance with AB 2208. The ~$4,000,000 project will require no up-front expense from the City and will be fully funded by a 0 percent loan from the PG&E On-Bill Financing Program. Repayment of the loan will be made entirely from the utility savings produced by the project. The project is cash flow positive from day one producing net cumulative savings of > $1,000,000 in 10 years escalating to > $7,000,000 in 20 years.

<u>Revenue Enhancement Options</u>

In addition, staff identified several revenue enhancement options that could be considered by the City.

The City may consider several general or special tax measures such as an increase in the local sales tax or the transient occupancy tax (hotel tax). A sales tax increase of an additional half percent would generate the most significant dollar amount of revenue, totaling approximately $13.5 million per year.

Other specific benefit property taxes may be considered. The City is engaged in studying possibilities to expand the Landscape Districts, which could shift the expenditures from the General Fund to the special revenue source.

The City could also consider business license tax restructure to tax businesses based on percent of sale.

Most of the options would require a form of voter approval and would take time to realize revenue. A summary of estimated revenue generation from each potential source is listed in the table below. Further information regarding each potential source is also outlined in further detail below.

Revenue Enhancement Option	Estimated Revenue Increase	Voter Approval
Sales Tax 0.5%	$13,500,000	Yes, at large
Landscaping District	requires further study	Yes (impacted parcels)
Downtown Improvement District	$750,000	Yes (impacted parcels)
Transient Occupancy Tax 4%	$1,600,000	Yes, at large
Cannabis Tax	$300,000-$2,000,000	Yes, at large
Parking Fees	requires further study	No (Council approval)
Property Tax (specific benefit)	requires further study	Yes (impacted parcels)
Update Recreation & Parks Fees	requires further study	No (Council approval)
Utility User Tax	$1,000,000 +	Yes, at large
Fire Medical Response Fee	$1,000,000 +	No (Council approval)
Business License Tax Restructure (by volume of sales)	requires further study $3M +	Yes, at large

Local Sales Tax:
The chart below shows the components of the statewide 7.25 percent sales and use tax collected by the State of California. Further information can be found on the CDTFA (California Department of Tax and Fee Administration) website.

Components of the Statewide 7.25% Sales and Use Tax Rate:

Rate	Jurisdiction	Purpose	Authority
3.6875%	State	Goes to State's General Fund	Revenue and Taxation Code Sections 6051, 6201
0.25%	State	Goes to State's General Fund	Revenue and Taxation Code Sections 6051.3, 6201.3 (Inoperative 1/1/01 – 12/31/01)
0.50%	State	Goes to Local Public Safety Fund to support local criminal justice activities (1993)	Section 35, Article XIII, State Constitution
0.50%	State	Goes to Local Revenue Fund to support local health and social services programs (1991 Realignment)	Revenue and Taxation Code Sections 6051.2, 6201.2
1.0625%	State	Goes to Local Revenue Fund 2011	Revenue and Taxation Code Sections 6051.15 and 6201.15
1.25%	Local	0.25% Goes to county transportation funds 1.00% Goes to city or county operations	Revenue and Taxation Code Sections 7202 and 7203
Total:			
7.25%	State/Local	Total Statewide Base Sales and Use Tax Rate	

Local jurisdictions may impose additional local/district sales tax. The City of Santa Maria voters passed Measure U 1 percent local sales tax, which brings in nearly $27 million in annual revenues. The City of Santa Maria voters can increase the local sales tax further. An additional half percent tax would generate approximately $13.5 million in annual revenues.

The following are the sales tax rates within Santa Barbara County by jurisdiction.

SANTA BARBARA COUNTY 7.75%

City of Carpinteria 9.00%
City of Goleta 8.75%
City of Guadalupe 8.75%
City of Lompoc 8.75%
City of Santa Barbara 8.75%
City of Santa Maria 8.75%
City of Solvang 8.75%

Landscape District

The City is in process of studying a citywide Landscape District model. Assessment of citywide landscape district could raise $24,632,376-$28,202,510. This citywide option model would eliminate the requirement for matching General Fund funds, which would make an additional $760 thousand available toward the General Fund operations.

Downtown Improvement District

This would entail creating Business Improvement District (BID) in existing commercial centers and/or to have in place the BID structure when new commercial centers develop with the city's projected growth.

Transient Occupancy Tax (TOT) Increase
The County of Santa Barbara and our surrounding cities are proposing a TOT increase to a total of 14 percent. The City of Santa Maria is currently charging 10 percent. Additional 2 percent is collected for the Santa Maria Tourism and Marketing District. A 4 percent increase toward City revenues, could provide an additional $1,600,000. The estimate is based on current level of hotels. This would put the City on an even footing with surrounding cities and prepare the City for the projected grow, which will surely include new hotels further positively impact this revenue stream.

Cannabis Tax
The City of Santa Maria's may desire to align with community sentiment by imposing significant regulations to protect public health and safety, as well as the broader goal of protecting local control, the City may opt to move forward with a limited cannabis regulatory program that ensures the Santa Maria community – and not Sacramento legislators – dictate the terms of local commercial cannabis activity.

Such a proposal could generate tens of millions of dollars in tax revenues in the first few years of operations, providing vital funding for municipal priorities including law enforcement, youth drug prevention education, and more. It would also allow the City to beat back legislative attempts to mandate a cannabis retail program of the State's choosing and allow the City to enforce against bad actors selling intoxicating hemp and "CBD" products in convenience stores throughout the City while also allowing for regulation of cannabis deliveries services who are servicing Santa Maria today. Depending on the extent of the program, the rough estimate is that the City could generate up to $2 million in additional annual revenue.

Parking Fees
The City of Santa Maria does not charge for city parking. While this option may provide for sustainable revenue source to provide parking in some jurisdictions, the model may not be actionable for the City of Santa Maria due to lack of high activity areas where parking may benefit from such regulation via parking fee program.

Property Tax
With voter approval, municipalities may impose property tax for specific benefit. The City may explore such options. Stormwater program, for example, may be eligible for some additional tax basis.

Recreation and Parks Fees Update
The City has increased its user and fees rates to full cost recovery starting July 1, 2024. However, Recreation & Parks user fees were not included in the study. Recreation & Parks fees are typically subsidized by municipalities. Full cost recovery is often cost prohibitive to participants to be able to afford the programs. Staff will complete the additional fee study and provide the Council with cost recovery policy recommendations.

Utility User Tax
Assessment of Utility User Tax has been presented to past Councils and has been declined. In comparison some surrounding cities, such as the City of Santa Barbara raise over $16m per year with a 6 percent utility tax. The City of Guadlupe raises about $500,000 with a 5 percent utility tax. As the City continues to grow, these types of diversified revenue streams are critical to the City being in the position to provide desired levels of services to the community.

Fire Medical Response Fee
California jurisdictions found that a significant portion of fire department responses are not calls for fire emergencies, the main purpose of a city having a fire department. Calls for medical assistance have overtaken call to put out fires or similar emergencies. Section 13916 of the California Health & Safety Code provides the authority for local jurisdiction to establish and collect fee to cover fire department response to medical assistance calls. Many cities and special districts have imposed a recovery fee for some medical assistance calls. Since 69 percent of calls to the Santa Maria Fire Department are for medical assistance, we propose that this option be studied. A conservative estimate for Santa Maria could be over $1m per year in new and sustained income.

Business License Tax
The City of Santa Maria business license tax structure is tier based. The revenue source generates approximately $650 thousand per year.

RATE SCHEDULE			
Gross Receipts in Preceding Four Quarters			**License Tax Per Year**
$-0-	to	$600	$ None
600.01	to	3,000	40
3,000.01	to	10,000	60
10,000.01	to	40,000	80
40,000.01	to	70,000	100
70,000.01	to	100,000	120
100,000.01	to	160,000	140
160,000.01	to	220,000	160
220,000.01	to	280,000	180
280,000.01	to	340,000	200
340,000.01	to	420,000	220
420,000.01	to	500,000	240
500,000.01	to	650,000	320
650,000.01	to	800,000	400
800,000.01	to	1,000,000	480
1,000,000.01	and over		500

(Ord. 99-14, eff. 7/20/99)

Alternatively, the City could impose a business license tax based on gross receipts. For comparison, the City of San Luis Obispo generates over $3 million dollars per year charging 50 cents tax on $1,000 of gross receipts.

Staff recommends taking a deep dive into the revenue options and provide the City Council with the necessary information to make an informed decision in the Spring of 2025. It is important to consider the timing for any of these options to move through the voter approval process, could take a minimum of 18 months, and an additional 6 months before a revenue is received IF approved by the voters.

Alternatives

The City Council has full discretion over the allocation of the City's discretionary revenues (taxes) toward City operations. The City Council could provide staff with the following alternative direction:

1. The City Council could direct staff to further study fiscal sustainability to determine long-term operating model, including priorities and objectives for the funding streams and expenditure allocations.
2. The City Council could direct staff to return to the City Council at a sooner date than proposed by staff to begin implementation of reductions through budget amendments. If this option is selected, staff requests that the City Council provide staff with policy direction regarding service level reductions that should be studied by staff.
3. The City Council could also direct staff to begin the process of pursuing one or more revenue enhancement options.

Impact to the Community

Budget reductions may lead to service level reductions and impacts to the services provided to the community

Fiscal Impact

The Fiscal Year 2023-24 Year End unaudited revenue and expenditure results present **one-time** estimated positive fiscal impact to the General Fund (including Measure U) balance, estimated at $3.32 million.

The **ongoing** budget gap is identified at $15.8 million in today's dollars. This estimate is based on the updated revenue forecast, assumption of 3 percent salary and benefits savings on annual basis, and exclusion of one-time transfers for insurance reserves in the amount of $3.3 million.

The identified Tier 1 and Tier 2 reductions result in approximately $4.3 million on an annual basis. If the reductions take effect in the middle of the fiscal year, the estimated savings in expenditures are estimated at approximately $2.15 million within the current fiscal year.
The ongoing budget deficit will remain at approximately $11.5 million in today's dollars, assuming that the City continues to realize salary savings similar to historic rates.

It should also be noted that the assumptions in this report do not include actions to meet all of the City Council reserve allocation goals per the adopted policies.