

**CITY OF SEBASTOPOL CITY COUNCIL  
AGENDA ITEM REPORT FOR MEETING OF:            March 19, 2024**

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**To:**                            Honorable Mayor and City Councilmembers  
**From:**                        Don Schwartz, City Manager  
**Subject:**                    Preparation for FY 24-25 Budget

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**RECOMMENDATION:**

- 1. Provide direction on development of FY 24-25 budget.

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**EXECUTIVE SUMMARY:** The City of Sebastopol faces major long-term budget challenges with our General Fund, which supports most City functions including police, fire, land use, housing, maintenance of parks and facilities, support for non-profits, and administrative functions. The long-term challenges are outlined in another item on this agenda. The City’s water and sewer funds also face major challenges; we will discuss these with the City Council in forthcoming meetings.

With this item, staff are proposing to take some initial steps to address the General Fund challenges. We are also proposing that the Council review staff’s proposed approach for preparation of the FY 24-25 budget and provide direction as it deems appropriate.

**BACKGROUND:** Sebastopol’s General Fund is confronted with chronic structural deficits. In FY 23-24, the adopted budget contained a deficit of \$1.68 million. With savings due largely to vacant positions, we anticipate we will end the year with a \$1.1 million deficit, although this estimate may change by the end of the Fiscal Year. The deficit will grow to nearly \$2 million in FY 24-25 without lowering costs, reducing services, or adding revenue.

The budget model presented as part of this agenda projects an on-going structural deficit of \$2.9 million per year. A structural deficit means that on-going revenues are insufficient to meet on-going expenses. The challenges that the City faces are likely to become more difficult over the next ten years as expenses increase from deferred maintenance and payments for unfunded pension liabilities. The model suggests that the City will run out of General Funds within three years. This time can be extended through maintaining higher position vacancy rates, as we have had the past two years, but the forecast assumes the City fills more positions so that the vacancy rate drops to 6% in FY 24-25 and 4% thereafter.

The City has been fortunate in recent years to receive substantial “one-time” funding. These are funds which we cannot count on to be available again. They include:

- \$1,500,000    State funding toward flood recovery
- \$370,000     County Funds for Closure of Sebastopol Hotel
- \$95,000      Care Act (COVID) Funds
- \$14,000      Flood Reimbursement /FEMA Claim
- \$80,000      Grant from County for Homeless Outreach
- \$1,800,000   Federal ARPA (COVID) Funds
- \$420,000     Approximate donation for the benefit of the Police Department

\$420,000      Approximate donation for the benefit of the Fire Department, under management of the Firefighters' foundation.

These funds have often supported ongoing expenses; however, because we cannot expect to receive them again we need to find alternative sources of funding or reduce City expenses and services.

**COST ANALYSIS:** Per the prior agenda item on the City's long-term financial model, Sebastopol's costs of providing services are relatively high compared to other small cities in Sonoma County. Also, while the City's budget for the current Fiscal Year extensively discusses cuts, it was nearly the same as the \$12.5 million level in FY 22-23. This likely occurred as increases in some expenses over which the City has little control, such as liability insurance and employee retirement (or PERS) costs, required off-setting cuts.

While some costs are difficult to control, the high per capita costs suggest that the cost of services is worthy of more in-depth review. This could include looking at our models for providing service; for example, regional options are often the most cost-effective. We should consider the costs of services that we purchase, and use competitive procurements whenever feasible. In addition, the cost of labor is the single largest category of expenses. We could look closely at the elements that make up our labor costs. This may include comparing the compensation of City employees to other cities.

**MEASURE H, FIRE SALES TAX:** It appears that voters in Sonoma County recently approved a ½ cent sales tax to improve fire services. We expect this tax to generate about \$1.1 million/year for Sebastopol, all of which must be dedicated to improving fire services. The Measure requires that the City maintain funding from the General Fund near the FY 21-22 operating Fire Department adopted budget, which was \$1.2 million. This is about \$300,000 less than the FY 23-24 adopted operating budget.

**REVENUE OPTIONS:** Last Fall the City Council identified numerous options to explore for increasing revenue. Those of greatest Council interest included:

- a. Increasing the sales tax
- b. Reviewing the enforcement process for licenses for events
- c. Exploring the sale of City properties: staff was asked to review properties and return with recommendations
- d. Pursuing financial support from the County as Sebastopol is the hub of services for many residents of the unincorporated areas
- e. Formula Businesses: Staff indicated that they would explore changes to the City's formula business restrictions in terms of potential new revenue.

Other possibilities, including some that have emerged since, include:

- f. Pursuing an Enterprise Infrastructure Financing District (EIFD). This would be a way of obtaining a share of the County's future property taxes, which we would combine with a City share, to improve infrastructure. It could take effect in several years.
- g. Renegotiating the City's lease with the Library so that the Library pays a greater portion of the costs of major maintenance and repair, particularly as voters have approved a 1/8 sales tax for the Library that allows funding for buildings.
- h. Updating the City's building fees so that they reflect the costs of service for major projects.

- i. Exploring the potential for an additional fee to cable bills to cover the City's costs of broadcasting public meetings.
- j. While not formally addressed at a Council meeting, staff and the prior Budget Committee suggested that we review leases of City buildings for changes such as potentially charging for rent and utilities upon lease expiration. Leases that have expired within the last year include Luther Burbank Farms, Western Sonoma County Historical Museum, and the Senior Center.

**SHORT TERM CHANGES:** Staff has initiated some changes to save money in the current fiscal year. These include reducing expenses. Per Council intent, we have not filled a second fire engineer position nor a new police officer position. We have also had numerous vacancies that have created savings. We are shifting some responsibilities for attending regional meetings on stormwater from expensive outside consultants to existing staff.

Staff are requesting that the Council provide direction on additional options to save money or staff time to focus on other priorities. While these might not take effect until the next Fiscal Year, we would suggest moving forward with these by engaging the affected parties and assessing the potential for savings in both dollars and staff time. These include:

1. Eliminating staff support and City expenses (primarily for broadcasting) for the Public Arts and Climate Action Committees. This would include exploring options to re-structure these Committees so that they continue to provide input to the City in a different way. For example, the Peace Wall Committee performs their function independently of the City, coming to the Council for approval of new names to add to the Peace Wall when needed. The Library Advisory Board primarily advises the Library, and also provides input to the City on Library-related matters without the benefit of staff time or broadcasting services. Savings in staff time would lead to saving money and/or reallocation of time to other priorities such as pursuing the Enterprise Infrastructure Financing District, participating in regional discussions on potential bond funding for housing, economic development, or other projects.
2. Exploring consolidation of the Planning Commission and Design Review Board, as is common in other cities. There is some overlap between the functions of these bodies. Combining them would require changing the City code. In addition to saving money and staff time, streamlining the process for applicants could reduce permit costs and time, therefore making it easier for new businesses to locate in Sebastopol.
3. Considering eliminating the business license fee for vendors at events, or collecting the funds in a different manner (such as having the event sponsor pay an amount equivalent to the fees). Currently, the City receives about \$6,200/year from these vendors. The staff work required to process these funds and licenses as well as follow up and enforcement likely costs more than we collect. Also, these fees may be uncommon in other jurisdictions, making Sebastopol less welcoming to vendors who help to attract visitors and spending here. If we were to pursue this option, we would also look to ensure that sales tax from these events are collected appropriately. We could also consider the \$2,300 in vendor fees for the Farmers Market as part of this effort.
4. Providing direction to eliminate the Community Grants program formally. It is highly unlikely that staff would recommend funding these grants until the City is on stronger financial ground. Currently, the City's approach is to revisit this annually, which creates uncertainty and may create unrealistic expectations about the potential for City funding.

5. Considering shifting \$1 million set aside for future retirement costs to the City's Section 115 Trust. This Trust has the potential to generate higher returns. The City Council approved shifting \$1.8 million to the Trust last year.

**FY 24-25 BUDGET PREPARATION:** For FY 24-25, the forecast model projects a deficit of \$1.97 million. Attachment 1 illustrates the primary changes in revenues and expenses.

Overall, our goal is to stabilize the City's finances by presenting a balanced operating budget or a clear path to get to a balanced budget soon. The principles we suggest to guide our work include:

1. Preparing the annual budget to ensure it aligns with Council goals and values.
2. Preparing the budget in the context of the City's long-term finances, service needs, and infrastructure. In terms of the FY 24-25 budget, staff proposes that we submit a balanced budget, where on-going revenues and expenses are in alignment. This would include adding \$300,000 in funding our physical assets. This approach would lead to very difficult decisions.
3. Submitting a budget that generally uses one-time funds - including fund balance - for one-time expenses. For example, the long-term budget model suggests increasing spending on maintaining and replacing assets (parks, buildings, fleet, technology, etc.) by \$900,000/year. While we have some funds set aside these purposes, they are not sufficient.
4. Submitting a budget that includes selective one-time investments with the potential for high leverage in efficiency or future cost savings. For example, selectively investing in technology may help the City become more efficient in the long-run. Leadership development may also be a high-leverage investment as strong leadership is essential to high-performing organizations.
5. Recognizing that like any successful organization we need an administrative core, or foundation, to operate. While we will look at every Department for potential savings, it is unlikely that we can reduce certain core functions significantly without endangering the health of the organization.
6. We need to support an internal culture that values strong performance, promotes accountability, and recognizes excellence. Such a culture promotes strong employee engagement, which demonstrably improves results and will help us to attract and retain talented staff.
7. Creating a more business friendly reputation that attracts visitors and their spending to the City - but does not compromise our standards. This might include shifting some staff time to support economic development.
8. Supporting financial transparency. This includes sharing financial information with the public, making staff reports on financial matters easy to understand by those unfamiliar with City finances, and using our public communication channels to share information.
9. Leveraging regional opportunities for shared services; examples include our use of the Santa Rosa Sewage Treatment Plant and REDCOM, the regional dispatch center for the Fire Department.
10. Contracting out only when one or both of two conditions met: The level of effort needed exceeds staff capacity (available time), and/or staff lack the expertise needed to complete work at an acceptable level of quality. The financial model presented is an example of using consultant assistance appropriately.

**BUDGET PROCESS, TIMING, AND OTHER NOTES:** Staff have not yet proposed a firm schedule for presenting a recommended budget to the City Council. We are working to develop this schedule. We anticipate discussing initial recommendations with the Budget Committee later this Spring.

Additionally, staff are likely to present changes in the budget in a new format, with a table that outlines:

- a. The proposed change
- b. The dollar amount of the change
- c. The percentage of the Department's General Fund budget represented by the change
- d. A brief description of the impacts of the change

The goal is to provide the Council and the Community with a transparent explanation of proposed changes.

The presentation of the long-range plan and this report reflect several changes in Sebastopol's fiscal practices. These include:

- a. Counting funding from the water and sewer fund to the General Fund as revenue rather than as a negative expense, making the budget simpler and more transparent.
- b. Combining the General Fund (Fund 100) with Fund 124, which collects  $\frac{3}{4}$  cent in Sebastopol-specific sales taxes approved by voters, to make the budget simpler and more transparent.
- c. Removing a donation used to support the police from the General Fund. The donation funds are restricted, and thus should not be included in the unrestricted General Fund.

As we proceed with developing the budget, we may learn of additional opportunities to simplify the budget and promote transparency. If so, we will include these as part of the Recommended Budget.

Furthermore, we will update some of the information presented here with the Recommended Budget if we have better information on revenues, expenses, or deficiencies in our funds for infrastructure, buildings, etc.

Also, the water and wastewater (sewer) funds are facing major challenges. To keep them solvent, we are drawing on balances in the General Fund. Upcoming agenda items on the water and sewer funds will consider this issue in further detail. We anticipate, and are assuming in this report and budget preparation, that the Council will approve re-paying the General Fund to make up for this situation.

As a final note, we acknowledge that reducing expenses and increasing revenue can be difficult. Sebastopol has beloved facilities and programs, offered by the City and community partners. We will not propose any reduction, or revenue increase, lightly. Yet the current path is not sustainable, and a financially healthy City is essential to the well-being of all. We hope and look forward to robust engagement from our residents as we face what is truly a community challenge. We are committed to making recommendations with the long-term best interests of residents in mind.

**COMMUNITY OUTREACH:** This item has been noticed in accordance with the Ralph M. Brown Act and was available for public viewing and review at least 72 hours prior to scheduled meeting date.

**FISCAL IMPACT:** There is no financial impact from receiving this report or providing direction to staff.

**OPTIONS:** The City Council can provide different direction on policy questions raised in this report.

**ATTACHMENTS:**

1. Change in General Fund Budget Shortfall

Attachment 1

<b>Combined Funds 100 &amp; 124 (\$ in mil.)</b>		
<b>Adopted Budget Shortfall for FY24</b>		<b>(1.68)</b>
Improved property tax revenue projected for FY24	0.22	
Reduced sales tax revenue projected for FY24 by Avenu	(0.07)	
Net projected change in other revenue for FY24	0.01	
Personnel cost savings in FY24 due to high position vacancies	0.92 <sup>1</sup>	
Net change in projection for all other expenses	(0.50) <sup>2</sup>	
<b>Revised Budget Shortfall for FY24</b>		<b>(1.09) <sup>3</sup></b>
FY25 revenue assuming 2.5% overall growth above FY24 levels	14.72	
Reduction in Cost Plan revenue per latest plan update	(0.71)	
FY25 personnel costs with 6% vacancy rate	(8.63)	
FY25 O&M costs at 2.5% growth	(6.76)	
Year 1 of 3-yr phase-in to \$900K replacement/maint costs <sup>4</sup>	(0.30)	
Added cost above 2.5% growth for Liability/Workers Comp <sup>5</sup>	(0.17)	
FY25 debt service & capital costs	(0.47)	
<b>Projected Budget Shortfall for FY25</b>		<b>(1.98)</b>

<sup>1</sup>**FY24 Personnel Savings (net):**

0.09	Sergeant
0.17	Engineer
0.28	Chief
0.12	Officer
0.12	Sergeant
0.08	Dispatcher
0.14	Accountant
0.99	Totals
(0.07)	Added OT/PT
0.92	Net Cost Savings

<sup>2</sup>**FY24 O&M Increase:**

(0.31)	Contract labor
(0.03)	Forecast contract
(0.35)	Transfer Police donation
0.17	Capital tied to donation
0.02	Insurance/Work Comp
(0.50)	Net Cost Increase

<sup>3</sup>\$1.04M transfer of an assigned balance to Flood Control Fund 127 is excluded from this annual deficit calculation as it has no net impact on unassigned balance

<sup>4</sup>City does not adequately budget these costs to support current service levels and facilities; based on annual depreciation of depreciable governmental assets

<sup>5</sup>JPA expects 10% Workers Comp growth & 20% liability insurance growth