



**Staff Report**

**Date:** March 12, 2020  
**To:** Mayor Brekhus and Council Members  
**From:** Joe Chinn, Town Manager  
**Subject:** Discussion of Five Year Financial Forecast and Upcoming Budget

---

**Recommendation**

This report is information only and for Council discussion related to the financial forecast and upcoming budget.

**Background and discussion**

The purpose of this report is to provide the Council with an update of the five year financial forecast for the Town's Operating Fund and to discuss the upcoming Fiscal Year 2020-21 budget. The financial forecast projects revenues and expenses over the next fiscal years from Fiscal Year 2019-20 through 2024-25. A financial forecast provides an order of magnitude estimate of revenues and expenses based on current Town policies and State statutes. A financial forecast assists the Council and Town management in understanding the Town's ability to fund the current level of services being provided and determine if it is likely to be sustainable in the future under the current Town revenue structure. The financial forecast assumes the Town provides a similar level of services in the future as it does today – there is no attempt to either increase or decrease the current level of services in order to balance the budget with the financial forecast.

The Town's Operating Fund consists of all the Town's General Fund operational services such as the police, fire, recreation, planning and building, public works staff and operations and maintenance, and general government costs and a transfer out related to capital facilities that are funded by the Facilities Fund. The financial forecast thus includes a significant level of capital expenses coming from the Operating Fund each year (average approximately \$475,000 yearly which includes average \$400,000 transfer to the Facilities Fund). That being said the Town's facilities are physically and functionally obsolete and have a significant amount of deferred maintenance. In the future significant financial resources will be required to update the facilities for better organization functionality and improved public spaces. The financial forecast also includes an additional contribution of \$200,000 per year to pay down the CalPERS Unfunded Accrued Liability (UAL) and reduce future principal and interest costs of the UAL.

### Financial Forecast Results

Current estimates for Fiscal Year Ending 2021 (FYE21) show an estimated operating surplus of approximately \$296,000 on revenues of \$8.7 million and expenses of \$8.4 million. Expenses are projected to grow at a slightly higher rate than revenues over the five year forecast under current conditions and statutes. Because of this, the surplus is anticipated to decrease each year down to \$41,000 in FYE25, which is breakeven given the surplus for that year is projected to be less than 1% as a percent of expenses.

### Town of Ross Operating Fund Financial Forecast

Item	Projected FYE 2020	Projected FYE 2021	Projected FYE 2022	Projected FYE 2023	Projected FYE 2024	Projected FYE 2025
Total Revenues	\$8,469,000	\$8,727,000	\$8,996,000	\$9,261,000	\$9,536,000	\$9,818,000
Total Expenses	\$8,034,000	\$8,431,000	\$8,758,000	\$9,085,000	\$9,425,000	\$9,777,000
<b>Net Surplus/(Gap)</b>	<b>\$435,000</b>	<b>\$296,000</b>	<b>\$238,000</b>	<b>\$176,000</b>	<b>\$111,000</b>	<b>\$41,000</b>
<b>Surplus/(Gap) as % of Expenses</b>	<b>5.4%</b>	<b>3.5%</b>	<b>2.7%</b>	<b>1.9%</b>	<b>1.2%</b>	<b>0.4%</b>

The surpluses each year provide the Town the opportunity to help fund the need for significant capital improvements related to the outdated facilities, fund a greater portion of the growing CalPERS UAL costs to assist the Town's long-term financial position, or fund one-time project or study costs particularly in the next few years.

At the end of this report, Figure 1 shows the revenues and expenses by major category and Figure 2 shows a more detailed listing of revenues and expenses from FYE19 through the FYE25 period.

### Revenues

The growth rate of revenues has been slowing down the last two years after the prior years' recovery following the great recession. Property taxes are the Town's largest revenue source accounting for 67% of the Town's revenue when including the public safety parcel tax (and 57% without the public safety parcel tax). The growth rate in FYE20 is lower than the prior four years which is a trend expected to continue in the future years with the assessed value (and property tax) growth rate estimated to be about 4.1% in FYE20, and the 3.5% range in the years that follow. The Town receives on average 18.8 cents per every dollar of property tax; the other 81.2 cents goes to the County, Schools, and other public agencies.

Other revenue such as business licenses, franchise, property transfer taxes, investment income, and intergovernmental revenue are expected to have slow growth in the coming years (in total

1.0% to 1.5% average annual growth). In most California cities, the two largest revenue sources are property taxes and sales taxes. In the case of Ross, sales tax revenues are very minor (\$75,000 projected this year) because there is little retail or other taxable sales occurring in Ross. Overall, total revenues are projected to increase by approximately 3.1% next fiscal year and then in the following years are estimated to range between 2.9% and 3.2% annually.

The Town's second largest revenue category is building revenues. These revenues along with planning department revenues are primarily charges for service and permits related to development activity, and thus are very volatile and are related to the expenses for those services. Recreation revenues, which are slightly lower than Recreation expenses, are the next largest category of revenues.

### **Expenses**

The projected expenses for FYE20 in the Operating Fund are currently estimated to be \$8.0 million and growing to \$9.8 million by FYE25. The average growth rate of expenses is approximately 3.9% per year. Wages and benefits comprise approximately 43% of total expenses. Wages are estimated to increase at 4% per year from FYE21 forward. Benefits particularly medical and pension have been increasing at higher rates than inflation. For the forecast, medical costs are assumed to increase at a 5% annual rate after FYE20.

Pension rates are anticipated to increase at much higher rates than inflation moving forward. In December 2016, CalPERS lowered the discount rate it anticipates earning on investments from 7.5% to 7.0% per year. The effect of this change is being phased in from FYE19 to FYE25 which initially resulted in adding \$7 million of pension costs to the Town over 30 years. The Town took numerous steps to significantly lower future pension costs over the next 30 years as described below. The Town's pension costs were \$487,000 in FYE19 and are estimated to go to \$739,000 by FYE25 (a 7% average annual increase).

The Town has been aggressive in paying down the CalPERS UAL to reduce long-term costs of CalPERS. The Town's numerous steps to reduce total PERS costs include:

- In June 2016, the Town made an additional \$1 million payment to CalPERS to reduce our UAL debt that saved the Town \$1.2 million of interest costs
- Paid an additional \$200,000 down in FYE17 (saving the 7% to 7.5% interest cost a net savings of over \$200,000)
- Paid an additional \$820,000 down in FYE18 that saved the Town approximately \$720,000 of interest costs over 20 years.
- In FYE19 established a Section 115 Trust through PARS to diversify and reduce long-term pension debt and funded it with \$200,000 last fiscal year and another \$200,000 this fiscal year. The Financial Forecast continues to include \$200,000 additional funding each year related to either continue funding the Section 115 Trust for funding long-term pension cost or directly paying a portion of CalPERS UAL costs to reduce the long-term annual interest charged and thus total CalPERS long-term costs.

- Town has also reduced the amortization schedules for PERS costs from 30 years to 20 years which results in higher costs in the short run but much lower total costs due to significantly less interest paid in the long run.
- Police personnel are paying a 3% portion of the employer share of CalPERS reducing the Town's costs.

The positive news is that these additional steps have reduced the long-term pension costs substantially. The pension costs in FYE22 and FYE24 are approximately \$125,000 lower each year compared to prior forecasts due to the steps we have taken in the last three years to reduce our long-term pension costs. The financial forecast does not take into account further lower future PERS costs due to our future additional paydowns of the UAL. Thus, the Financial Forecast is likely overstating the pension cost in the latter years of the forecast. That being said, PERS costs can increase if PERS investment returns fail to reach the 7% investment target or actuarial assumptions are modified that increase costs such as if the assumption is changed for longer life expectancies. Pension costs are volatile and staff anticipates these costs will need to be continually analyzed and updated.

The Town's Other Post-Employment Benefits (OPEB) Retiree Health Care cost went from approximately \$63,000 in recent years to \$0 annually in future years as shown in the financial forecast. The Town maintains a Section 115 trust fund dedicated to prefunding our OPEB costs which we have been advance funding to reduce our unfunded liabilities through the California Employers' Benefit Trust (CERBT) Fund. The Total Compensation Systems (TCS) actuarial study results as of June 30, 2019 show the Town has more money in the CERBT fund than the OPEB Retiree Health liability, thus we have a net OPEB asset. As such, we will fund future ongoing cost of Retiree Healthcare cost straight from the CERBT fund and there will not be an Operating Fund cost.

Outside services that include contracts with outside firms are another significant cost representing approximately 13% of the Town's costs in FYE19. Many services are provided to the Town through contracts such as attorney, accounting, audit, building plan check and building official, landscape maintenance, and recreation instructors. There are alternative ways of providing many of these various services such as by staffing or contracting. The Town will continually evaluate the efficiency, effectiveness, and service levels provided by contracts and staff and at times there may be adjustments of whether to staff or contract. For example, the prior fiscal year the Town hired a Senior Building Inspector to perform building inspection and some building plan review services which has both saved the Town some money and provided more responsive services to our customers. The forecast is showing 3.0% annual inflation on outside service costs in FYE21 through FYE25.

The Ross Valley Fire services are provided through the Ross Valley Fire Department JPA and at approximately \$2.1 million annually are 27% of total expenses. These costs increased 5.8% each of the last two fiscal years due largely to a labor contract and benefit cost increases. Fire service costs are anticipated to increase in the 4% to 4.5% annual range in the following years with labor cost and pension cost increases, and fully funding the apparatus replacement schedule.

### **Financial Forecast Summary**

- Current level of services is fundable for the next five years. Small surpluses are likely available to help fund capital or one-time expenses.
- The passage of the public safety parcel tax measure (Measure K) in November 2016 stabilized the Town's funding of operations for the next eight year period. The current parcel tax is \$1,039 per parcel and increases each year with CPI. The eight year tax measure expires at the end of FYE25.
- The Town's additional payments to CalPERS and OPEB retiree health care costs have generated significant cost reductions that enhance the Town's financial sustainability in future years.

### **Challenges**

- Revenue growth which is largely property taxes, service charges, and miscellaneous taxes, franchises, and lease and investment income are challenged to keep up with expense growth. Strategies should be developed to improve revenue growth and to reduce the rate of expense growth.
- Pension and medical costs have been growing significantly faster than inflation and the challenge will be finding ways to reduce the growth rate including funding the long-term pension UAL. CalPERS decision to decrease the pension discount rate from 7.5% to 7.0% dramatically increased the future pension costs to all CalPERS entities. The Town has been pro-actively dealing with pension and post-retirement medical costs (OPEB costs) and will have to continue to find ways to reduce total retirement and medical cost increases.
- Fire costs have been growing at a higher rate than inflation and as the Town's largest cost item, there is a need to keep future cost increases closer to the inflation rate. The Town working with the other JPA members will need to find strategies to reduce long-term cost increase while providing effective, efficient fire protection and emergency services for our residents.
- Deferred capital needs and physically and functionally obsolete facilities will need additional funding beyond the approximately \$400,000 capital maintenance money included in the fiscal forecast. The Town will need to substantially rehabilitate or replace existing Town facilities such as the outdated and obsolete public safety building. In the coming year, a plan is needed on which facilities to replace and rehabilitate and then develop site plan options and funding plan for funding the construction costs. The strategy of transferring \$400,000 annually from the Operating Fund to the Facilities Fund has helped the Facilities Fund balance increase from \$1.7 million at the end of FYE16 to \$3.4 million. Staff will be recommending significant increases in the transfer of Operating Fund balances to the Facilities Fund in the next several months to help pay for a greater portion of a very large future facilities cost. It is likely a future bond measure will also be needed to pay for future facilities costs but the more that can be cash funded will both reduce the long-term interest costs and tax needed to fund the costs.

**Budget Schedule**

Town staff has already begun the process of preparing the FY 2020-21 budget. A Town Council public hearing workshop on the FY 2020-21 draft budget and Capital Improvement Plan (CIP) will be held on April 23. Based on the input received at that workshop, staff will update the budget for a Town Council hearing to be held at the June 18 Council meeting for budget adoption.

Some steps already undertaken related to the budget process include at the February 13, 2020 Town Council meeting, the staff presented and discussed with the Council the draft five year CIP. The CIP represents the capital portion of the upcoming budget. The Five Year Financial Forecast is also an important part of the budget process as it provides a longer-term overview of Town finances and ability to fund services next year and the following years.

As part of this meeting, staff will be discussing priorities for inclusion in the upcoming budget.

**Alternative actions**

Informational report only

**Environmental review (if applicable)** – Not applicable