City of Pleasant Hill

MEMORANDUM

TO: Tim Flaherty, Budget Committee Chair
Sue Noack, Budget Committee Member

FROM: Mary Mc Carthy, Finance Manager
Andrew Murray, Assistant City Manager

DATE: June 7, 2017

SUBJECT: Fiscal Year (FY) 2017/2022 Five-Year Financial Forecast for the General Fund

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INTRODUCTION

The City of Pleasant Hill (City) has traditionally published a five-year financial forecast as part of each two-year (biennial) budget. The forecast is one of the activities undertaken by the City to help ensure its financial soundness. Since the publication of the last five-year forecast with the fiscal year (FY) 2016/2018 biennial budget in June 2016, there have been some significant changes in expected future revenues and expenditures.

SUMMARY

The City is projecting that General Fund revenues will total $28.5 million in FY 2017/2018 and increase to $31.9 million in FY 2021/2022. General Fund expenditures are projected to total $30.3 million in FY 2017/2018 and increase to $33.4 million in FY 2021/2022. The General Fund balance is projected to total $10.1 million at the end of FY 2017/2018 and to decline to $6.9 million at the end of FY 2021/2022, the final year of the forecast. The forecast assumes that the City will generally provide the same level of services throughout the five-year period. Table 1 below illustrates the projected surplus/deficit and ending fund balance for FY 2017/2018 through FY 2021/2022.

Table 1 - Projected General Fund Balance for FY 2017/2018 through FY 2021/2022 (in $1,000s)

	FY 17/18 Adopted Budget	FY 17/18 Revised Budget	FY 18/19 Forecast	FY 19/20 Forecast	FY 20/21 Forecast	FY 21/22 Forecast
Fund Balance, Beginning	11,044*	11,875	10,058	9,952	9,496	8,382
Revenues	24,543	28,469	29,362	30,202	31,071	31,889
Expenditures	26,223	30,286	29,468	30,658	32,185	33,370

Surplus (Deficit)	(1,680)**	(1,817)**	(106)	(456)	(1,114)	(1,481)
Fund Balance, Ending	9,364	10,058	9,952	9,496	8,382	6,901***

*For the purpose of this forecast, staff assumed that Measure K revenues would first be received in FY 2017/2018, and that they would be expended in their entirety each fiscal year.
**The City intentionally budgeted more General Fund expenditures than revenues in FY 2017/2018, resulting in an operating deficit, by allocating some excess General Fund balance to road resurfacing.
***The City's current General Fund reserve policy requires a minimum balance of $8.0 million.

GENERAL FUND REVENUES

General Fund revenues for FY 2017/2018 are projected to total $28.5 million and increase to $31.9 in FY 2021/2022. Staff is projecting that most General Fund revenues will grow at 3% annually throughout the forecast period. (Three percent is City staff's estimate of the average rate of inflation over the next five years.) Certain revenue streams have particular dynamics that have led staff to forecast a growth rate other than 3% annually, as described below. The following table summarizes General Fund revenue by category.

Table 2 - FY 2017/2018 – FY 2021/2022 General Fund Revenue Summary (in $1,000s)

Revenue Type	FY 17/18 Adopted Budget	FY 17/18 Revised Budget	FY 18/19 Forecast	FY 19/20 Forecast	FY 20/21 Forecast	FY 21/22 Forecast
Sales Tax	9,173	8,770	9,158	9,359	9,568	9,776
Measure K Transaction and Use Tax		4,114	4,201	4,293	4,387	4,481
Property Tax	2,947	2,982	3,108	3,240	3,377	3,521
Property Tax in Lieu of VLF	3,213	3,242	3,382	3,528	3,680	3,839
Business License Tax	2,600	2,600	2,665	2,731	2,800	2,884
Transient Occupancy Tax	2,607	2,743	2,825	2,910	2,998	3,088
Other Taxes	326	329	339	350	359	286
Other Revenue						
Franchise Fees	1,987	1,987	2,046	2,108	2,171	2,236
Licenses and Permits	648	653	673	693	714	735
Charges for Services	465	469	483	498	512	528
Other Revenue	176	177	182	188	194	199
Transfer	208	208	100	100	100	100
Use of Money and Property	53	53	55	56	57	57
Fines and Forfeitures	57	58	59	61	63	65
Intergovernmental	83	83	86	87	91	94
Total Revenue	**24,543**	**28,469**	**29,362**	**30,202**	**31,071**	**31,889**

<u>Sales Tax</u>

Based on recent analysis by the City's sales tax consultant, HdL Companies, sales tax revenue for

FY 2017/2018 is expected to be lower than budgeted due to a decline in receipts from service stations and other fuel-related expenditures. In addition, as has been widely reported in the media, there has been a softening and change in consumer behavior in retail, which is reflected in weaker sales tax revenue in the forecast for FY 2018/2019 – FY 2021/2022. HdL Companies estimated sales tax will grow 2.2% annually. Nonetheless, sales tax revenue is expected to increase from $8.8 million in FY 2017/2018 to $9.8 million in FY 2021/2022. The forecast includes $200,000 in additional annual sales tax revenue beginning in 2018/2019 generated from the refresh of the southern portion of the Diablo Valley (DV) Shopping Center site. Development of the northern portion of the site might eventually result in significant additional sales tax revenue, which has not been included in the forecast. The forecast also includes additional sales tax of $150,000 beginning in FY 2017/2018 due to the formation of a tourism improvement district (TID) that will market hotels in Pleasant Hill. Staff expects increased occupancy at hotels will generate additional sales tax from visitors shopping and eating in Pleasant Hill.

Measure K Transaction and Use Tax

Measure K became operative on April 1, 2017. Based on recent discussions with HdL Companies, the City is expecting to receive $4.1 million in FY 2017/2018, growing at 2.1% annually to $4.5 million in FY 2021/2022.

Property Tax

Based on consultation with HdL Coren & Cone (HdL), an experienced consultant in the field of property tax analysis, property tax revenue is projected to grow at 4.2% annually, from $2.9 million in FY 2017/2018 to $3.5 million in FY 2021/2022. Revenue is forecasted to increase each year due to higher assessed valuations on residential properties that have changed ownership and the recapture of Proposition 8 valuation reductions.

Property Tax in Lieu of Vehicle License Fee (VLF)

The motor vehicle license fee (VLF) is an annual tax on the ownership of registered vehicles collected by the State Department of Motor Vehicles and subsequently distributed to cities and counties. In 2004, the State Legislature permanently reduced the tax rate from 2% to 0.65% of a vehicle's current market value. The reduction in VLF revenue to cities and counties was offset by an increased transfer of property tax from the State to cities and counties. This transfer is called the "Property Tax in Lieu of VLF." Based on discussions with HdL, property tax in lieu of VLF is projected to increase at 4.3% annually, from $3.2 million in FY 2017/2018 to $3.5 million in FY 2021/2022.

Business License Tax

The City collects a business license tax. Based on an analysis of historical data, the City is projecting that business license taxes will be $2.6 million in FY 2017/2018 and will grow to $2.9 million in FY 2021/2022, a 3% annual growth rate.

Transient Occupancy Tax

The City also collects a transient occupancy (hotel) tax (TOT) of 10%. Based on a 3% annual growth rate, this revenue is projected to increase from $2.7 million in FY 2017/2018 to $3.0 million in FY 2021/2022. The budget and forecast also assumed Homewood Suites by Hilton will open during FY 2017/2018 and generate approximately $400,000 annually in TOT.

Other Taxes

The City collects a number of small taxes, such as property transfer tax and utility user tax. These taxes are projected to range from $286,000 to $359,000 during the period of the forecast.

Other Revenue

The City collects a number of non-tax General Fund revenues, as described below.

Franchise Fees

Franchise fees are rent paid by utilities or other businesses for the privilege of using the City's right of way (streets, alleys, sidewalks, etc.) to locate utility lines or operate vehicles. The City collects a franchise fee of 1% of revenue from Pacific Gas & Electric (PG&E) and 5% of revenue from cable operators AT&T/Pacific Bell, Comcast, and Astound. The City also collects a franchise fee of 12% of revenue from Allied Waste Management. Franchise fee revenues were budgeted at $2.0 million in FY 2017/2018 and are expected to increase 3% annually to $2.2 million in FY 2021/2022.

Licenses and Permits

The revenue in this category is due to permits and fees, which were budgeted at $648,000 for FY 2017/2018 and are expected to increase to $735,000 in FY 2021/2022, 3% annually. This category includes building, electrical, plumbing, and energy permits, primarily generated from construction-related activity.

Charges for Services, Transfers, Use of Money and Property, and Miscellaneous Other Revenue

This category includes numerous miscellaneous "other" revenues. The major sub-categories include charges for services, fines and forfeitures, interest revenue, Police Officer Standards and Training (POST) reimbursements from the State, accounting fees, and transfers from other funds. The City is projecting these revenues will increase from $1.0 million in FY 2017/2018 to $1.1 million in FY 2021/2022 based on a 3% annual growth rate.

GENERAL FUND EXPENDITURES

General Fund expenditures for FY 2017/2018 are projected to total $30.3 million and increase to $33.4 million in FY 2021/2022. Staff assumed that staffing and service levels will remain constant throughout the term of the forecast, with the exception that the General Fund contribution to street resurfacing, which was historically high in FY 2016/2017 and FY 2017/2018 (nearly $1.5 million annually), would return to its traditional level of $200,000 annually in FY 2018/2019 and beyond. The following table summarizes General Fund expenditures by category.

Table 3 – FY 2017/2018 – FY 2021/2022 General Fund Expenditure Summary, By Category (in $1,000s)

Expenditure Category	FY 17/18 Adopted Budget	FY 17/18 Revised Budget	FY 18/19 Forecast	FY 19/20 Forecast	FY 20/21 Forecast	FY 21/22 Forecast
Personnel						
Salaries	11,121	11,475	11,440	11,814	12,152	12,492
Benefits	6,080	5,688	6,410	7,244	8,078	8,752
Benefit Buybacks and Contrib to Retiree Health	423	423	572	589	598	498
Public Safety PERS Side Fund Loan Debt	890	890	0	0	0	0
General Expenses	792	810	832	854	877	900
Prof and Contract Services	1,594	1,565	1,567	1,573	1,661	1,669
Other Expenditures:						
Conferences and Training	199	207	213	220	226	233
Maintenance and Repair	324	325	334	345	355	365
Supplies and Materials	268	274	282	290	299	308
Utilities	468	471	485	500	515	530
Insurance	623	623	776	800	824	848
Promotions and Contributions	545	524	703	467	474	477
Fixed Assets	34	35	36	37	38	39
Measure K Expenditures for Capital Projects		4,114	4,201	4,293	4,387	4,481
Transfer	2,862	2,862	1,617	1,632	1,701	1,778
Total Expenditures	**26,223**	**30,286**	**29,468**	**30,658**	**32,185**	**33,370**

Personnel

Salary

The forecasted staff salaries include all of the cost of living adjustments (COLAs) agreed to in the current employee labor contracts. Staff forecasted annual COLAs of 3%, the expected average rate of inflation, in years beyond the current labor contracts. Salaries are projected to total $11.5 million in FY 2017/2018 and forecasted to increase to $12.5 million in FY 2021/2022. For the purpose of the forecast, staff assumed annual salary savings of $450,000 due to vacancies.

Benefits

Benefit costs, primarily composed of medical insurance and retirement, are projected to increase from $5.7 million in FY 2017/2018 to $8.8 million in FY 2021/2022. Employee benefits other than medical insurance and retirement, which are described in greater detail below, are forecasted to increase by 3% annually.

Medical Insurance

The FY 2016/2018 budget assumed that medical insurance premiums would increase 10% annually through December 31, 2017. Thereafter, the City assumed that it would provide health insurance with premiums capped at the Affordable Care Act (ACA) excise tax threshold in order to avoid any excise taxes. Achievement of this goal is subject to future labor negotiations. Note that the City's medical benefit costs are actually projected to be $0.4 million lower than budgeted for FY 2017/2018 due to employees' enrollment in lower cost medical plans and lower than expected increases in premiums.

Retirement

In December 2016, the California Public Employees' Retirement System (CalPERS), the City's retirement benefit provider, decided to decrease its assumed long-term rate of return on its assets (referred to as the "discount rate"), phasing in a change from 7.5% to 7% over three years. This requires the City and all other CalPERS participating agencies to increase their contributions in order to pay out the same level of benefits to their retirees.

CalPERS has made a number of other decisions over the past few years to strengthen the system's financial position, which will also result in higher contributions from participating agencies. These decisions include making mortality assumptions more conservative, achieving higher funded status more quickly, and more quickly amortizing investment losses.

Most of these changes are being phased in over a fixed 20-year period with a 5-year ramp up at the beginning and a 5-year ramp down at the end of the amortization period. A new ramp is established with each change to the discount rate. As a result of the 5-year ramp up and the effective date of the increase, it will be seven years until the full impact of the change in discount rate is completely phased in. Contribution rates are expected to reach their maximum in 2032, then drop very slowly, falling back to current levels somewhere in the 2042 time frame.

The City's FY 2017/2018 total CalPERS contribution (including normal cost and paying down unfunded liability) is expected to be $3.1 million, as budgeted. Based on all of the recent CalPERS changes, staff forecasts that the City's total CalPERS contribution will be $5.7 million in FY 2021/2022. In total, CalPERS costs are now forecasted to be $1.9 million higher over FY 2018/2019 – FY 2020/2021 than forecasted in the FY 2016/2018 budget.

Benefit Buybacks and Contributions to Retiree Health Savings Plan (RHS)

This category includes sick leave and vacation buybacks for retiring employees. Depending upon an employee's bargaining unit, this benefit provides limited reimbursement of medical premiums or a contribution to a retirement health savings plan based on an employee's unused sick leave and vacation leave balances when they retire. Several conditions must be met in order to qualify for this benefit. The timing of these payments is not cyclical; however based on experience and the projected timing of future retirements, the City is projecting expenditures will range from $423,000 to $598,000 annually.

Public Safety PERS Side Fund Loan Debt Payment

This category is comprised of an annual debt service payment of $890,000 related to the payoff of the CalPERS public safety side fund obligation. Rather than make annual payments to CalPERS to slowly pay off this obligation, the City took a loan from Umpqua Bank to pay off the obligation more quickly at a lower interest rate, resulting in significant savings. This debt will be paid off in full during FY 2017/2018.

General Expenses

This category includes expenditures for postage, printing, memberships, publications and subscriptions, police jail booking fees and maintenance and gas for City vehicles. The City is projecting expenditures will be slightly higher than originally budgeted for FY 2017/2018 at $810,000 and are forecasted to grow by 3% annually to $900,000 in FY 2021/2022.

Professional and Contract Services

This category includes expenditures for contractual services such as legal counsel, auditing, videotaping, and animal control. The City is projecting expenditures will be on track with budget for FY 2017/2018 at $1.6 million and are forecasted to increase by 3% annually to $1.7 million in FY 2021/2022.

Measure K Transfer

Measure K became operative on April 1, 2017. For the purpose of this forecast, staff assumed that Measure K revenues would first be received in FY 2017/2018, and that they would be expended in their entirety each fiscal year. Measure K expenditures are expected to be $4.1 million in FY 2017/2018 and increase to $4.5 million in FY 2021/2022. Specific projects funded by Measure K will be approved by the City Council through a revised Capital Improvement Plan (CIP).

Other Expenditures

The "other expenditures" category includes the major subcategories of conferences and training; maintenance and repairs; supplies and materials; utilities; insurance; promotions and contributions;

fixed assets; and transfers. Note the promotions and contributions category includes a $238,000 contribution toward the Gateway project in FY 2018/2019. This category includes an additional $1.3 million contribution (above the historical average of $200,000) toward the street resurfacing program in FY 2017/2018, which enables the City to marginally increase the Pavement Condition Index (PCI) rating of City streets and to also prevent an increase in the level of deferred maintenance of the streets. The forecast assumes that the General Fund will contribute $200,000 annually during FY 2018/2019 – FY 2021/2022 for street resurfacing.

This category also includes the City's ongoing annual contribution toward library facility maintenance and 43 library open hours (including Monday hours) weekly. The City is projecting that expenditures in the "other expenditures" category will match the amount budgeted of $5.3 million for FY 2017/2018 and will decline to $4.6 million in FY 2021/2022, primarily due to the reduced contribution to the street resurfacing program.

NEXT UPDATE

Staff is intending to work with the Budget Committee to develop a Long-Term Financial Plan for FY 2017/2018 through FY 2021/2022 in fall 2017.

STAFF RECOMMENDATION

Accept the Fiscal Year (FY) 2017/2022 Five-Year Financial Forecast for the General Fund.