Santa Cruz Fiscal Sustainability Planning
Budget Strategies for Consideration

Baker Tilly Project Team

Led by:

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City Council Presentation

November 28, 2023

PROVIDED AS BACKGROUND, WILL NOT BE IN 11/28 PRESENTATION

Overview of Today's Meeting

1. Fiscal Gap and Long-Range Financial Planning Overview
2. Potential Budget Strategies to Address the Fiscal Gap
3. Strategies to Address Capital Needs
4. Wrap Up and Next Steps

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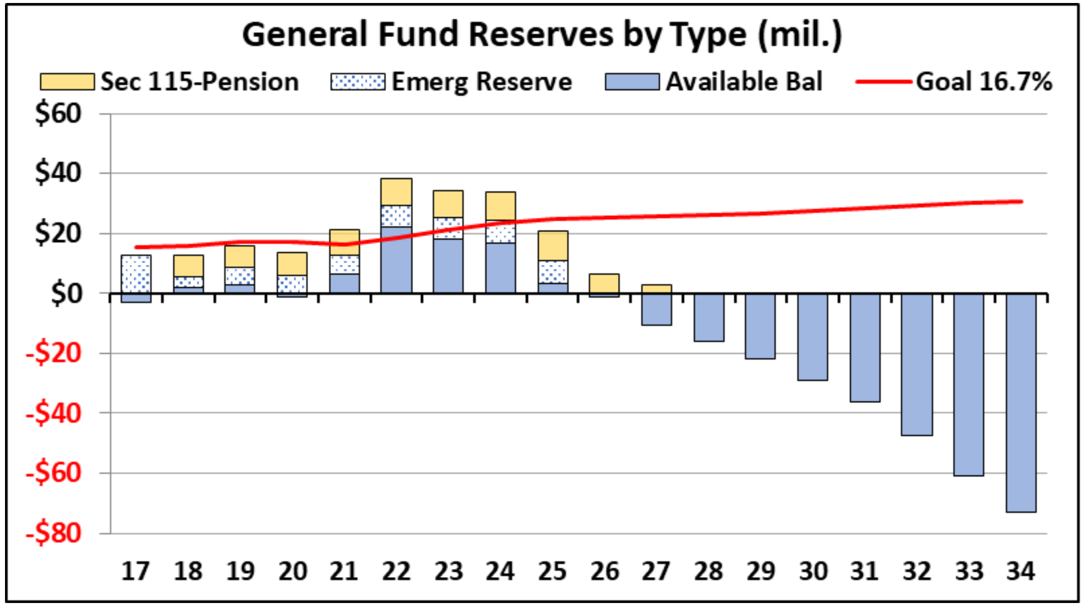
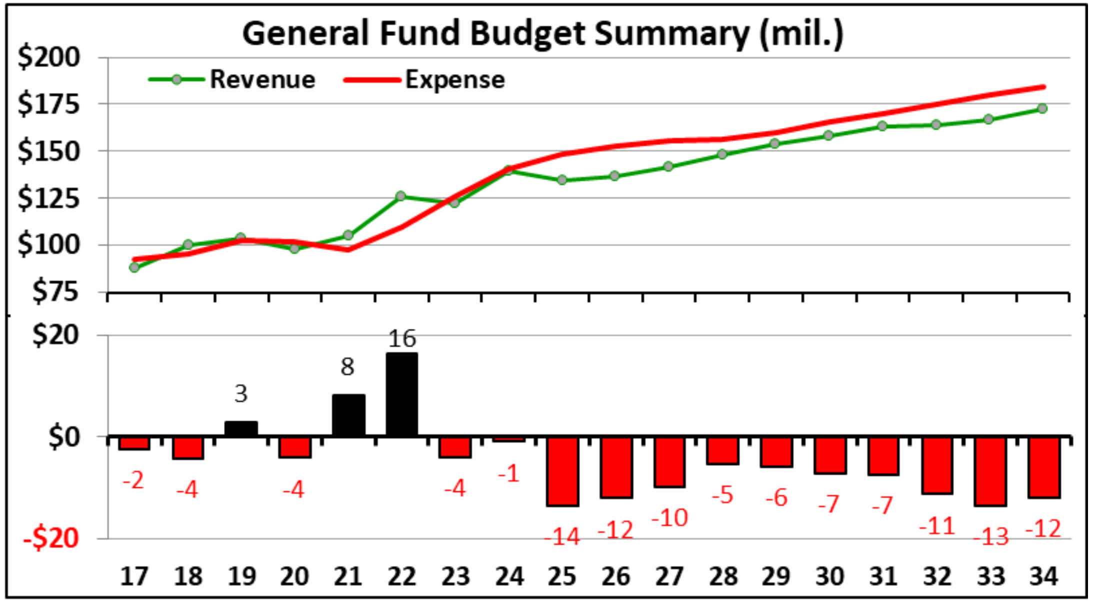
General Fund Financial Forecast





- Baseline financial forecast maintains **homelessness response at $8M** in costs, with the General Fund replacing lost federal and state funding in FY 2025 and beyond
- Without corrective action, **General Fund available reserves** would **fall below** the City's **minimum reserve threshold of ~17%** of annual expenditures **by FY 2025**, and would be depleted by FY 2027
- The ongoing **annual fiscal gap averages $10.5M** from **FY 2025 to 2034**

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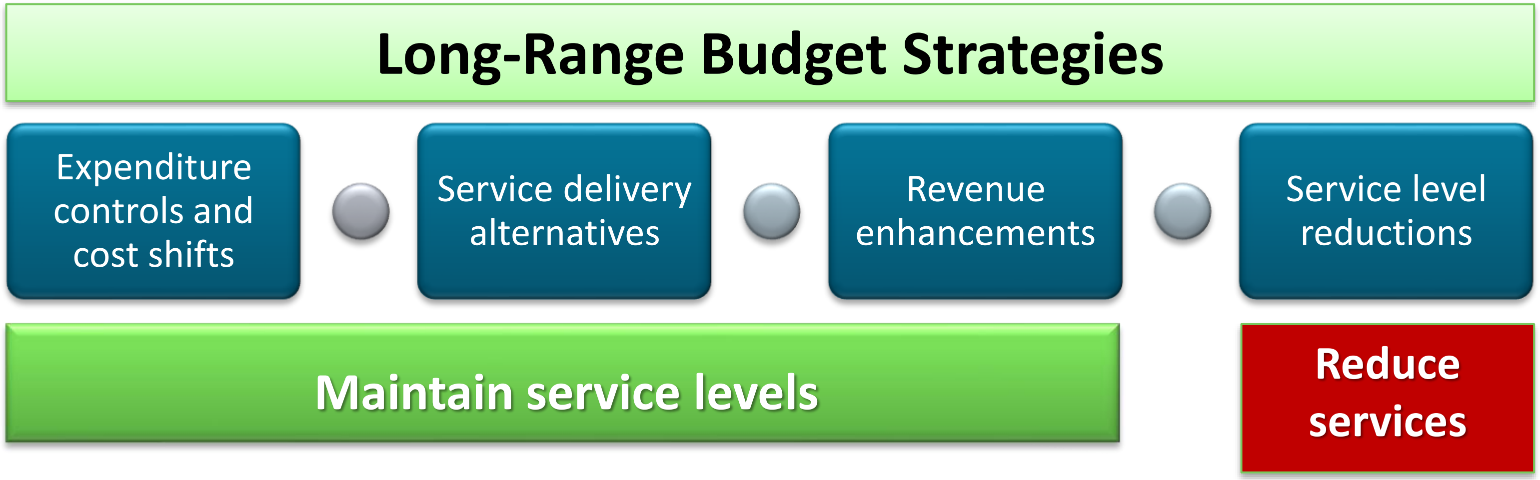
Key Assumptions in Forecast

- Revenues
  - Moderate recessions every 7 years starting FY 2025
  - Assessed value growth averages 3.8% (includes 80 new units/year and $25M new non-residential value/year)
  - Sales Tax growth averages 2.9%
  - TOT includes new La Bahia hotel in FY 2025 ($1.4M) & Cruz hotel in FY 2028 ($1.4M)
- Reserves
  - Minimum reserve goal of two-months annual operating expenditures (16.7%)

- Expenditures
  - **Existing service and staffing levels**
  - **Unfunded capital needs & new initiatives (e.g., climate action) are not included**
  - **Placeholder** assumption of 2.5% cost-of-living adjustments (30-year historical regional average), plus merit increases & savings from employee turnover
  - Annual capital contribution of $5M
  - General Fund backfill of $5.5M lost federal (ARPA) & state (CA14) homelessness response funding
  - Continued support of ED Trust, IT fund, Children’s fund, Wharf fund

Long-Range Financial Planning – An Overview

- Comprehensive set of fiscal policies and action steps to provide services in the long term without the threat of insolvency or default of promised expenditures or liabilities
- Customized to the requirements and priorities of the City
- In-depth analysis of fiscal strategies
  - Fiscal impact
  - Feasibility



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Fiscal Sustainability Strategy Types

A. Expenditure controls and cost shifts	• Reducing expenses or shifting the cost burden away from the General Fund	Maintain Service Levels
B. Service delivery changes	• Changing the way that services are delivered, either through contracting for services, insourcing services from other agencies, or through public-private partnerships	Maintain Service Levels
C. Service delivery changes	• Increasing the resources available to pay for services through new or increased revenues	Maintain Service Levels
D. Service level reductions	• Service level reductions that must be implemented to the extent that the items above are not able to be implemented or do not sufficiently address the fiscal gap	Reduce Services

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Assessing Budget Strategies

Evaluating Strategies

- **Fiscal Impact**
- **Difficulty of Implementation**

Difficulty: Most difficult — Least Difficult

$ Impact: Least $ Impact — Most $ Impact

High Difficulty, Low Return

- Numerous examples, typically not great strategies (high pain, low gain)

High Difficulty, High Return

- Typically not numerous but can be extremely important to pursue

Low Difficulty, Low Return

- Typically with many opportunities that should be pursued in normal course of business

Low Difficulty, High Return

- Strategies with greatest potential for success (high gain, low pain)

Assessing Budget Strategies

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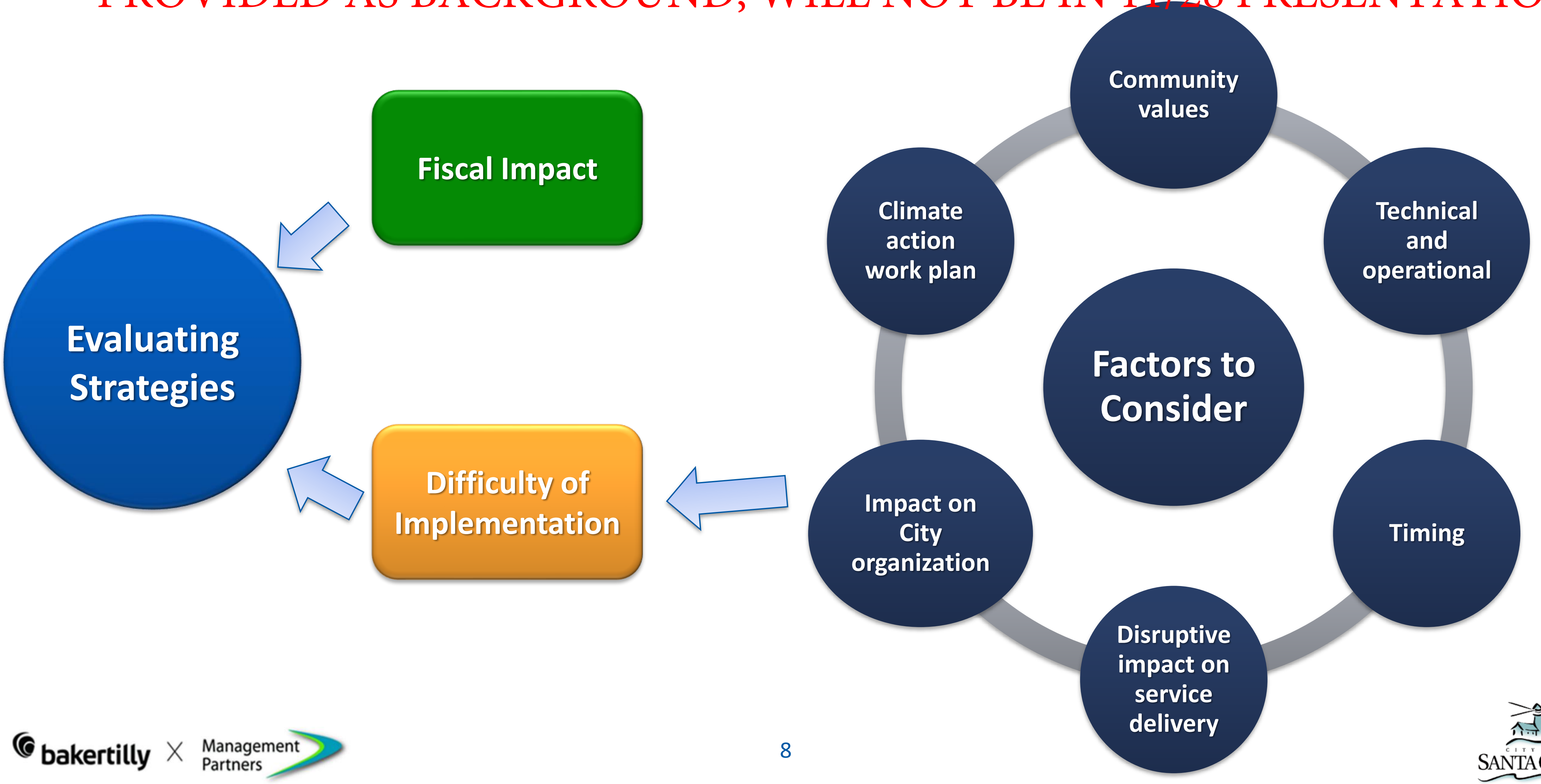

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Summary of Budget Strategies Identified

Category	# of Strategies	Estimated Annual Fiscal Impact
Expenditure controls/cost shifts	4	$3,450,000
Service delivery changes	4	$4,000,000
Revenue enhancements	14	$25,150,000
Total	**22**	**$32,600,000**
Other strategies identified with minimal fiscal impact[1]	*14*	*~ $2,000,000*
Goal to address fiscal gap		**$10,500,000**

- The fiscal sustainability plan should include budget strategies that yield at least $10.5 million in annual fiscal impact for conservative planning purposes to address operating needs
- Identified strategies exceed the recommended goal threefold and provides options to City Council and management

[1] – **Individual strategies with an estimated fiscal impact of less than $500,000 annually**

Budget Strategies Identified

Expenditure Controls and Cost Shifts	Service Delivery Changes	Revenue Enhancements
• Implement operational efficiencies, streamlined operations, and/or strategic filling of vacant positions[1] • Invest in CIP Manager • Full cost recovery in grants • Implement technology[2]	• Explore regional shared service models (e.g., fire/EMS services) • Share homeless response with County • Diversify investment portfolio/allocation • Reassess some maintenance functions[1,2]	• Increase sales tax • Create a community facilities district (parcel tax) • Increase Parks and Recreation cost recovery to 50% • Modernize business license tax methodology • Increase admissions tax • Increase utility user tax • Increase transient occupancy tax • Increase cost recovery for GF fees[2] • Increase landfill tipping fees • Initiate disc golf program • Resume audits of taxable entities[2] • Diversify investment portfolio/allocation • Increase parking fees and permit requirements[3]
Total: $3,450,000	**Total: $4,000,000**	**Total: $25,150,000**

Notes:
1 – Strategy could require discussions and/or agreement with affected bargaining units
2 – Project is currently in the planning stages by City staff
3 – Strategy impacts enterprise funds, but reduces burden on taxpayers that may necessitate increase in parking taxes to cover costs of parking operations

*High (Over $1,500,000), Moderate ($1,000,001 - $1,500,000), Low ($500,001 -$1,000,000)

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Expenditure Controls and Cost Shifts

Operational efficiencies, cuts through attrition

- $1,200,000

Invest in CIP Manager

- $1,000,000

Full cost recovery in grants

- $750,000

Implement technology[3]

- $500,000

Total: $3,450,000

1 – Cost savings to future projects; not currently anticipated to come from General Fund
2 – Strategy could require discussions and/or agreement with affected bargaining units
3 – Project is currently in the planning stages by City staff

*High (Over $1,500,000), Moderate ($1,000,001 - $1,500,000), Low ($500,001 -$1,000,000)

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Service Delivery Changes

Explore regional shared service models (e.g., fire)[1]

- $1,500,000

Share homeless response with County[1,4]

- $1,500,000

Improve investment yield/allocation

- $500,000

Reassess some maintenance functions[2,3]

- $500,000

[1] – Cost savings to future projects; not currently anticipated to come from General Fund
[2] – Strategy could require discussions and/or agreement with affected bargaining units
[3] – Project is currently in the planning stages by City staff
[4] – This does not include potential fiscal impacts regarding existing homelessness capital transfers nor increased capital and operating investments

*High (Over $1,500,000), Moderate ($1,000,001 - $1,500,000), Low ($500,001 -$1,000,000)

Total: $4,000,000

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Revenue Enhancements (1 of 3)

Increase sales tax

- $8,400,000 (0.5% rate increase)

Create a community facilities district

- $4,000,000

Meet Parks and Recreation cost Recovery

- $3,000,000

Modernize business license tax

- $1,500,000

[1] – Cost savings to future projects; not currently anticipated to come from General Fund
[2] – Strategy could require discussions and/or agreement with affected bargaining units
[3] – Project is currently in the planning stages by City staff

*High (Over $1,500,000), Moderate ($1,000,001 - $1,500,000), Low ($500,001 -$1,000,000)

High Impact: $16,900,000

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Revenue Enhancements (2 of 3)

Increase admissions tax

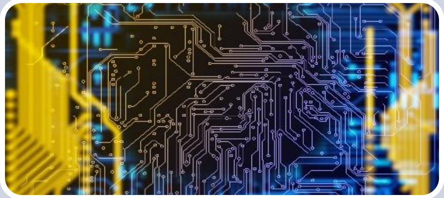
- $1,400,000 (added 3% rate)

Increase utility user tax

- $1,400,000 (added 1% rate)

Increase transient occupancy tax

- $1,100,000 (added 1% rate)



Increase development review fees[3]

- $1,000,000

Increase cost recovery for GF fees

- $1,000,000

Medium Impact: $5,900,000

[3] – Strategy is currently in the planning stages by City staff.

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Revenue Enhancements (3 of 3)

Increase landfill tipping fees

- $750,000

Initiate disc golf program

- $600,000

Increase audits of taxable businesses[3]

- $500,000

Increase investment yield/allocation

- $500,000

Increase parking fees and permit requirements[5]

- N/A

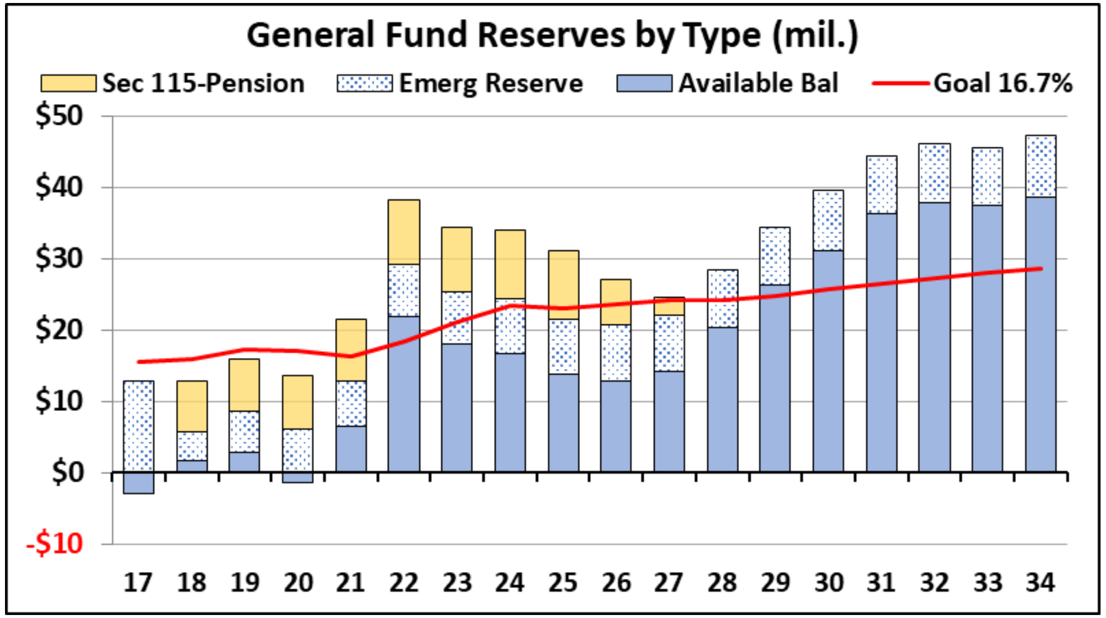
Low Impact: $2,350,000

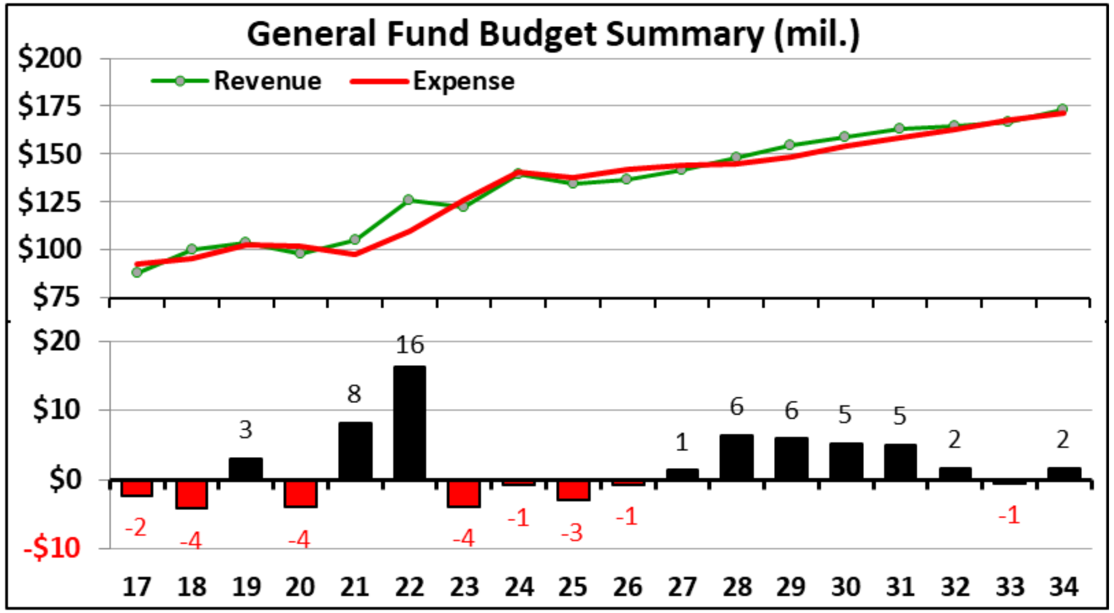
Total revenue enhancements: $25,150,000

[3] – Strategy is currently in the planning stages by City staff.
[5] – Strategy impacts enterprise funds, but reduces burden on taxpayers that may necessitate increase in parking taxes to cover costs of parking operations

*High (Over $1,500,000), Moderate ($1,000,001 - $1,500,000), Low ($500,001 -$1,000,000)

Solving the Fiscal Gap – Maintaining Reserves At or Above Minimum Reserve Policy





- Requires **$10.5M in budget strategies** starting in **FY 2025**, to maintain reserves at or above the minimum reserve goal of ~17% and to eliminate the fiscal gap in every fiscal year of the forecast
- Assumes Pension Trust reserves are fully utilized by FY 2028
- Operating budget is balanced at existing service levels; provides **additional fiscal capacity beyond FY 2027** to partially address underfunded/unfunded capital investments or other service needs

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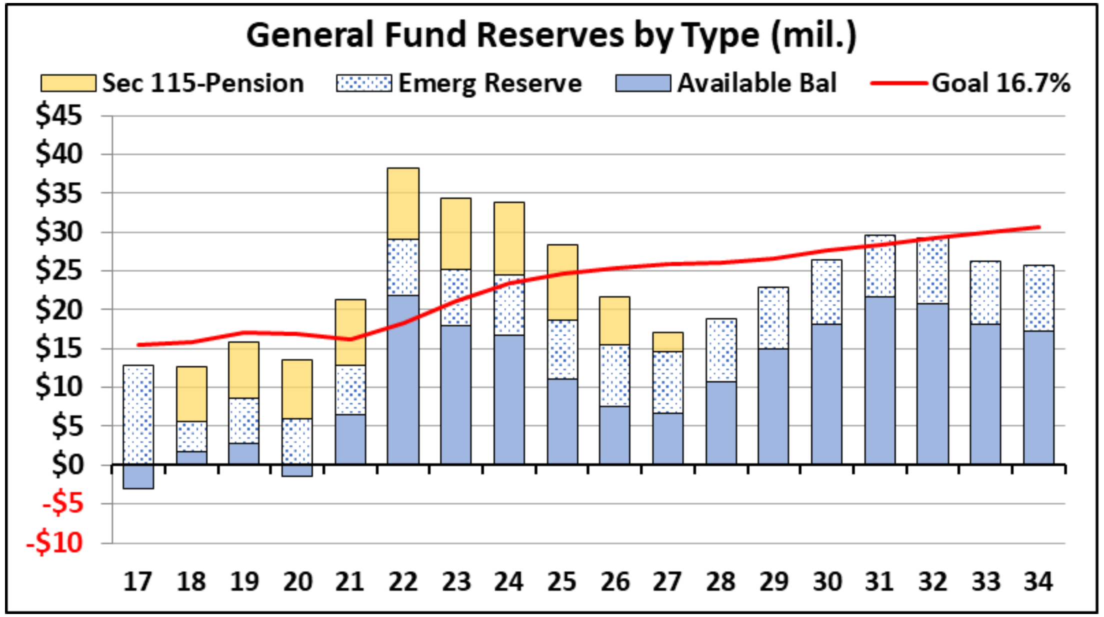
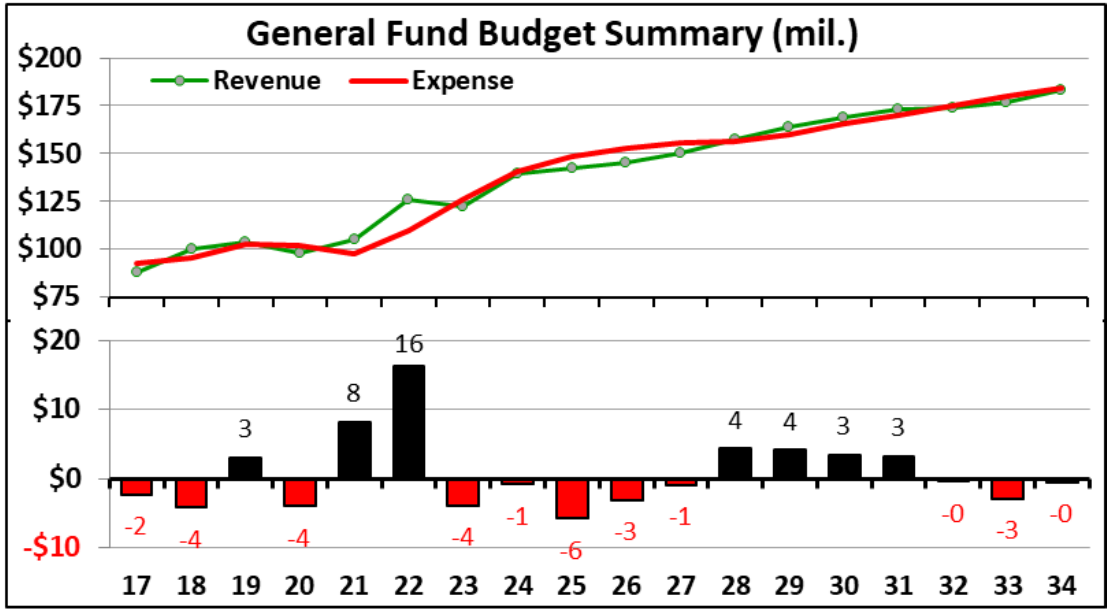
Budget Scenario Example – Relying Exclusively on 0.5% Sales Tax Measure





- Assumes voter-approval of **0.5% local sales tax rate** on **Mar 2024** ballot, to take effect 9/1/2024
- Raises $7.7M in FY 2025 & **$8.3M in FY 2026** (first full year)
- **Sales tax measure alone does not fully solve the fiscal gap and maintain reserves at or above reserve goals;** additional budget strategies would be required to meet reserve goal in all years
- **Still does NOT address underfunded/unfunded capital investments**

Spectrum of Budget Strategy Scenarios

Strong Revenue Enhancements	Blended Approach (revenue leaning)	Blended approach (expenditure leaning)	Strong Expenditure Reductions
• Primary focus on revenue strategies to solve the fiscal gap	• Focus on revenue enhancements with minor expenditure efficiencies and/or service delivery changes	• Blend of revenue enhancements and expenditure reductions to solve the gap attempting to mitigate service level reductions as much as possible	• Reliant primarily on expenditure reductions with significant cuts to service levels

Revenue Enhancements ⟷ **Expenditure Reductions**

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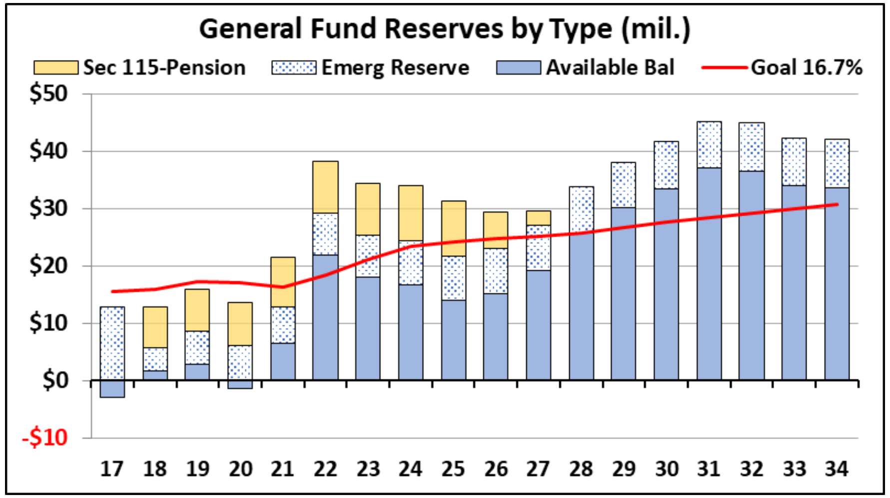
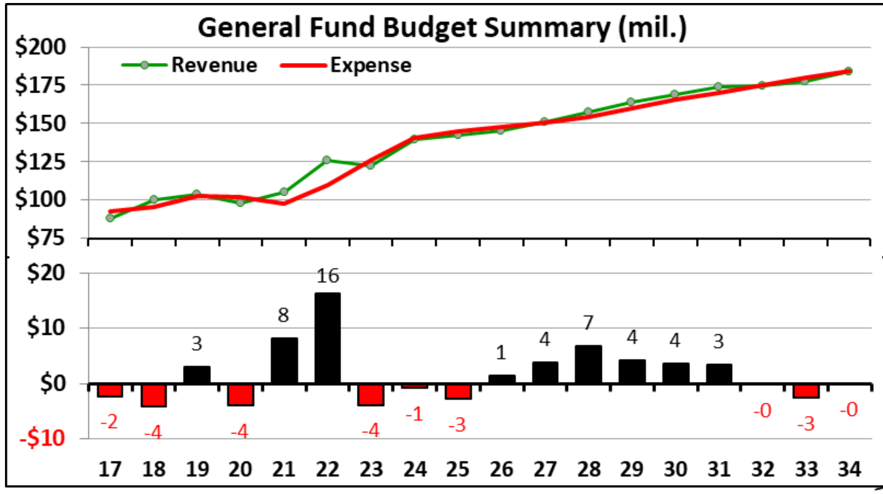
Budget Strategy Scenarios – Three Sample Options

Scenario 1 – Revenue-Centric Approach (<u>includes</u> sales tax)	Scenario 2 – Balanced Approach (<u>includes</u> sales tax)	Scenario 3 – Expenditure-Centric Approach (<u>excludes</u> sales tax)
• Local **sales tax** increase by 0.5% • General Fund (GF) **fees and charges** full cost recovery • **Parks & Recreation** services cost recovery to 50% • Diversified **investment portfolio/investment allocation**	• Local **sales tax** increase by 0.5% • **Fire shared services** model • **Operating efficiencies** and **reductions through attrition**	• **<u>No</u> local sales tax** increase • **GF fees and charges** full cost recovery • **Parks & Recreation** services cost recovery to 50% • Professionally managed **investment portfolio/ shift interest allocation to General Fund** • **Resume audits** for Business License Tax/TOT • **Grant management** full cost recovery • **Fire shared services** model • **Technology** improvements/cost reductions • **Operational efficiencies/attrition cuts** • **Reduce annual CIP investment or homelessness investment** by $2 million

Scenario 1 – Revenue Centric Approach (sales tax measure approved)

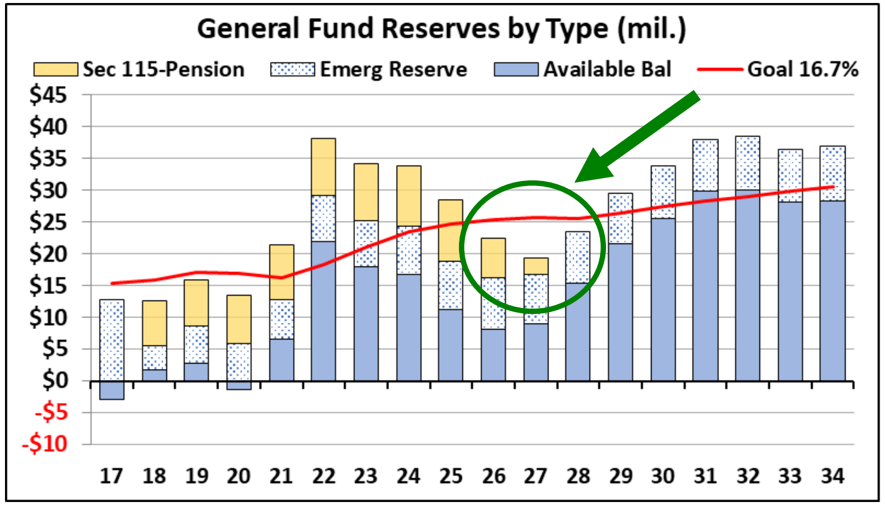
Strategy	Description (Fiscal Impact)	Ballot Measure	Timing (Phase In)
Local sales tax	Increase by 0.5% ($8.4 million)	Yes	March 2024 (implement 9/1/2024)
Park & Rec fees/charges	Increase to 50% cost recovery ($3 million)	No	FY 2025 (over 2 years starting 7/2024)
Other GF fees/charges	Increase to 100% cost recovery ($1 million)	No	FY 2025 (starting Jul-24)
Investment portfolio	Diversify investments through professionally managed portfolio, increase interest allocated to GF ($0.5 million)	No	FY 2025 (starting Jul-24)
Capital investment	Capacity to increase annual capital investment or other initiatives (e.g., climate action) ($5 million increase)	No	FY 2028 (over 2 years starting Jul-27)

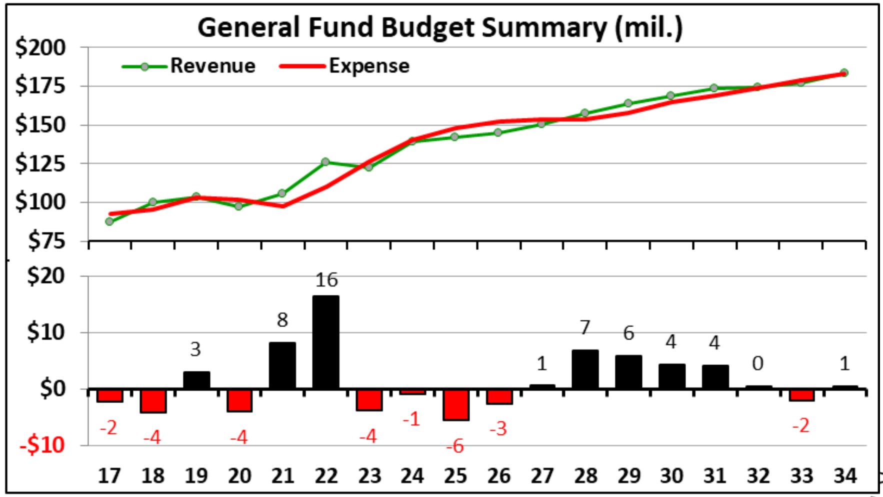




Scenario 2 – Balanced Approach (sales tax measure approved)

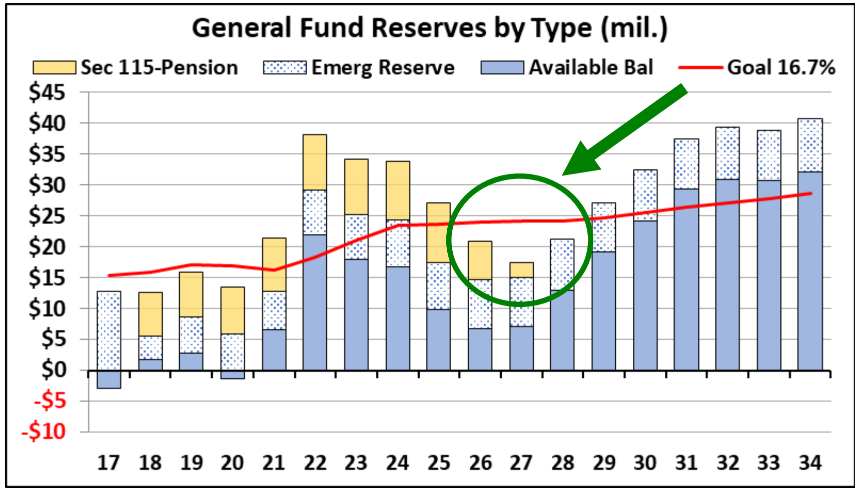
Strategy	Description (Fiscal Impact)	Ballot Measure	Timing (Phase In)
Local sales tax	Increase by 0.5% ($8.4 million)	Yes	March 2024 (implement 9/1/2024)
Operational efficiencies	Implement operational efficiencies, reduce positions through attrition ($1.2 million)	No	FY 2025 (over 4 years starting Jul-24)
Fire shared services	Implement shared services model for fire and EMT services ($1.5 million)	No	FY 2027 (over 2 years starting Jul-26)
Capital investment	Capacity to increase annual capital investment or other initiatives (e.g., climate action) ($2 million increase)	No	FY 2029 (over 2 years starting Jul-28)

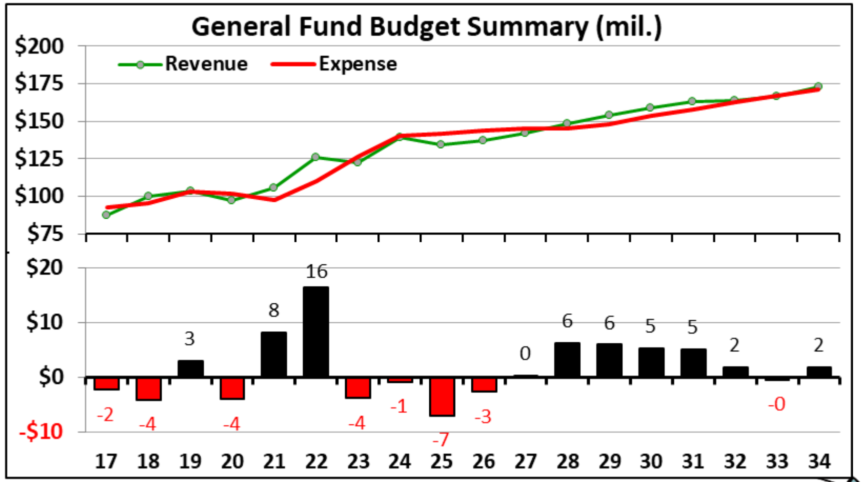




Scenario 3 – Blended Approach (sales tax measure not approved)

Strategy	Description (Fiscal Impact)	Ballot Measure	Timing (Phase In)
Park & Rec fees/charges	Increase to 50% cost recovery ($3 million)	No	FY 2025 (over 2 years start Jul-24)
Other GF fees/charges	Increase to 100% cost recovery ($1 million)	No	FY 2025 (start Jul-24)
Investments	Portfolio diversification through professional manager, increase interest allocation to GF ($0.5 million)	No	FY 2025 (start Jul-24)
Grants cost recovery	Include project management and overhead cost recovery in grants ($0.75 million)	No	FY 2025 (start Jul-24)
Business tax audits	Resume audits of entities for tax remittance ($0.5 million)	No	FY 2025 (start Jul-24)
Operational efficiencies	Implement operational efficiencies, reduce positions through attrition ($1.2 million)	No	FY 2025 (over 4 years start Jul-24)
Technology	Implement technology tools and reduce ongoing operating costs ($0.5 million)	No	FY 2026 (start Jul-25)
Fire shared services	Implement shared services model for fire and EMT services ($1.5 million)	No	FY 2027 (over 2 years start Jul-26)
Other cost reductions	Reduce investment in capital projects, homelessness response and/or other operating costs ($2 million)	No	FY 2025 (start Jul-24)





Financing Capital Needs

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Benefits Assessments

- Mello Roos assessment districts
- Community facilities districts
- Landscape/lighting district
- Business improvement district

Regulatory Fees

- Development impact fees
- Regulatory fees

Other Financing Strategies

- General obligation (GO) bonds
- Revenue bonds
- Enhanced infrastructure financing district
- Certificates of participation
- Tranche financing
- Federal/state grants

Other Budget Strategies with Greatest Potential to Provide Fiscal Capacity for Capital Investments

Budget Strategy	Description	Estimated Annual Fiscal Impact	Voter Approval
Create community facilities district (parcel tax)	Tailored to infrastructure funding (e.g., streets, parks, facilities)	Based on identified need	Yes (2/3rd majority)
Increase admissions tax rate to 8%	Dedicate incremental revenues toward parks/recreation amenities	$1,400,000	Yes (majority vote)
Debt financing (e.g., GO bonds)	Debt financing tools funded through excess fiscal capacity from other strategies	Based on identified need	GO Bond – Yes (2/3rd majority)

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Thank you!

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