



Long-Term Financial Forecast and Local Sales Tax Analysis

July 21, 2020



Presentation Overview

Overview – Long-Term Financial Forecast

- UFI Overview & Experience
- Why Do Cities Need a Long-Term Forecast
- Developing a Baseline Forecast Model

10-Year Baseline Forecast & Analysis

- Key Baseline Assumptions
- Revenues & Expenses – Significant Gap
- Operating Deficit Grows to \$5 million
- Fund Balance – Potential Insolvency by FY 2024

Local Sales Tax Scenario Forecast & Analysis

- Assumption Changes
- Revenues & Expenses - Better Aligned
- Operating Deficit Reduced
- Fund Balance Improves

Forecast Take-a-Ways

- Fiscal Strengths
- Fiscal Challenges

UFI – Financial Advisors & Consultants



Public Management Group



- Financial & Forecast Modeling
- Fiscal Sustainability Strategies
- Pension/OPEB Liabilities Solutions
- Local Revenue Measure Analytics

Public Finance Group

- Municipal Advisory Services
- Capital Improvement Planning
- Alternative Financing Analysis
- Post Issuance Compliance

Staffed with former city managers, chief financial officers, legal counsel and public finance investment bankers, UFI combines the practical aspects of public financial management with the technical fiscal expertise.

Why Do Cities Need a Long-Term Forecast?

	Annual Budget 	Forecast & “What If” Analysis 
Outlook	Current FY and two years prior	10 to 20 years; long-term trends
Design	Bottom-up development; budgets by dept. and service (siloed) with roll-up summary	Income statement approach; all revenues and expenses aggregated into economically uniform categories
Purpose	Allocate available funding by dept/service; adjust to known conditions	Proactively align city’s goals & service objectives with long-term revenue capacity
Pros	Available funds = Current FY expenses	Fiscal stability & solvency
Cons	Difficult to understand long-term impact of decisions & fiscal structure	Discipline & fiscally constrained decisions

Developing a Baseline Forecast Model

- ✓ Ensure general level of reconciliation between the financial data in budget categories and CAFR
- ✓ **Isolate and remove one-time revenues & expenses that obfuscate annual ongoing operational costs**
- ✓ Disaggregate revenue & expense categories to ensure data driven by appropriate indexes
- ✓ **Develop average, moderate and conservative trends and apply appropriate index to drive each budget revenue and expense category (*utilize econometric/forecast data from multiple sources, historical trend/regression analysis of city's financial data, and other financial metrics*)**
- ✓ Create graphical outputs of measurements and metrics that facilitate understanding and insight about General Fund's projected financial condition over the forecast period

What is a “Baseline” Forecast?

Neutral, fiscal assessment and decision-making tool that establishes a common understanding of the status quo: “If the City makes no changes to its organization or operations, and there are no significant external economic impacts to the City (other than what’s known today), what is the predicted financial condition of the General Fund over the next ten years?”



10-YEAR BASELINE FORECAST & ANALYSIS

Baseline Forecast – General Assumptions

- **Forecast Fallacy: new residential development can solve an existing city operating deficit**
 - Expands city's tax base (prop tax from new homes, sales tax from new commercial development, etc.)
 - HOWEVER, brings demand for expanded city services
 - Difference between new revenue and new expenses from new development is rarely a significant net positive for cities over the long-run; and in fact, it may exacerbate an existing operating deficit
- **City's baseline forecast built around FY 2020-21 budget adopted by the City Council in June 2020**
- **COVID-19 Recession Assumptions**
 - FY 2020-21 impact contained in adopted budget
 - FY 2021-22 assumes return to year-over-year historic growth norms
 - Impact understated if recession elongates/deepens

Forecasts – Indexing the Drivers

Indexes primarily derived from local, regional and state economic indicators, adjusted where appropriate for:

- City revenue and expense history (if strong correlation between data and trendline);
- Local economic or city operational particularities (e.g., sales tax base composition, development cycles, service delivery model (contract vs. in-house)).

Under/over performance of regional, state or national economy affects these indexes and underlying assumptions.

Baseline Forecast – Revenue Assumptions

Top 5 Revenue Categories = 90% of total @ 3.16%

Property Tax + VLF



3.47%

\$7.2 million

Stable Revenues

Steady growth projected

Sales Tax



3.12%

\$3.2 million

Volatile Revenues

Rebound & then flatten

Admin. Allocation



2.75%

\$3.5 million

Net neutral

Indexed to salary growth

Franchise Fees



2.60%

\$2.2 million

Utility-based, consistent

Slower projected growth

Development Services Fees



3.66%

\$1.3 million

Variable

Cyclical

Baseline Forecast – Expense Assumptions

Top 5 Expense Categories = 80% of total @ 3.84%

Salaries & Wages



2.74%

Pension & Health



3.05%

Public Safety



3.87%

\$11.0 million

Cost inputs
set by County

Contract Services



5.16%

\$3.1 million

Controllable
expenses

Faster
projected
growth

Cost Recovery



-2.49%

(\$554,000)

Offsets
admin. costs

Linked to
salary growth

\$3.5 million

Controllable
expenses

Growth keeps
pace with CPI

\$2.4 million

Long-term
managed
costs

Economy
driven

Consistent
with historic
growth rate

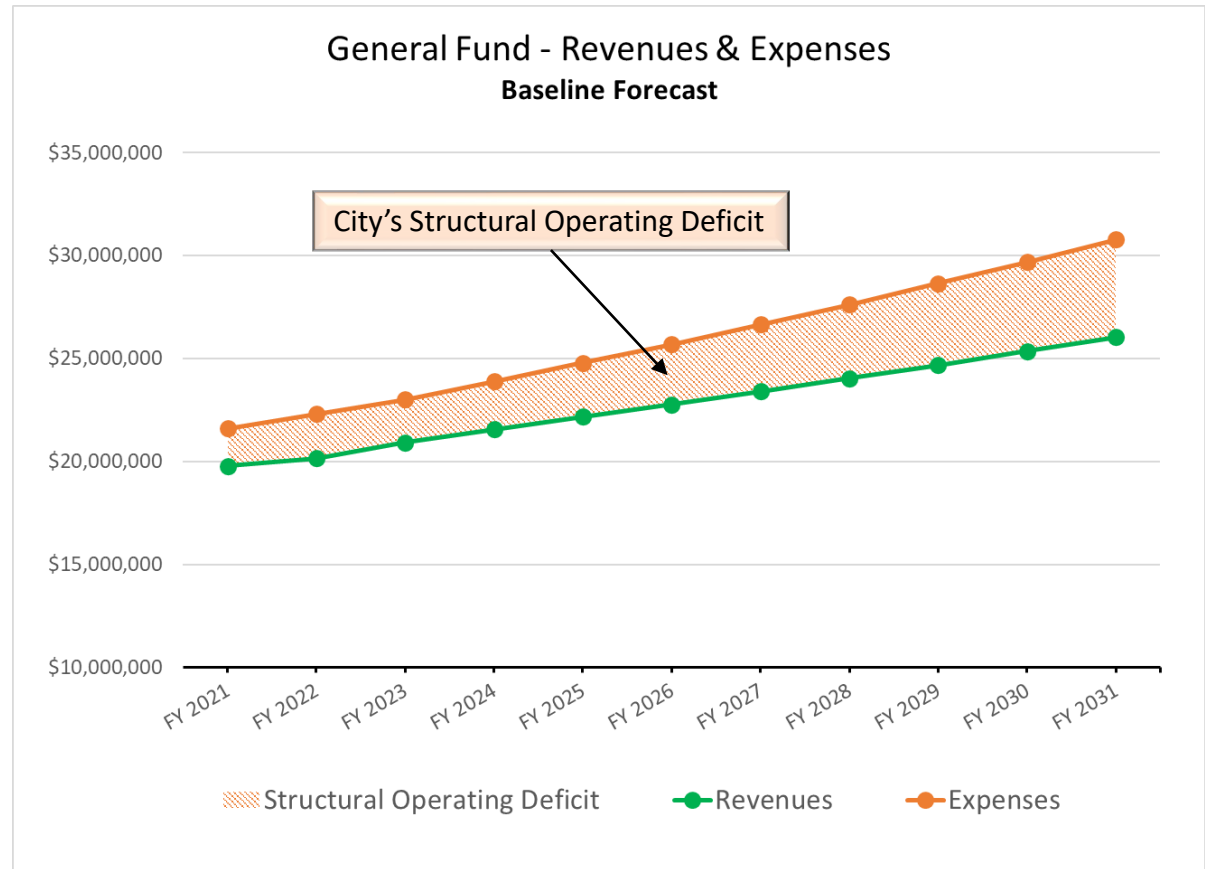
Baseline Forecast – Historical Comparison

Key Categories & Totals	10-Year Avg. Annual Growth	
	Historical	Forecast
Revenues	4.84%	2.78%
<i>Property Tax + VLF In-Lieu</i>	<i>5.44%</i>	<i>3.47%</i>
<i>Administrative Allocation</i>	<i>5.59%</i>	<i>2.75%</i>
<i>Franchise Fees</i>	<i>4.92%</i>	<i>2.60%</i>
Expenses	6.19%	2.96%
<i>Salaries & Wages</i>	<i>9.61%</i>	<i>2.74%</i>
<i>Professional & Contractual Services</i>	<i>8.34%</i>	<i>5.16%</i>
<i>Public Safety Contracts</i>	<i>3.84%</i>	<i>3.87%</i>

Baseline Forecast – Revenues & Expenses

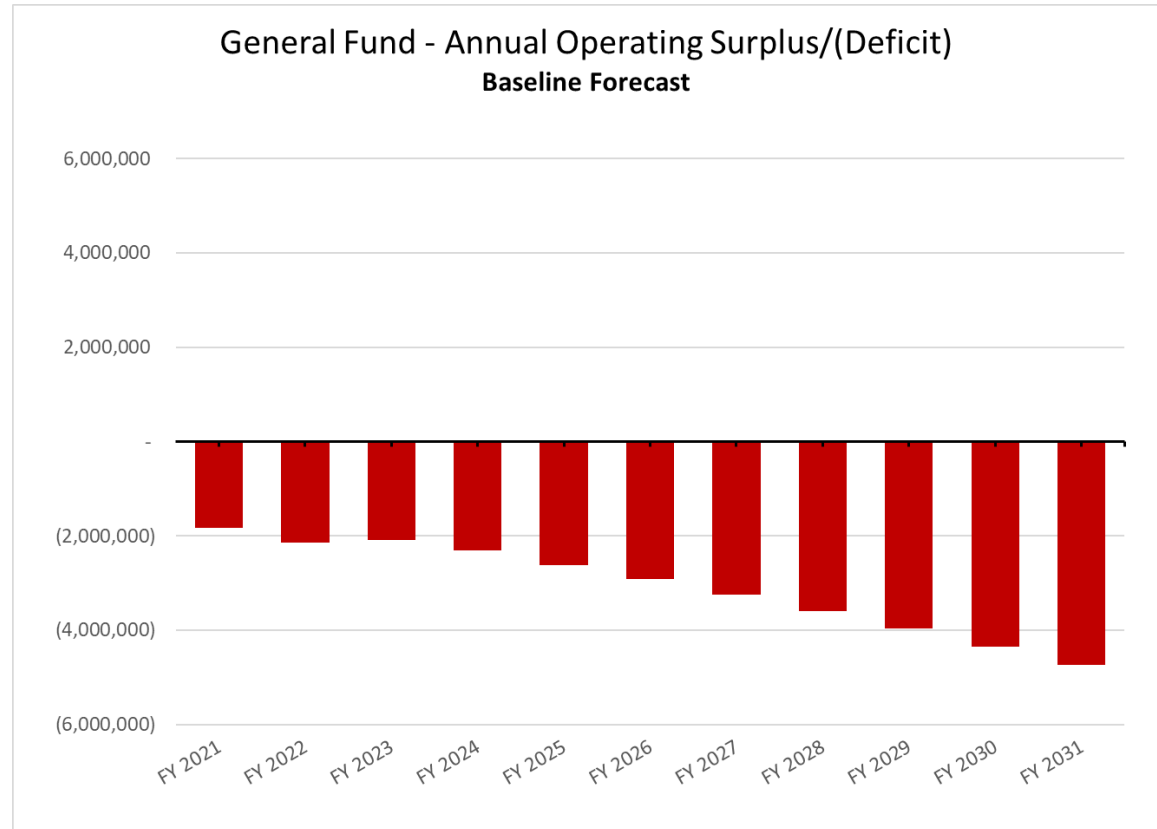
- **City has a significant Structural Operating Deficit in General Fund**

- City has not been living within its fiscal capacity and revenue limits for most of the last decade
- \$1+ million operating deficits in 5 of last 10 yrs.
- One-time revenues and increasing cost-recovery from other City funds have kept budgets balanced
- **General Fund has been transferring \$1 million annually to CFD-2003 to cover operating deficits – forecast assumes this does not continue**



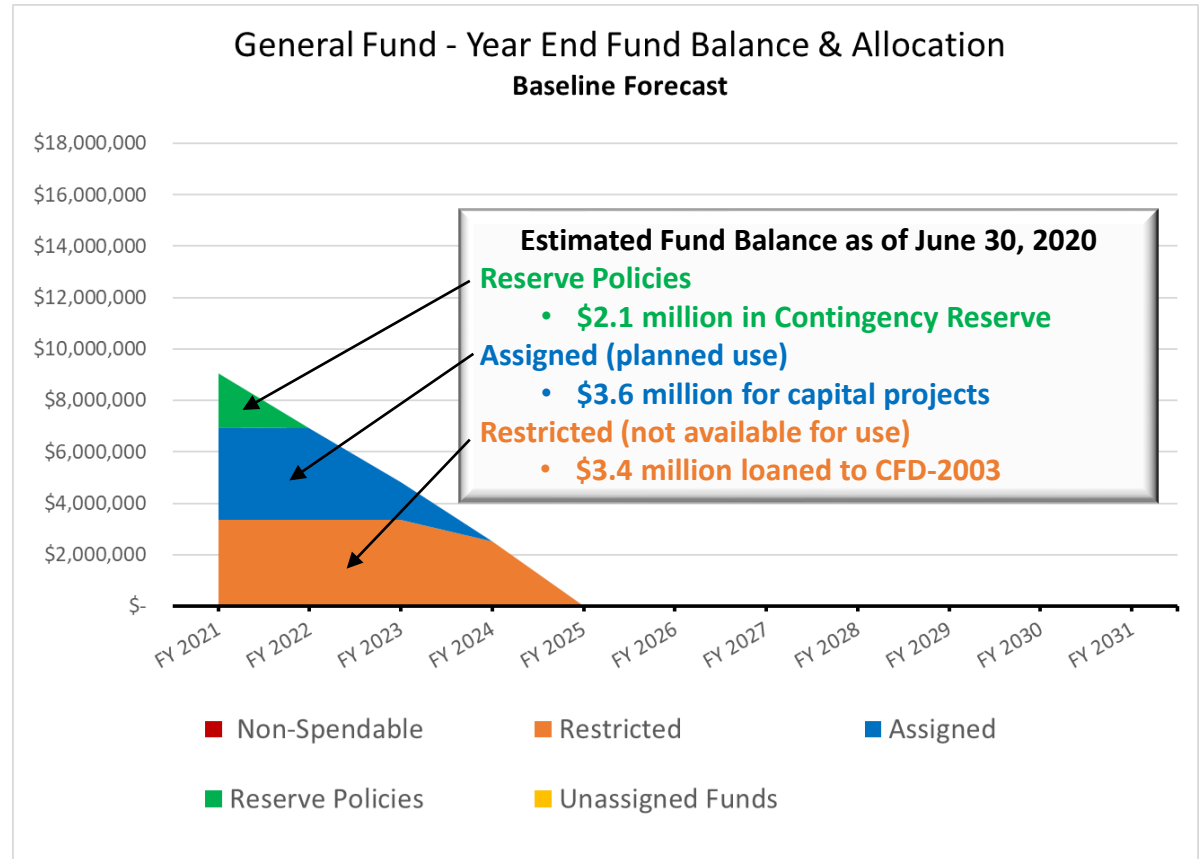
Baseline Forecast – Operating Deficit

- **Currently, Structural Operating Deficit is \$1.8 million (11% of budget)**
 - FY 2020 – COVID-19 impacts exacerbated City’s existing structural operating deficit
 - FY 2021 – adopted budget continues spending at current growth rate despite net decline in revenues
- **Annual Operating Deficit grows from \$1.8 million to \$4.7 million during the forecast period**
 - Expenses increasing faster than revenues



Baseline Forecast – Fund Balance

- **Fiscal Position of the General Fund is Very Concerning & Precarious**
 - **Currently, 37% of General Fund balance not available because of \$3.4 million loan to CFD-2003**
- **If City continues current course with no changes to General Fund finances:**
 - **FY 2022 – General Fund must use assigned capital project funds to balance**
 - **FY 2025 – General Fund is insolvent unless major service cuts/reductions**



LOCAL SALES TAX SCENARIO FORECAST & ANALYSIS

TUT Scenario Forecast – Changed Assumptions

1. Add Local Sales Tax (TUT)

- 1% addition to current countywide sales tax rate
- Approval by voters in Nov. 2020
- City receives first receipts in Q4 of FY 2020

2. All other revenue and expense assumptions remain the same as Baseline Forecast

- Structural Operating Deficit still in forecast
- Assume no further loans from General Fund to CFD-2003 after current FY
- Extent of COVID-19 impacts still uncertain

Scenario Forecasts – Answering “What if...”

A baseline forecast examines what happens if nothing changes. Yet the only thing we know for certain is that nothing remains the same – change is constant.

The true power of a forecasting model is to be able to answer the “what if” questions in terms of the impact to city finances:

- *What if... voters adopt 1% increase in sales tax?*
- *What if... there's another recession in next 5 years?*
- *What if... we increased salaries or benefits by __% in the next MOU?*

The financial impact of these “what if” scenarios are developed as an alternative forecast (scenarios can be stacked together) and then compared against the City’s Baseline Forecast to compare/analyze alternate futures.

Understanding a Local Sales Tax (TUT)



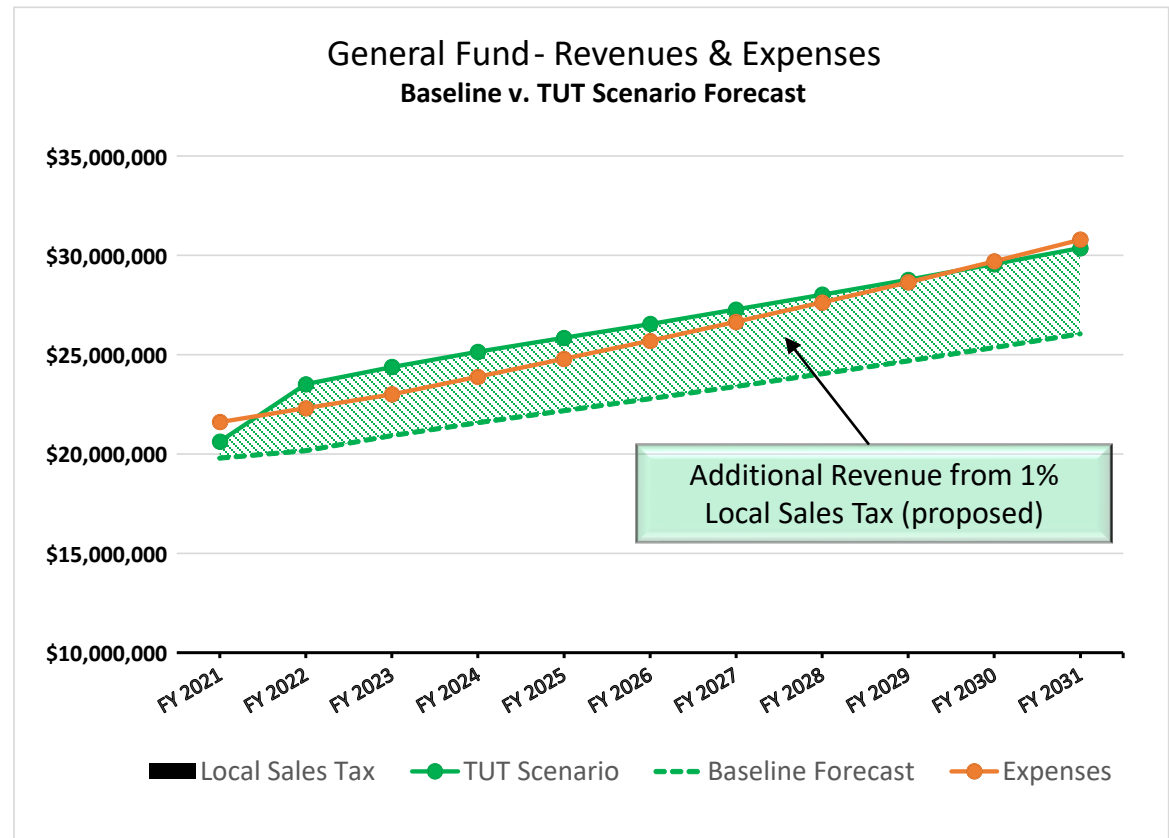
- **Called Transactions and Use Tax (TUT)**
- **Functionally similar to state Sales and Use Tax (SUT) but important difference:**
 - SUT – Point of Sale (where did sales transaction occur?)
 - TUT – Point of Delivery/Use (where did Buyer receive goods or put them to use?)
- **“Use It or Lose It”**
 - Statewide Cap = 9.25%
 - Once cap is reached, local jurisdictions cannot adopt new or increase existing TUT
- **Additional Annual Revenue (estimated)**
 - FY 2020 = \$835,000 (one-quarter)
 - FY 2021-31 = \$3.3 increasing to \$4.3 million

San Jacinto – Total Sales Tax Rate (proposed)	8.75%
State Sales and Use Tax (SUT)	6.25%
<i>Bradley-Burns Statewide Local Share</i>	1.00%
Riverside County Transportation Commission (Measure A)	0.50%
<i>City’s TUT (proposed)</i>	1.00%

Nearby Cities with TUT	Rate
City of Hemet	8.75%
City of Menifee	8.75%
City of Murrieta	8.75%
City of Riverside	8.75%
City of Temecula	8.75%
City of Wildomar	8.75%

TUT Scenario Forecast – Revenues & Expenses

- **New revenue from 1% TUT closes gap between expenses and revenues compared to Baseline Forecast**
 - Expense growth still outpaces revenue growth
 - Without additional action to reduce expense growth, City returns to operating deficit by FY 2030
- **Scenario does not include new programs or services**
 - Council has discussed at least \$1.1 million for public safety + more for economic develop. & capital projects



TUT Scenario Forecast – Operating Deficit

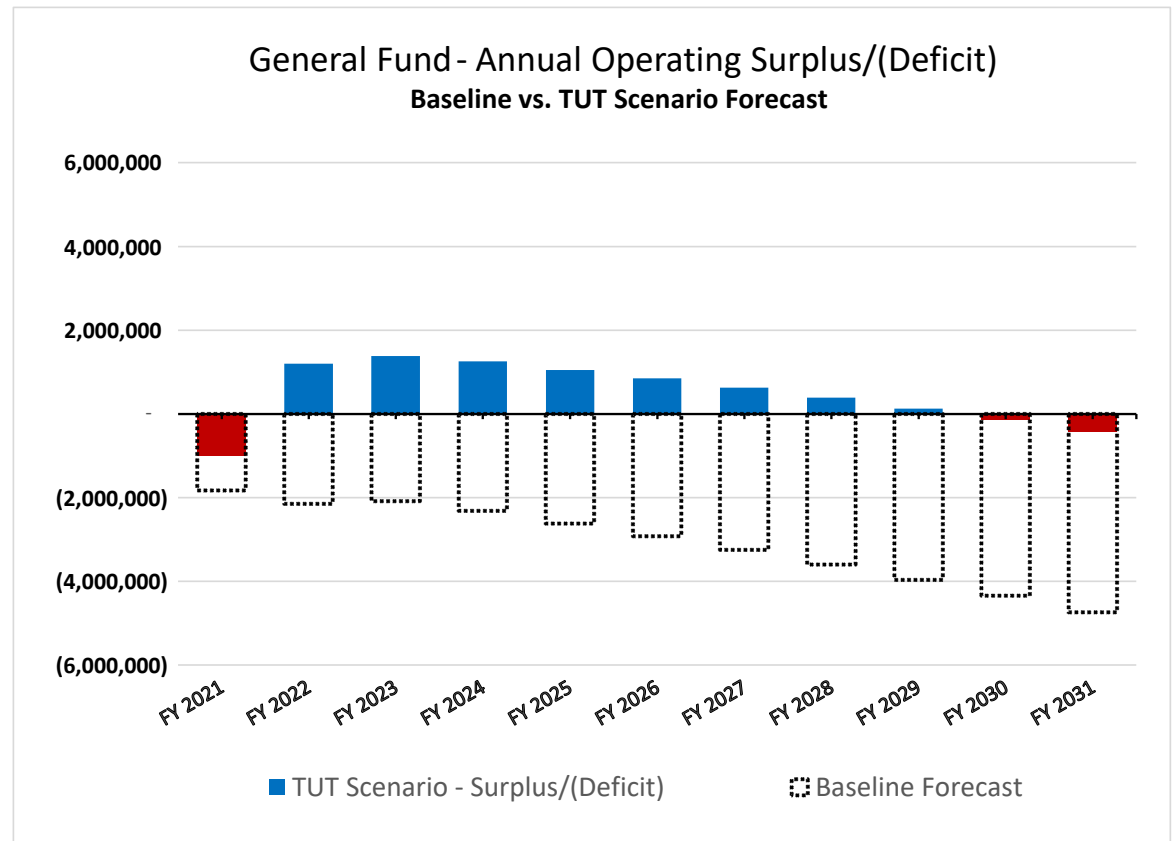
- **New revenues from 1% TUT erase much of the Structural Operating Deficit**

- Structural operating deficit
 - ✓ Baseline: \$1.8 to \$4.7m
 - ✓ Scenario: \$125 to \$275k

- **TUT revenues create operating surpluses in initial years**

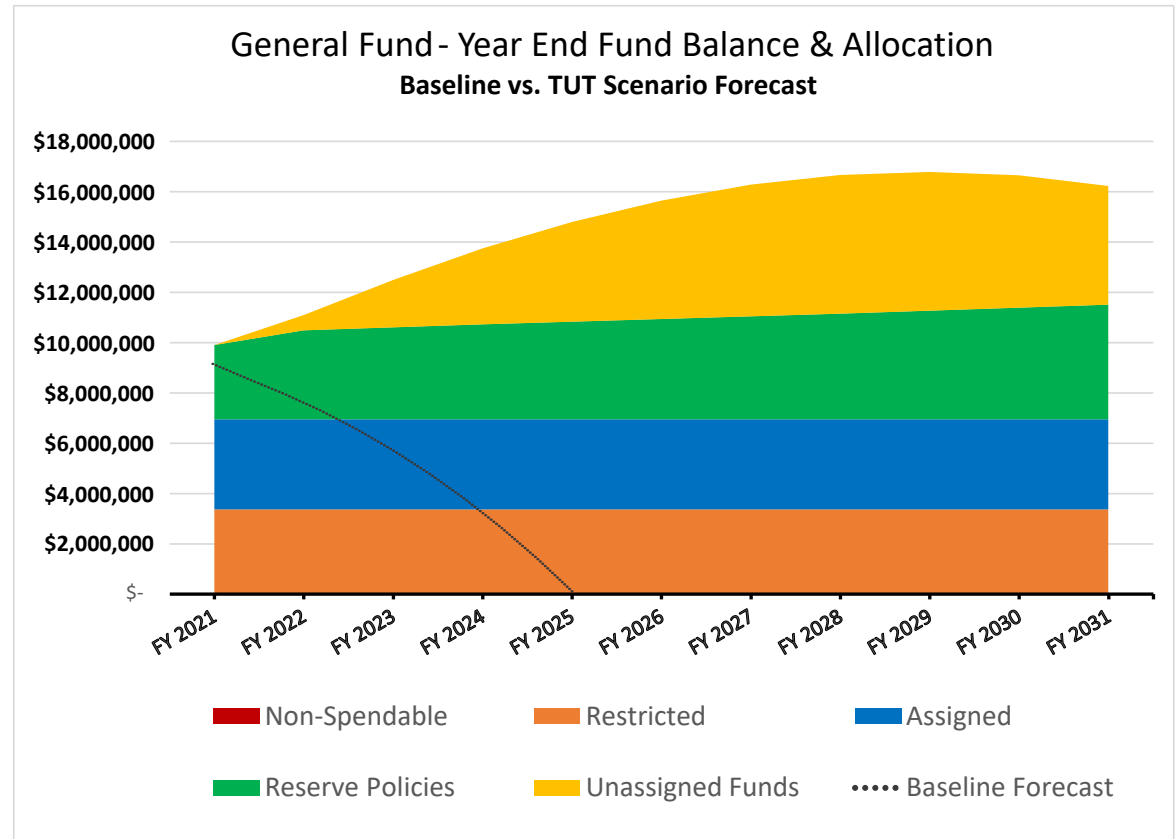
- ✓ \$1.3m annual surplus by FY 2023, deficit spending drives accelerating decline of surplus

- **Without additional action, budget deficits return in FY 2030**



TUT Scenario Forecast – Fund Balance

- **Fund Balance begins to get healthy with reduction in Structural Operating Deficit**
 - Contingency Reserve of 15% (per city policy) is fully funded next year
 - City develops unassigned fund balance of \$5.5m by FY 2028
- **Assuming no new positions, programs or projects, Fund Balance is declining in later years**
- **“What if...” there is another recession during next 10 years (very likely)**



Forecast Take-a-Ways - Fiscal Strengths



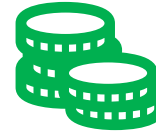
Property Tax

- 36% of total revenue
- Non-elastic and stable revenue source
- *If COVID-19 recession too deep or long, could impact property taxes*



Salary, Benefits & Pensions

- 20% of total expenses
- Pension costs total increase \$125,000
- *Salary growth rate in forecast requires strong fiscal discipline*
- *Health care inflation*



Long-Term Debt

- General Fund has minimal long-term debt obligations
- 2.2% of total expenses
- Improves financial flexibility and adaptability



Administrative and Overhead Costs/Recovery

- Aggressively spread and recovered from other funds and cost centers
- Net positive for General Fund
- *Ensure updated & compliant CAP*

Forecast Take-a-Ways - Fiscal Challenges



Local Sales Tax (TUT)

- 1% TUT is essential for City's fiscal stability and avoid potential insolvency or major cuts
- Use it or lose it
- **More volatile revenue stream (reserve policy)**



Structural Operating Deficit

- TUT not enough for long-term solvency & Council goals
- *Contract services*
- *CFD-2003 operating deficit (not included)*
- **1-time revenue & expense policy**



Public Safety

- Council priority to improve public safety
- Cost inputs controlled by County; City's only control is demand
- Per deputy cost (\$393k/year) and increasing
- *Alternatives?*



Community Development Strategy

- Align community development strategy with fiscal strategy
- New retail > residential growth
- Non-retail business growth