

Financial Security (Structural Budget Balance)

There are multiple financial issues facing the city.

- A critical issue is the imbalance between recurring revenue (sales and property taxes) and recurring operating expenses
- Longer term expenses, particularly salaries and benefits (60% of budget) are growing faster than recurring revenue.
- Critical has been the long-term inability for revenue to support basic maintenance of city streets leading to the currently situation where ½ of the streets have gone 15 years or more with no maintenance and have deteriorated to the point they have no further useful life. Cost to repair is now 10X what the cost to just maintain them had been.

For FY 2025–26, recurring revenues—including property tax, sales tax, user taxes, and transient occupancy tax—are budgeted at **\$11,460,355**. Operating expenses (net of transfers out) total **\$14,716,469**, resulting in an operating deficit of approximately **\$3,256,114**.

According to the 2025 Streets study the city needs to invest \$1.8MM annually in road repairs to gradually increase the overall Pavement Quality Index. This leaves the city with a \$5MM annual structural deficit. The first step is always acknowledging the problem.

Accepting the simple reality that recurring revenues exceeding required expenses by \$5MM per year is the first step. The Financial Emergency is still in place. Missing is the reaction from City Finance, the budget committee and the City Council to recognize and take actions to address the problems before it is too late.

Longer term - expenses are growing faster than tax revenues. This is particularly true of Salaries and Benefits which make up more than half the budget. Increasingly Workman's Comp and Liability insurance are growing even faster. This is difficult for Council to see as the city does not present financial data in terms of historical rates of change of actual expenditures.

For many years the city has obscured its financial issues by over allocating costs to the Water and Wastewater Enterprise funds. Given the restrictions imposed by Proposition 218, the city should prioritize transparency, clear justification for shared-cost allocations, and corrective action if past practices were inconsistent with ratepayer protections.

One time revenue sources have in the past obscured financial issues.

More recently, renewed development activity has generated impact fees that provide short-term financial relief. However, those fees are intended to support infrastructure required by new development. Using them to support ongoing operations is inappropriate and will only further delay needed capital investment and increase long-term risk. Reliance on development fees, grants, or enterprise-fund transfers is not a stable financial strategy.

Structural reform should therefore be a top priority, including evaluation of governance and financing models that could both stabilize the General Fund and provide dedicated funding for long-neglected infrastructure.

Making Sebastopol financially stable for future years requires significant change.

Step 1: Look at overall allocation of budget resources based on changing demands in the city

Budgeted expenditures need to be allocated based on changing needs for the city. For example, serious crime is up in the city. At the same time police are facing up to 50% of their time spent dealing with homelessness issues. A consultant hired by the city advises us to expect even more issues with homeless when the Commons opens later this year. There should be serious consideration for increasing police staffing to anticipate growing demand for services.

At the same time in the last couple of years Admin/Finance staffing doubled without clarity around changing demands. Their primary role is billing and customer service for water and wastewater. There have been about 3,000 customers for many years. It changes very little from year to year. The wireless water meters automated much of the data collection and were projected to decrease time for billing.

Finance does have a unique challenge in that bi-monthly utility billing means the workload is very high for one month and relatively lower in the other month. If staffing was increased to meet peak demand, that approach should be revisited as it is both costly and inefficient. Outsourcing some of the billing tasks that create peak workload would be an alternative that should be considered to reduce admin headcount and costs.

Contract Services should be compared to full-time staffing. Increases in Salaries and Benefits, particularly CalPERS projected into the future will put the city into bankruptcy in 5 years or less. Recent vacancies resulted in hiring contract services to fill the roles. In nearly every case the cost of contract services was at least no more than budgeted salaries and benefits. Mostly it appeared to be less. If you can use a contract service and avoid annual increases in salaries and benefits which exceed revenue increases, it makes financial sense to downsize some functions and contract for the expertise you need.

Contract Services may be less costly because they are more efficient. For example, during lulls in workload the contractor can deploy their resources to other demands where the city experiences low productivity. In periods of high demand or need for specialized expertise the contractor can again deploy the correct resources and at a lower cost.

Criticism of contract services is they do not know our local city. This is a legitimate criticism of hiring a short-term contractor, however, over time a long-term contract like we had with the City Engineer proves that contractors can become as knowledgeable about the city than full-time workers.

Step 2: Seek a larger share of the Property Tax Revenue

Currently the city collects only 19.7% of the property tax revenue collected from city property. A 3% increase (21.7%) would add \$500,000 in revenue to the city. There are several arguments that could be used:

1. Healdsburg (20.135%), Santa Rosa (20.003%) and Sonoma (20.662%) all get higher shares than Sebastopol
2. Sebastopol is disadvantaged because of a small population, limited commercial property, and limited space for new development. At the same time the burden on the city created by two major highways and 30-40,000 travelers per day from outside the city is unprecedented in the County. Sebastopol receives only \$148,000/mile of streets compared to Healdsburg and Sonoma at over \$200K/mile from property taxes. This explains why the city can never find enough money to just do even routine maintenance of highways.
3. The County took away our only downtown hotel. Regardless of reasons, the fact is that the city lost somewhere between \$200, 000 and \$400,000 a year in TOT revenue, plus lost sales tax and property tax. Throw in \$1MM in police costs to address issues at the facility and nearly ½ of the operating deficit can be attributed to that move by the county.
4. Sebastopol currently has an outsized share of Homekey beds, a disproportionate share of low-income housing that does not pay property taxes, and a huge amount of community resources (parks, shopping, medical) that are used by West County Residents at higher levels than city residents (based on population differences).
5. Nearby Marin County cities get 25-30% of property tax
6. East Palo Alto gets 33% which is higher than other cities in that county, the rationale was as a small city they needed more to be financially viable.

Sebastopol as a small city cannot continue to provide large city services on its current revenue based. If not addressed within five years the County will be absorbing the city and all of the costs associated with years of neglect.

Step 3: Consider annexation of properties in 95472

Annexation means more property tax comes to the city. One of the issues recently has been that the city is providing services to nearby residents who in turn pay no taxes to the city. There needs to be a serious well-informed analysis of the increased revenue vs the cost of providing services (police, building, planning) and maintenance of streets. This is mostly math problem. There is lots of data available. In addition to revenue, other benefits might include more property to develop affordable housing.

Step 4: Cut entire functions/Services

The goal is not so much to cut the services as to make them less of a burden on the city's limited revenue sources. At the same time there is significant potential to improve the services offered. Our Fire Service was underfunded and poorly managed. As a separate district they provide similar services, do a great job managing their money and are already gaining new assets. None of this was imagined when it was part of the city

1. Consider establishing a separate Parks and Recreation District.

One structural option is the creation of a Parks and Recreation District separate from city governance. Based on the current budget, approximately **\$1.03 million** in annual operating costs could potentially shift out of the General Fund:

- Senior Center — \$47,650
- Community Center — \$164,202
- Ives Pool — \$225,761
- Parks and Landscape — \$588,384

Total: \$1,025,997

Moving these functions into a district could reduce the General Fund deficit by roughly one-third while aligning governance, funding, and community expectations. Some of these costs are personnel costs which would either be transferred to the District or the District could contract the city for needed services. The District becomes a revenue source for the city rather than a cost center.

Such a district could be funded through a combination of program fees, facility fees, and—if voters support expanded services, a dedicated parcel tax. Governance could include an independent board composed of community stakeholders, user groups, and nonprofit partners who already help support these facilities. There may be synergies to coordinating, parks, Ives pool, and the senior and community center activities.

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2. Separate Governance for Utilities and Streets (Infrastructure Focus)

The city's has valuable assets in both the water and wastewater enterprise funds and it's city streets. All carry significant deferred maintenance obligations, and recent oversight work suggests governance and financial questions that may not have received adequate attention in the past.

More broadly, when Council and staff attention is spread across too many initiatives, core infrastructure planning can fall behind. Utilities and streets are foundational services and should be treated as such. Council should evaluate whether governance structures and staffing should be reorganized to ensure consistent focus on these systems.

It is important to recognize that the Council has made significant progress on affordable housing in recent years, including farmworker housing at Woodmark; supportive housing at Park Village, Elderberry Commons, and the upcoming Gravenstein Commons; affordable housing at Canopy; and planned middle-income housing at the LDS site on Valentine Avenue.

However, in order to sustain continued growth in housing there must be a dedicated focus and sustained attention applied to infrastructure to support growth.

Current estimates suggest major capital needs across these systems:

- Water infrastructure: **\$30–40 million**
- Wastewater infrastructure: **\$30 million**
- Street repairs: **\$30–50 million**

These systems are physically interconnected. A heavy truck hitting a pothole in a street in poor condition places stress on water and particularly sewer pipes. Replacing a water main often creates a cost-efficient opportunity to replace sewer lines. Trenching or utility services require pavement restoration. Coordinated planning across these functions can significantly reduce costs and avoid repeated disruptions.

Conclusion - Implementation

Establish a Financial Oversight Committee to replace the current budget committee. Recruit a number of local residents with experience in government and finance to participate in reassessing the city's finances and to make recommendations to create a stable platform for a solid financial future.

This refocuses the budget committee on longer-term financial issues and less on day to day decisions that belong at the staff level.

The city has had recent success involving citizens on task forces and oversight committees to better address issues in the community. The Enterprise Oversight Committee is making progress. The Sebastopol Commons Committee is digging deeply into options for a new community center. We need this kind of deep dive into future financial options