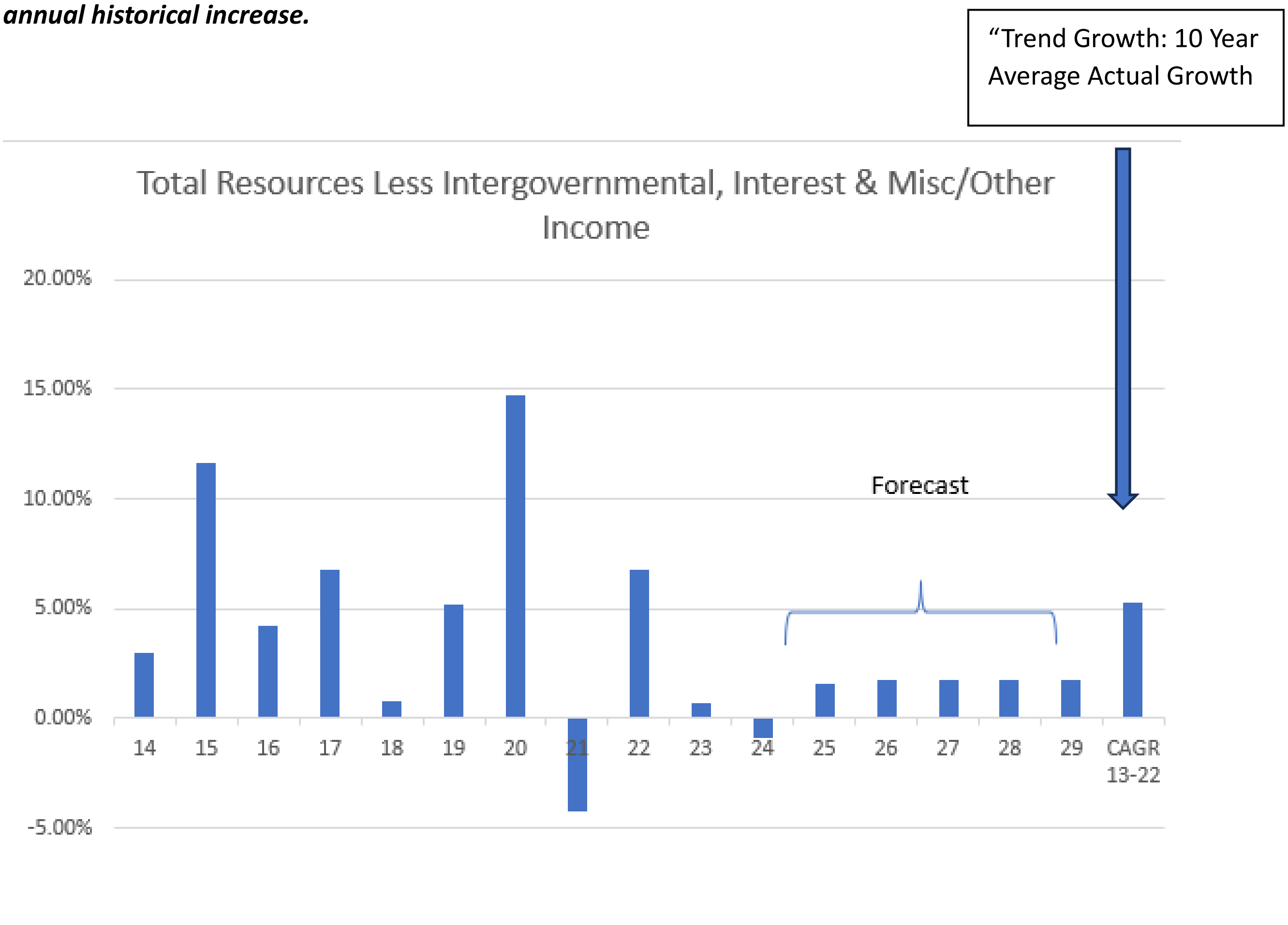
"VERY CONSERVATIVE REVENUE FORECAST DRIVING THE EMERGENCY; IS IT TOO CONSERVATIVE?"

The current 5-year revenue and expense forecast creates a growing deficit that eventually takes reserves below the 15% policy level. While it has been postulated, we have a revenue problem, ***maybe we have a revenue forecast issue instead.***

The graph below shows year over year change in Total Resources (Revenue plus Transfers in) beginning in the FY 2013-2014. The negative bar for FY 23-24 is the current adopted budget. The flat series of bars to the right of the current year are the Y/Y changes (2%) being used to forecast revenue for the next five years.

The financial emergency is in large part due to a forecast revenue decline in 2024 followed by only a 2% annual increase in revenues going forward. This is against a backdrop of a 5% 10-year average annual historical increase.



Data from 23-24 Adopted Budget 10-year Forecast

The budget committee identified one-time intergovernmental transfers as the main issues driving our deficits, so these have been removed. Further the $1.2MM theft and the subsequent booking of the insurance payout as revenue are confusing the Interest data and Miscellaneous and Other Income so that is removed as well as they contain both insurance payouts and a substantial one-time donation in 2022.

A key driver of future budget deficits and declining general reserve balances ***is the 2% revenue growth forecast. We need to understand the drivers of this conservative forecast – changing conditions or just being conservative. Economic conditions seem good for now.***

The proposed Emergency Declaration states that our financial issues are being created by an economic downturn. However, the 21-22 Audited Financial Report for the city shows economic activity has been strong over the last 10 years and accelerating with 13% growth in the past three years.

The data below taken from the audited report shows accelerating sales growth which should be driving sales tax revenues unless something has changed in the city. It seems like new restaurants are opening. Our lone Car Dealer has more inventory on his lot. Benedetti and Big O seem busy as ever.

Category	2022	2021	2020	2019	2018	2017	2016	2015	2014	2013	CAGR 2013-2022	CAGR 2020-2022
Eating Drinking	$ 134,993	$ 125,046	$ 100,593	$ 129,249	$ 118,216	$ 112,516	$ 100,029	$ 96,436	$ 89,102	$ 69,988	8%	16%
Food Stores	$ 122,620	$ 113,584	$ 108,895	$ 112,662	$ 122,367	$ 134,383	$ 129,670	$ 125,326	$ 102,265	$ 74,878	6%	6%
Apparel Stores	$ 16,213	$ 15,018	$ 13,380	$ 15,995	$ 16,528	$ 17,077	$ 16,080	$ 15,980	$ 10,921	$ 8,656	7%	10%
Auto Dealers and Sup	$ 103,852	$ 96,199	$ 76,513	$ 91,855	$ 90,004	$ 97,536	$ 94,005	$ 89,250	$ 238,577	$ 222,850	-8%	17%
Service Stations	$ 63,747	$ 59,050	$ 50,907	$ 66,208	$ 58,032	$ 50,997	$ 51,592	$ 61,102	$ 44,970	$ 36,524	6%	12%
Other Retail	$ 191,047	$ 176,969	$ 148,224	$ 140,420	$ 138,145	$ 131,621	$ 122,975	$ 115,389	$ 83,500	$ 65,374	13%	14%
All Other Outlets	$ 205,640	$ 190,487	$ 161,117	$ 166,791	$ 143,070	$ 135,790	$ 136,807	$ 134,947	$ 140,945	$ 115,105	7%	13%
	$ 838,112	**$ 776,353**	**$ 659,629**	**$ 723,180**	**$ 686,362**	**$ 679,920**	**$ 651,158**	**$ 638,430**	**$ 710,280**	**$ 593,375**	4%	13%

Higher Inflation is forecast to continue but this increases the cost of retail goods and services. as well as the cost of utilities, so these tax revenues should be increasing at or above recent trends. In the absence of a significant period of deflation these prices help to ensure higher revenues going forward.

The City Manager reported at the November 14 special meeting that the city staff budgets revenues very conservatively. ***2% growth indeed is very conservative. Revenue each year for the last 10 years exceeded 2% - 8 out of 10 times.*** The historical average "trend growth" over the last 10 years was a bit higher than 5%. We have never had 6 years at anything close to 2% growth.

The table below shows the 10 Year growth history for each budget category in the first column. Second is the current growth estimates being used in the 23-24 Adopted budget for the next five years.

The Right hand column is the growth rates needed to achieve "historical trend" levels of growth of just over 5%

23-24 Adopted Budget - Published*	CAGR 10 YEAR HISTORY	CAGR BUDGET FORECAST	CAGR PROPOSED FUTURE
Property Tax	**2.7%**	2.0%	2.7%
Sales and Use Tax	**7.8%**	2.0%	7.0%
User Tax	**10.2%**	1.5%	6.0%
Intergovernmental	**15.3%**	1.0%	6.0%
TOT Tax	**3.5%**	0.2%	2.0%
Other Taxes and Fees	**6.1%**	1.1%	5.0%
Total Revneues	**5.9%**	1.8%	1.8%
Transfers In	**13.6%**	-0.4%	0.0%
Total Resources available	**5.9%**	1.8%	5.2%

Applying the new “proposed future” growth rates we can test the sensitivity of the deficit and the reserves to the higher “trend growth” rate assumptions. Current Status is excerpted from the staff document from the 11/4 meeting. Y/Y Changes are added.

CURRENT STATUS	2023-24	2024-25	2025-26	2026-27	2027-28	2028-29	CAGR
Revenues	$ 10,860,460	$ 11,022,140	$ 11,259,630	$ 11,497,043	$ 11,732,327	$ 11,967,541	
%Y/Y CHG		1.5%	2.2%	2.1%	2.0%	2.0%	2.0%
Expenses	$ (12,537,996)	$(12,489,796)	$(12,827,017)	$(13,239,030)	$(13,656,076)	$(14,311,580)	
%Y/Y CHG		-0.4%	2.7%	3.2%	3.2%	4.8%	2.7%
Shortfall	$ (1,677,536)	$ (1,467,656)	$ (1,567,387)	$ (1,741,987)	$ (1,923,749)	$ (2,344,039)	

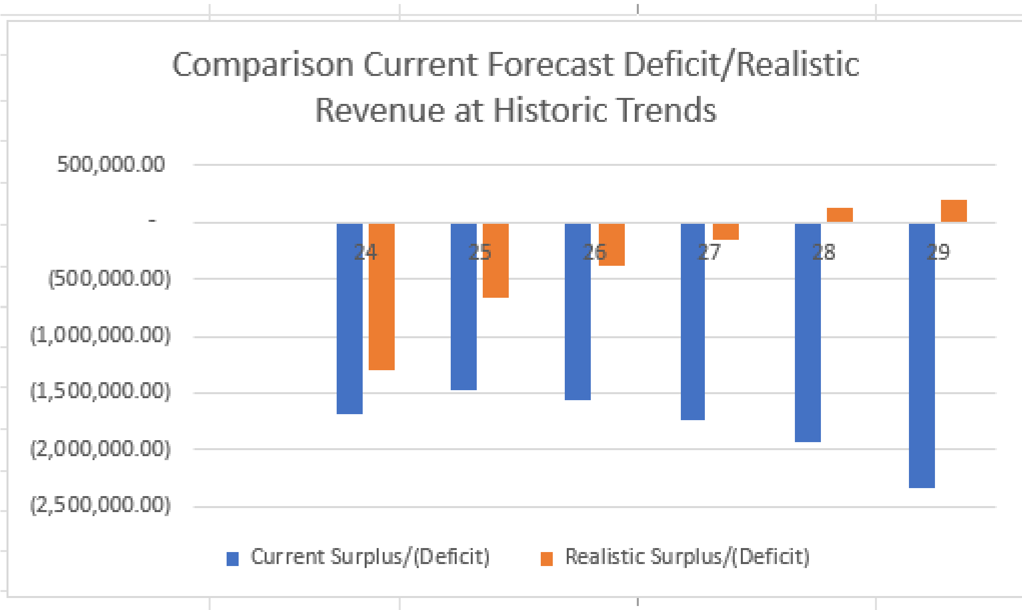
REALISTIC FORECAST	2023-24	2024-25	2025-26	2026-27	2027-28	2028-29	CAGR
Revenues	$ 11,244,505	$ 11,824,545	$ 12,439,098	$ 13,090,371	$ 13,780,720	$ 14,512,654	
%Y/Y CHG		5.2%	5.2%	5.2%	5.3%	5.3%	5.2%
Expenses	$ (12,537,996)	$(12,489,796)	$(12,827,017)	$(13,239,030)	$(13,656,076)	$(14,311,580)	
%Y/Y CHG		-0.4%	2.7%	3.2%	3.2%	4.8%	2.7%
Shortfall	$ (1,293,491)	$ (665,251)	$ (387,919)	$ (148,659)	$ 124,644	$ 201,074	

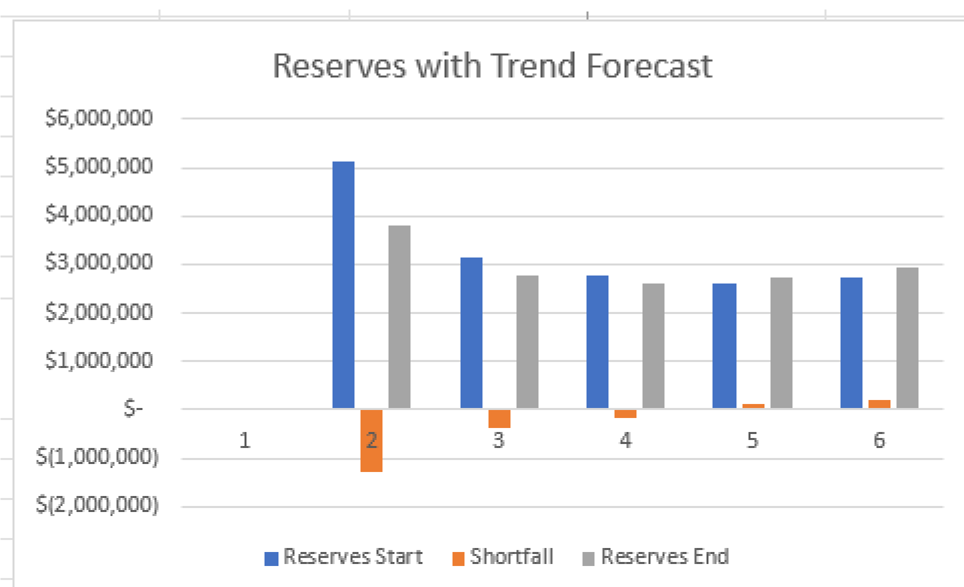
RESERVES	2023-24	2024-25	2025-26	2026-27	2027-28	2028-29
Reserves Start	$ 5,118,800	$ 3,825,309	$ 3,160,058	$ 2,772,139	$ 2,623,480	$ 2,748,124
Shortfall	$ (1,293,491)	$ (665,251)	$ (387,919)	$ (148,659)	$ 124,644	$ 201,074
Reserves End	$ 3,825,309	$ 3,160,058	$ 2,772,139	$ 2,623,480	$ 2,748,124	$ 2,949,199
% Expense	-31%	-25%	-22%	-20%	-20%	-21%

RESERVES W/NEW HOTEL	2023-24	2024-25	2025-26	2026-27	2027-28	2028-29
New Hotel TOT			$ 800,000	840000	882000	926100
	$ 3,825,309	$ 3,160,058	$ 3,572,139	$ 3,463,480	$ 3,630,124	$ 3,875,299
	-31%	-25%	-28%	-26%	-27%	-27%

Above we see the more Realistic Forecast using “trend growth” shows a declining deficit (labeled shortfall) with a surplus beginning in 2027-28. The effect of adding a new hotel is shown as well.

Below the deficit and the impact on Reserves is shown visually.





<u>The City can and should take actions to ensure revenues achieved in the next 6 years are above "Trend Forecast"</u>

New Hotel:

If Council and City Manager can close ***a deal on a downtown hotel the resulting TOT tax would be a game changer***. Assuming we are collecting TOT tax by 2025 our reserves never go below 25%. Policy level is 15% leaving a cushion for error.

- The new hotel is probably the biggest impact City Council can have on future revenues. Done well it will improve the quality of our downtown area and increase property values all around. New shoppers and restaurant patrons will come to the city. There are many economic development synergies.

Council should focus on actions that can support future strength in key revenue categories.

- Intergovernmental grants may not reach covid levels but have been pretty standard over the last 10 years. In particular the County/State took away $200,000 in TOT revenue with promises this would be returned in the future. We should seek restitution for our lost TOT revenue via an annual grant that would promise consistent future revenue stream.
- Events draw people to Sebastopol to shop.
- Better signs and parking help visitors find or local stores and restaurants that may be a bit off the path.
- Perhaps we could consider city maps posted prominently around the city highlighting restaurants and stores. This could be tied to a website with a QR code that provides more information and directions.
- Parklets make restaurants and retailers more accessible with some downside protection if COVID reappears.
- Christmas is the main shopping season for many retailers. Supporting events such as tree lighting, downtown caroling, special holiday foods, free parking and extended hours for weekend shopping can all help ensure maximum sales tax revenue.

On the surface we likely need to raise revenue both to address the growing crisis in the Water and Wastewater operation and to address needed infrastructure such as city streets. We need a "whole of city" plan to balance revenue and the cost of creating and maintaining the beautiful city we all wish for.

The strategic financing <u>plan</u> needs consideration for the people who live in the city. It needs to be as affordable as possible realizing this is California.

The staff report for this meeting introduces a wish list of tens of millions of dollars in capital improvements not included in the current budget. **A proper infrastructure study is needed to understand the City's needs.** Proper means a full inventory of infrastructure, its age, condition, expected life and replacement/maintenance costs. **The study needs a plan to fund infrastructure that is long-term, dedicated, and sufficient without creating year to year unexpected demands on the general fund. Financing alternatives need to be analyzed and recommendations for a financing strategy need to be developed.**