



STAFF REPORT TO THE CITY COUNCIL

DATE: Regular Meeting of April 9, 2019

TO: Members of the City Council

SUBMITTED BY: David Biggs, City Manager
Edwin Gato, Finance Director

SUBJECT: **Long-Term Financial Projection for the General Fund**

RECOMMENDATION: Review and discuss the long-term financial projection for the General Fund.

COMMISSION/SUBCOMMITTEE ACTION AND RECOMMENDATION: The report was presented to the Finance Commission at their special meeting on Thursday, March 21, 2019, and has been refined and updated since that time.

FISCAL IMPACT OF RECOMMENDATION: There is no direct impact from the preparation and review of an updated long-term forecast. It is a planning tool that can be used to guide future fiscal decisions.

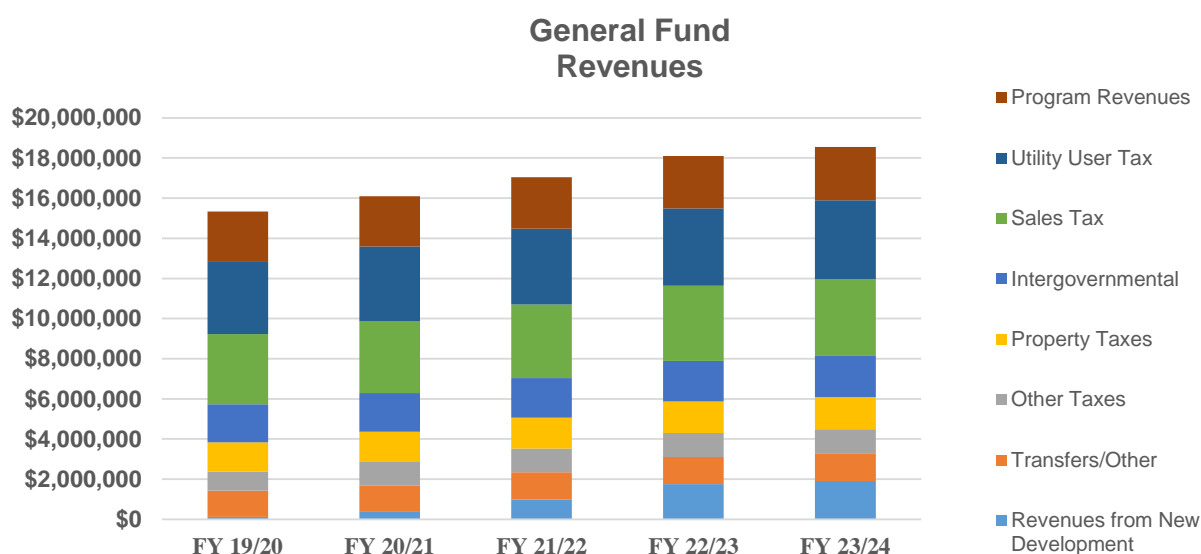
DISCUSSION: The City's finances are managed through four major efforts each year. The development and adoption of a budget for each fiscal year which starts July 1st is generally considered the first point in the annual cycle. This is generally followed by the completion and the acceptance of the audit for the prior fiscal year with the goal of having that completed by December 31st or earlier. The completion of the annual audit typically sets the stage for the mid-year budget review in February or March and can include some adjustments or additional appropriations or designations of reserves. The preparation of an update to the long-term forecast would also be done in the March/April timeframe to set the stage for the development of the budget for the next fiscal year.

With the City Council having undertaken the mid-year review on February 26th, and with the audit having been received by the City Council on January 22nd, it is timely to review an updated Long-Term Financial Projection. The forecast has been updated to reflect the FY 2017/18 audit results with the FY 2018/19 Year-End Projections indicated in the mid-year review.

A long-term forecast was prepared for the General Fund for the time period from FY 2019-20 through FY 2023-24.

REVENUE PROJECTION AND ASSUMPTIONS USED: The General Fund major revenue categories are summarized on page 1 of the Attachment. The City derives a significant portion of its General Fund revenues from economically sensitive sources such as property taxes, sales taxes (1% Bradley-Burns), and utility users' taxes. When one or more of these key revenue sources deviates from projections, funding for future programs and services may be affected.

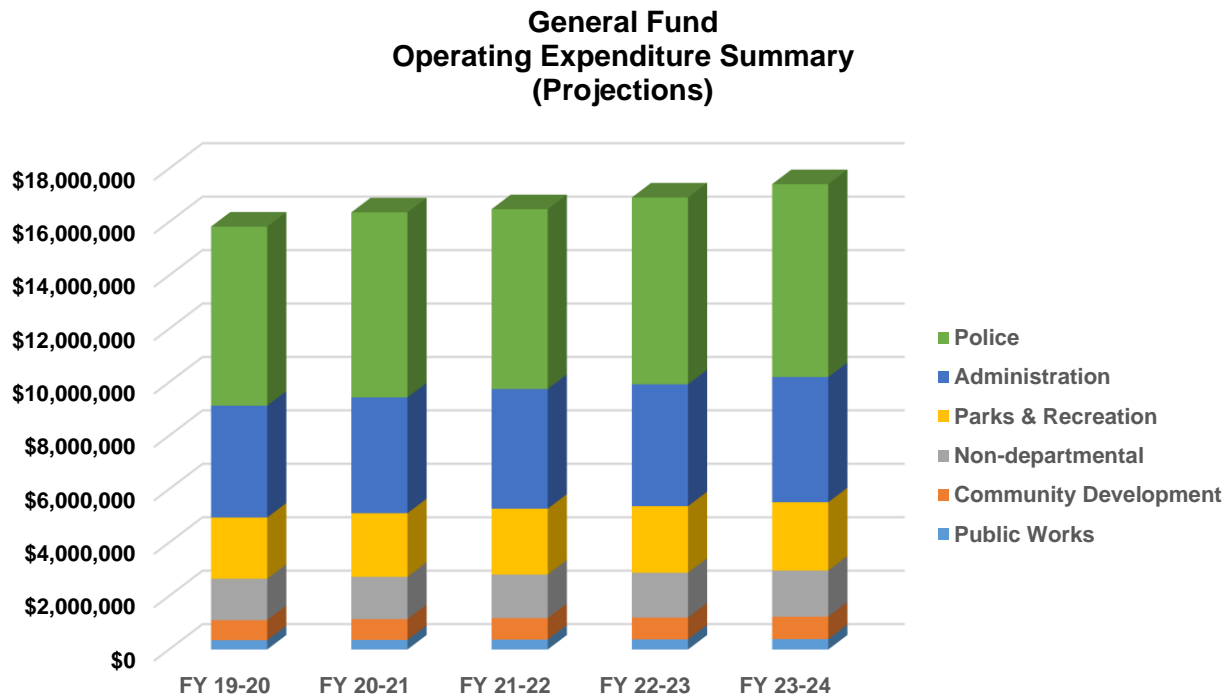
As shown in the following graph, General Fund revenues are projected to increase at the rate of 2% a year and including estimated revenues from new development. Revenue projections for a 5-year forecast period through 2024 range from \$15.3 to \$18.5 million. The following explains the major revenue assumptions used to estimate General Fund revenues.



- Utility User's Tax (UUT) are revenues collected from the consumption of utility services, including (but not limited to) electric, gas, water, sewer, telephone (including cell phone and long distance), sanitation and cable television. The City determines the rate of the tax and the use of its revenues. Based on the trend and its consumption rate, the City assumed revenue growth of 2% annually.
- Sales Tax revenue is projected to increase at an average of 2% a year. Total Sales Tax revenue is highly concentrated within one major operator. Over 80% of the City's sales tax is generated by this one producer. Based on the report received from MuniServices, Hercules' sales tax revenue is substantially generated from business and industry sources.
- The City is realizing a stable property tax related revenue growth and assumed at 2% annual growth. The County Assessor's Office reports an increase in property assessed values of 4.2% compared to the prior year. Future growth in assessed values above the State Prop 13 annual 2% cap is limited to property turnover or new development entering the tax roll.

- The new general tax revenues on new development, such as Muir Pointe, Bayfront, Safeway, Sycamore Crossing, Willow Auto Site, and Hilltown are estimated based on residential unit impact, assuming an average of 2.5 people per unit.

EXPENDITURE PROJECTION AND ASSUMPTIONS USED: Expenditure projections for a 5-year forecast period through 2024 range from \$15.8 to \$17.4 million assuming the same service level. The following chart shows the growth in General Fund expenditures.



The most significant cost in the General Fund is driven by its labor. Labor accounts for almost 60% of total expenditures. Below are significant assumptions used to estimate the cost of salaries and benefits:

1. Regular Salaries – Cost of living (COLA) increase by 3% per year.
2. PERS Miscellaneous and Public Safety Normal Cost rate applied are projected as follows based on CalPERS actuarial assumptions:

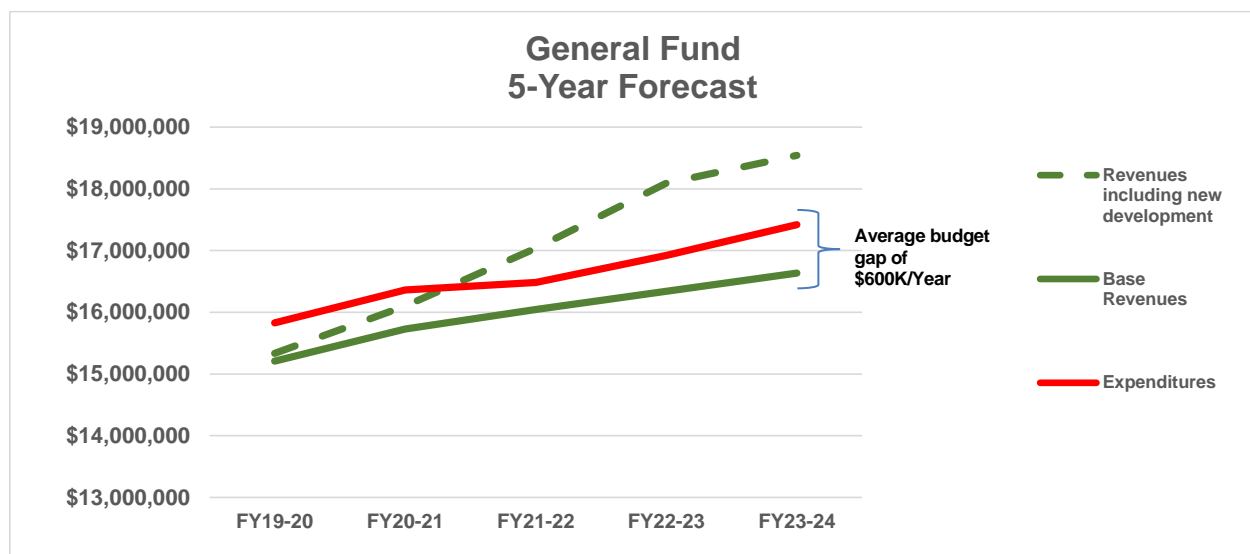
		<u>FY 19-20</u>	<u>FY 20-21</u>	<u>FY 21-22</u>	<u>FY 22-23</u>	<u>FY 23-24</u>
Police	Classic	18.93%	20.30%	20.30%	20.30%	20.30%
Police	2nd-Tier	17.07%	18.30%	18.30%	18.30%	18.30%
Police	PEPRA	10.03%	10.10%	10.10%	10.10%	10.10%
Misc	Classic	6.68%	7.30%	7.30%	7.30%	7.30%
Misc	PEPRA	3.99%	4.50%	4.50%	4.50%	4.50%

3. PERS Unfunded Accrued Liability (UAL) contribution rate are projected as follows based on CalPERS actuarial assumptions. The rate is calculated using projected payroll.

		<u>FY 19-20</u>	<u>FY 20-21</u>	<u>FY 21-22</u>	<u>FY 22-23</u>	<u>FY 23-24</u>
Police	Classic	46.47%	50.49%	31.43%	34.85%	36.95%
Police	2nd-Tier	1.58%	1.15%	0.96%	0.80%	0.68%
Police	PEPRA	0.38%	0.49%	0.63%	0.76%	0.54%
Misc	Classic	21.22%	23.45%	26.19%	20.76%	21.90%
Misc	PEPRA	0.20%	0.30%	0.40%	0.39%	0.47%

DISCUSSION:

Looking into the General Fund five year forecast, a deficit between revenues and expenditures for existing service levels is expected to return in FY 19-20. The revenues also include an estimated increase in general tax revenues on new developments. The graph below illustrates the impact of new developments on the City's general tax revenues and the effect on its annual operating results. Expenditures in this graph assumed a projected overall average increase of 3% a year. As shown in Attachment 1, the City have set-aside sufficient available cash balance and reserve to cover the projected deficits, and with the projected tax revenues from new developments, it is projected that this new revenues will close the budget gap in FY 20-21 and will start to accumulate surplus beginning FY 21-22. The FY 19/20 projections will be further updated and refined during the adoption of the budget in June 2019. As the City plans its ongoing programs and services, it will need to balance its increasing cash flow requirements for legacy pension/OPEB obligation and deferred maintenance with a commitment to maintain and enhance City services.



ATTACHMENTS:

1. City of Hercules – General Fund Long-Term Financial Forecast
2. Assumptions Used for the General Fund Long-Term Financial Forecast