



## MEMORANDUM

**TO:** CITY COUNCIL

**FROM:** JIM BERGMAN, CITY MANAGER  
DEBBIE MALICOAT, DIRECTOR OF ADMINISTRATIVE SERVICES

**SUBJECT:** CONSIDERATION OF GENERAL FUND 10-YEAR FISCAL FORECAST

**DATE:** JANUARY 23, 2018

**SUMMARY OF ACTION:**

Review and discuss a 10-Year forecast of revenue and expenditures for the General Fund.

**IMPACT ON FINANCIAL AND PERSONNEL RESOURCES:**

There is no direct financial impact of the fiscal forecast other than the staff time required to prepare it, however based on the forecast, significant financial impacts are projected in future years.

**RECOMMENDATION:**

It is recommended the City Council receive and file the updated General Fund 10-Year Fiscal Forecast.

**BACKGROUND:**

The General Fund is the City's largest financial account and is used to collect revenues that support the majority of services commonly associated with local government including police, fire, public works, and parks and recreation. One of the first steps in the City's budget process is the preparation of a 10-year forecast of anticipated revenues and expenditures for this fund. The forecast gives a long-term perspective of a likely financial future of the General Fund based upon known and estimated economic variables. The forecast is intended to provide an indication of capacity to increase or decrease services and a robust discussion will help the community, the City Council, and staff prioritize public services during the creation of the upcoming City budget.

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**ANALYSIS OF ISSUES:**

Caveats

How accurately we are able to predict revenue and expenditures will ultimately impact the quality of decisions made about the types and levels of services provided by the City. For this reason, the forecast is frequently updated and is informed by experts in various economic and financial areas and then ultimately accepted or modified through a robust public discussion. It is important to understand that the forecast is based on many assumptions and necessarily requires a certain amount of speculation. Some assumptions are easier to estimate due to previous actions by the City such as labor negotiations agreeing to specified cost of living adjustments for a set period of time. Other assumptions are more difficult or impossible to accurately predict such as when, how intense, and how long lasting the next economic downturn will be.

It should be noted that there are factors that could impact the financial condition of the City in the coming decade which are not addressed or are possibly underestimated in the forecast because there are too many unknown conditions surrounding them at this time. Some of these include: impacts to retirement costs if CalPERS makes additional changes to their actuarial assumptions such as discount rate or length of amortization, rising health insurance costs, increasing Workers' Compensation insurance costs, participation and ultimate cost of the County animal services facility, impacts from the closure of the Diablo power plant and any potential funding from PG&E to offset economic losses, and increases in liability insurance costs.

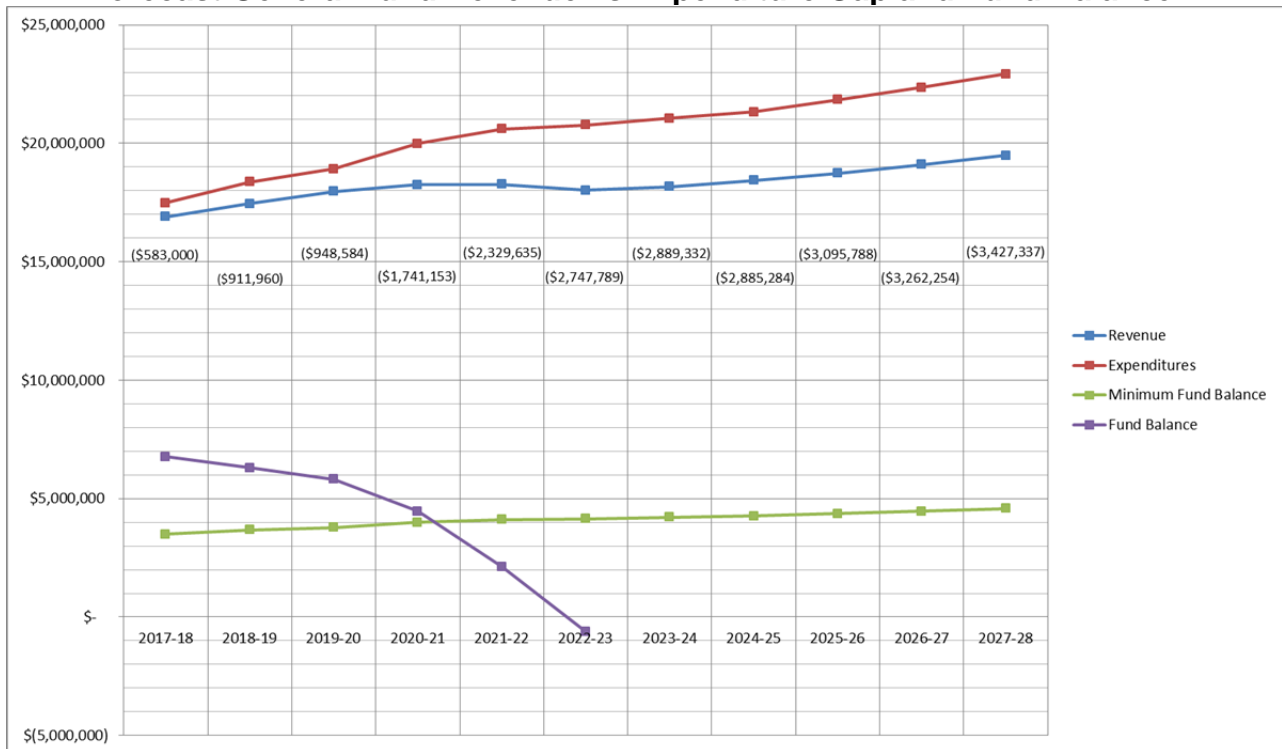
Key Points

This year's forecast indicates:

- A continuing trend of expenditures being greater than revenues with the deficit increasing over time.
- The gap between expenditures and revenues is \$912,000 in the first year of the forecast, growing to \$3.43 million in year 10.
- If status quo spending continues, reserves on hand will decrease to the minimum "15% of expenditures" policy level in 3 years.
- If status quo spending continues, the City's reserves will reach zero in 5 years.

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**Forecast General Fund Revenue vs Expenditure Gap and Fund Balance**



**Figure 1: Note - Parentheses indicate projected revenue/expenditure gap.**

**Notable Expenditure Increases**

Overall, total expenditures are forecast to increase annually at an average rate of 2.83 percent. The two expenditures highlighted below have average annual increases greater than 4 percent and also result in increases greater than \$1 million:

- Requested Increase in Five Cities Fire Authority Allocation (62% Increase over adopted FY 2017-18 Budget)** - As discussed with the City Council on January 9, 2018, the Five Cities Fire Authority (FCFA) believes that the current Reserve Firefighter model is unsustainable and additional funds will be needed from the partner agencies in order to provide stable emergency services to our community. These costs are expected to increase over the next five years as a phased transition is implemented to replace Reserve Firefighters with full-time Firefighters. The forecast assumes that over the 10-year period, the City’s cost for FCFA will increase from the current \$2.2 million to \$3.3 million. A thorough review of the request based on the benchmark cost of operating an in house fire service as well as an analysis of other service alternatives will be included in the future budget process.

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- CalPERS Full-Time Pension Costs (52% Increase over adopted FY 2017-18 Budget)** - Pension costs are expected to significantly rise as recent decisions by the CalPERS board to reduce the assumed rate of return (discount rate) on investments is lowered to 7%. The reduction of the discount rate will be phased by CalPERS in an attempt to lessen financial impacts to participants, with full implementation over 5 years. In addition to the change in discount rate, the City continues to work with CalPERS regarding the interpretation and implementation of exclusion language in the City’s contract with CalPERS. The forecast assumes that over the 10-year period, the City’s cost for CalPERS will increase from the current \$2.3 million to \$3.5 million. It should be noted that this issue is not isolated to the City of Arroyo Grande but all Cities will be facing increased CalPERS costs in varying amounts. The table below presents increased CalPERS costs to all San Luis Obispo County cities from 2018 to 2025, a slightly shorter timeframe than the 10-year forecast period.

Projected Increase in CalPERS Contributions 2018 to 2025		
Pismo Beach	34%	\$ 700,000
Arroyo Grande	34%	\$ 900,000
Paso Robles	65%	\$ 2,800,000
Morro Bay	66%	\$ 1,500,000
San Luis Obispo	76%	\$ 9,600,000
Atascadero	78%	\$ 4,400,000
Grover Beach	89%	\$ 1,000,000

Revenue Trends

The forecast indicates a modest overall revenue growth averaging 1.53 percent per year. However, the model does incorporate a downturn event in years 3 through 6. This downturn event is best seen in its effects on sales tax revenue which initially climbs, decreases, levels out, and then increases but never returning to beginning FY 2017-18 levels. An alternative forecast was developed that did not include a downturn event and the outcome was very similar to this forecast in that the revenue/expenditure gap was still present and the time to expend all reserves was extended out only one additional year.

Conclusion

Previous and current forecasts indicate a long-term trend of deficit spending which can only be sustained for a finite period of time. Activities that can reverse this trend and create a situation of surplus spending are basic - either reduce expenditures, increase revenues, or a combination of the two. A list of potential options for future consideration during the budget process are:

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Efforts to Reduce Expenditures

- Staff reductions associated with curtailed services
- Labor concessions related to salaries and benefits
- Reduction of payroll obligations through retirement incentives
- Prefunding efforts related to pension or retiree health benefits
- Transferring maintenance responsibilities of public rights-of-way to adjacent property owners
- Contracting services to third parties
- Increase operational efficiencies through process improvement or technology

Efforts to Increase Revenue

- Economic development activities that seek new development on vacant and underutilized properties
- Raise fees for services
- Raise taxes such as sales and use taxes, Transient Occupancy Tax, Business License Tax
- Community fund raising
- Sale of City owned property

**ALTERNATIVES:**

1. Receive and file the updated General Fund 10-Year Fiscal Forecast;
2. Direct staff to engage an independent consultant to prepare a fiscal forecast. This is not recommended as it would be an unbudgeted expense and is unlikely to result in a significantly different outcome.

**ADVANTAGES:**

Receiving the 10-Year Fiscal Forecast will assist in informed discussions between the community, City Council and staff about budgetary priorities as the City develops the 2018-20 Biennial Budget.

**DISADVANTAGES:**

There are no disadvantages.

**ENVIRONMENTAL REVIEW:**

No environmental review is required for this item.

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**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.

Attachments:

1. 10 Year General Fund Fiscal Forecast

**General Fund Ten Year Financial Forecast  
(Minimum 15% Fund Balance Policy/20% Fund Balance Goal)**

In Thousands	Budget	TEN YEAR FINANCIAL FORECAST									
	2017-18	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26	2026-27	2027-28
<b>REVENUES &amp; OTHER SOURCES</b>											
Sales Tax - General	\$ 3,778	\$ 3,854	\$ 3,892	\$ 3,775	\$ 3,587	\$ 3,407	\$ 3,407	\$ 3,441	\$ 3,476	\$ 3,528	\$ 3,598
Sales Tax - Proposition 172	145	148	149	145	138	131	131	132	133	135	138
Property Tax	4,819	5,026	5,237	5,394	5,448	5,285	5,285	5,338	5,391	5,472	5,554
Property Tax in lieu of VLF	1,550	1,617	1,685	1,735	1,752	1,700	1,700	1,717	1,734	1,760	1,786
Transient Occupancy Tax	1,030	1,061	1,093	1,109	1,109	1,109	1,109	1,109	1,142	1,177	1,212
Transient Occupancy Tax - Village Hotel		100	135	175	175	175	175	175	180	186	191
Business Licenses	94	96	99	101	104	107	110	114	117	121	124
Franchise Fees	612	624	637	649	662	676	689	703	717	731	746
Real Property Transfer Tax	103	106	108	111	114	117	121	125	128	132	136
<b>Aid From Other Governments</b>											
Other Subventions & Grants	128	131	133	136	139	141	144	147	150	153	156
<b>Service Charges</b>											
Recreation Fees	685	702	720	738	758	780	804	828	853	879	906
Permits & Licenses	403	413	423	434	446	459	473	487	502	517	533
Community Development Charges	259	264	269	275	280	286	292	298	303	310	316
Other Service Charges	207	211	215	220	224	229	233	238	243	247	252
<b>Other Revenues</b>											
Fines & Forfeitures	43	44	45	46	47	47	48	49	50	51	52
Use of Money & Property	369	376	384	392	399	407	416	424	432	441	450
Other Revenues	20	21	21	22	22	23	23	24	25	26	26
<b>Transfers</b>											
Transfer from Local Sales Tax Fund	344	290	297	305	312	320	328	335	342	349	356
Personnel, Cost & Operating Transfers	2,313	2,371	2,430	2,491	2,553	2,617	2,682	2,749	2,818	2,889	2,961
<b>Total Revenues</b>	<b>\$ 16,902</b>	<b>\$ 17,454</b>	<b>\$ 17,973</b>	<b>\$ 18,253</b>	<b>\$ 18,269</b>	<b>\$ 18,017</b>	<b>\$ 18,171</b>	<b>\$ 18,433</b>	<b>\$ 18,738</b>	<b>\$ 19,103</b>	<b>\$ 19,494</b>

## General Fund Ten Year Financial Forecast

In Thousands	Budget	TEN YEAR FINANCIAL FORECAST									
	2017-18	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26	2026-27	2027-28
<b>EXPENDITURES &amp; OTHER USES</b>											
Salary & Benefits	\$ 11,083	\$ 11,551	\$ 11,557	\$ 12,223	\$ 12,634	\$ 12,677	\$ 12,843	\$ 13,007	\$ 13,358	\$ 13,729	\$ 14,110
PERSable compensation	5,753	5,755	5,870	6,007	6,027	6,045	6,064	6,082	6,221	6,363	6,507
PERS Costs	2,296	2,506	2,284	2,683	3,010	2,950	3,031	3,141	3,243	3,359	3,479
Part Time/non-PERSable comp	1,174	1,256	1,293	1,339	1,379	1,413	1,441	1,456	1,500	1,545	1,591
PT PERS impacts		103	124	145	122	130	134	138	142	147	151
Insurance (including Workers Comp)	1,408	1,443	1,486	1,539	1,585	1,624	1,657	1,673	1,724	1,775	1,829
Medicare, FICA, other	452	489	499	511	512	514	515	517	529	541	553
Pre-fund Retiree Medical Costs	235	235	235	235	235	235	235	235	235	235	235
Operating Programs	5,792	6,086	6,619	7,017	7,183	7,291	7,401	7,475	7,624	7,776	7,932
FCFA contribution	2,062	2,244	2,662	2,941	3,026	3,071	3,117	3,149	3,212	3,276	3,341
All other operating programs	3,730	3,842	3,957	4,076	4,157	4,220	4,283	4,326	4,412	4,501	4,591
Debt Service	246	309	255	255	126	52	52	52	52	40	40
Minor Capital Outlay	124	60	65	65	75	75	75	75	75	75	75
Capital Improvement Projects	-	20	30	30	40	40	50	50	50	50	50
Vehicle Replacements		-	55	55	190	270	280	290	300	310	320
Technology Replacements		100	100	110	110	120	120	130	140	150	160
Transfers Out	5	5	5	5	5	5	5	5	5	5	5
<b>Total Expenditures</b>	<b>\$ 17,485</b>	<b>\$ 18,366</b>	<b>\$ 18,921</b>	<b>\$ 19,995</b>	<b>\$ 20,599</b>	<b>\$ 20,765</b>	<b>\$ 21,061</b>	<b>\$ 21,318</b>	<b>\$ 21,834</b>	<b>\$ 22,366</b>	<b>\$ 22,922</b>
<b>Revenues Over (Under) Expend.</b>	<b>\$ (583)</b>	<b>\$ (912)</b>	<b>\$ (949)</b>	<b>\$ (1,741)</b>	<b>\$ (2,330)</b>	<b>\$ (2,748)</b>	<b>\$ (2,889)</b>	<b>\$ (2,885)</b>	<b>\$ (3,096)</b>	<b>\$ (3,262)</b>	<b>\$ (3,427)</b>
Unspent appropriations (incr. fund bal)	428	447	460	389	-	-	-	-	424	435	446
<b>AVAILABLE FUND BALANCE</b>											
<b>START OF YEAR</b>	<b>\$ 6,933</b>	<b>\$ 6,778</b>	<b>\$ 6,313</b>	<b>\$ 5,825</b>	<b>\$ 4,473</b>	<b>\$ 2,143</b>	<b>\$ (605)</b>	<b>\$ (3,494)</b>	<b>\$ (6,379)</b>	<b>\$ (9,051)</b>	<b>\$ (11,878)</b>
Reserve for carryover											
<b>END OF YEAR</b>	<b>6,778</b>	<b>6,313</b>	<b>5,825</b>	<b>4,473</b>	<b>2,143</b>	<b>(605)</b>	<b>(3,494)</b>	<b>(6,379)</b>	<b>(9,051)</b>	<b>(11,878)</b>	<b>(14,860)</b>
Fund Balance Goal-20% Expend	\$ 3,497	\$ 3,673	\$ 3,784	\$ 3,999	\$ 4,120	\$ 4,153	\$ 4,212	\$ 4,264	\$ 4,367	\$ 4,473	\$ 4,584
<b>Ending Fund Balance %</b>	<b>39%</b>	<b>34%</b>	<b>31%</b>	<b>22%</b>	<b>10%</b>	<b>-3%</b>	<b>-17%</b>	<b>-30%</b>	<b>-41%</b>	<b>-53%</b>	<b>-65%</b>



## General Fund Ten Year Financial Forecast

PROJECTION FACTORS	TEN YEAR FINANCIAL FORECAST									
	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26	2026-27	2027-28
<b>DEMOGRAPHICS</b>										
Population	0.5%	0.5%	0.6%	0.6%	1.0%	1.0%	1.0%	1.0%	1.0%	1.0%
Housing Units	1.0%	1.0%	1.0%	1.0%	1.0%	1.0%	1.0%	1.0%	1.0%	1.0%
Inflation	2.0%	2.0%	2.0%	2.0%	2.0%	2.0%	2.0%	2.0%	2.0%	2.0%
Compound Pop & Inflation	2.5%	2.5%	2.6%	2.6%	3.0%	3.0%	3.0%	3.0%	3.0%	3.0%
<b>KEY REVENUES</b>										
Sales Tax	2.0%	1.0%	-3.0%	-5.0%	-5.0%	0.0%	1.0%	1.0%	1.5%	2.0%
Property Tax	4.3%	4.2%	3.0%	1.0%	-3.0%	0.0%	1.0%	1.0%	1.5%	1.5%
TOT	3.0%	3.0%	1.5%	0.0%	0.0%	0.0%	0.0%	3.0%	3.0%	3.0%
Business License/Tax	<i>2017-18 Projection Plus Compound Population and Inflation</i>									
Franchise Fees	2.0%	2.0%	2.0%	2.0%	2.0%	2.0%	2.0%	2.0%	2.0%	2.0%
Property Tax in lieu of VLF	4.3%	4.2%	3.0%	1.0%	-3.0%	0.0%	1.0%	1.0%	1.5%	1.5%
Development Review Fees	<i>2017-18 Projection Plus Compound Population and Inflation</i>									
Recreation Fees	<i>2017-18 Projection Plus Compound Population and Inflation</i>									
<b>EXPENDITURES</b>										
Salary	2.0%	2.0%	2.0%	0.0%	0.0%	0.0%	0.0%	2.0%	2.0%	2.0%
PERS Benefits	9.1%	-8.8%	17.5%	12.2%	-2.0%	2.8%	3.6%	3.2%	3.6%	3.6%
Non-PERS Benefits	2.5%	3.0%	3.5%	3.0%	2.5%	2.0%	1.0%	3.0%	3.0%	3.0%
Operating Programs	3.0%	3.0%	3.0%	2.0%	1.5%	1.5%	1.0%	2.0%	2.0%	2.0%
Debt Service	<i>Based on Lease Purchase Contracts for Vehicle Replacements</i>									

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