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Staff Report

Date: February 6, 2018

To: City Council

From: Valerie J. Barone, City Manager

Reviewed by: Karan Reid, Director of Finance

Prepared by: Karan Reid, Director of Finance
Karan.reid@cityofconcord.org
(925) 671-3192

Subject: **Presentation by Manangement Partners of General Fund Long-Range Financial Forcasting Model**

Report in Brief
As part of the Biennial Operating Budget process for Fiscal Years (FY) 2017-18 and 2018-19, the Council directed staff to begin work on a Fiscal Stability Plan (Plan) that would provide options that could be considered to address a projected $13.4 million structural budget deficit by FY 2026-27. The projected budget gap assumed the expiration of Measure Q[1] in 2025 and incorporated projected personnel costs increases. The model, at that time, did not include fully funding all of the City's infrastructure, facility and equipment needs. The City has hired Management Partners to work with staff on the development of the Fiscal Stability Plan. A first step in creating the Plan is to update the City's long range financial forecasting model. The updated model is intended to incorporate all investment needs, including those not previously incorporated into past City models. In so doing the Council will have better information on which to rely as they adopt a Fiscal Stability Plan.

An overview of the model will be presented on February 6. This new model incorporates the additional investment needs discussed at the January 9, 2018 Council meeting and

[1] Measure Q is a voter approved half-cent use and transaction tax and is intended to preserve City services. Originally approved by voters in November 2010 with a 5-year sunset, an extension of the tax measure was ratified on the November 2014 ballot. Measure Q will now expire on March 31, 2025.

will be used to project the long-term funded status of the City's General Fund as various budget stabilization measured[2]s are considered at a Council Workshop on February 24.

Recommended Action
Receive report; ask questions of staff and consultant. No decisions are being requested at this time.

Background
As part of the budget process for FYs 2017-18 and 2018-19, the City's Ten-Year General Fund Financial Forecasting model was updated and projected a budget gap of $13.4 million by FY 2026-27. This model built in the expiration of Measure Q in 2025 and included projected cost increases related to the City's personnel liabilities but did not include fully funding all of the City's infrastructure, facility and equipment needs. To fully understand the financial challenges facing the City, on January 9, 2018, staff presented an update on the current state of deferred maintenance needs and unfunded personnel liabilities, as well as furniture and equipment replacement needs.

To address the City's long range financial challenges and identify budget stabilization strategies, Council directed staff to prepare a Fiscal Stability Plan (Plan). The Plan will identify a range of strategies that can be considered to close the gap between revenues and expenditures. The City has hired Management Partners to work with staff on the development of the Plan. A first step in creating the Plan is to incorporate all investment needs into an updated long range forecasting model. This model will be presented on February 6, 2018.

Analysis
In fall 2017, the City entered into a contract with Management Partners to work with staff to develop a Fiscal Stability Plan. The consultant is in the process of developing potential strategies to help close the City's budget gap; these will be presented to Council for consideration at a Council Workshop on February 24.

In developing potential strategies for the Plan, the consultant utilizes a Long Range Financial Model that is a significantly more dynamic tool than the City's 10-Year Financial Forecast. This new financial forecasting tool has the ability to run a multitude of hypothetical scenarios in real-time to project both short-term and long-term fiscal impacts of differing financial decisions. The model is designed to run "what-if" statements allowing one to visualize the long-term impacts of hypothetical situations. In addition, the model has the ability to model phasing in fiscal impacts over a set period of time, and across a number of fiscal years.

[2] Budget stabilization measures may consist of new revenue, expenditure reductions, cost transfers, or a combination of all three.

One of the more significant features of the model is the inclusion of an adjustable recession scenario. In this model, one can build-in a recession scenario to visually illustrate both short-term and long-term financial implications. While the City cannot predict when a recession might occur, the tool will allow the City to model various recession scenarios. In addition, the new model projects further into the future,allowing the City to proactively plan ahead of a recession, rather than react once a recession is experienced.

The purpose of the February 6 study session is to familiarize the Council with the consultant's long range financial model and the key assumptions used in developing revenue and expenditure projections in preparation for the February 24, 2018 Council Workshop. The purpose of the February 24 workshop is for Council to begin consideration of a variety of budget strategies that could be used to close the gap between revenues and expenditures. Council is anticipated to adopt a Fiscal Stability Plan by June 30, 2018.

Financial Impact
No impact; this is an overview of a long range financial model that will be used to assist the Council and public in considering strategies to address the City's long term financial challenges.

Public Contact
The City Council Agenda was posted.

City of Concord
Long-Term Financial Forecast

Presentation to Concord City Council

Robert Leland, Special Advisor
Management Partners

February 6, 2018

Management Partners

20+ years — of service exclusively to local governments

Over **1,500** projects — successfully completed in 42 states

80+ associates — including generalists and subject-matter experts

3 national offices — in Costa Mesa and San Jose, CA and Cincinnati, OH

Served **70%** — of California cities with more than 100,000 people

Services

- Operations Improvement
- Strategic Planning
- Service Sharing
- Financial Planning/Budgeting
- Organization Analysis
- Organization Development
- Performance Management
- Process Improvement
- Facilitation and Training
- Executive Recruitment
- Executive Coaching

Experienced helping many California cities facing fiscal challenges, including: Fremont, Hayward, Long Beach, Oxnard, Sacramento, San Jose, Stockton, San Bernardino, Santa Ana and Tracy

Introduction

- City is already doing forecasting, a financial best practice
- This project is a “second opinion” and draws on Management Partners’ experience with long-range forecasting involving cities statewide, as well as providing a valuable financial planning tool, which the City will own
- City has made tough decisions in the past to produce balanced budgets during economic downturns; these typically lasted a few years
- Current fiscal challenge: *long-term* substantial pension cost increases and infrastructure maintenance needs
- City Council and management have already demonstrated leadership and commitment to developing a long-term sustainable budget
- Briefings on forecast given to executive team and labor groups

Major Elements of Financial Forecast

1. Identify Factors Driving Forecast

- Pressures on City revenues and spending levels over next 20 years

2. Create Baseline Forecast

- Long-term projections under current service levels and known increases
- Transparent and realistic assumptions, outside expertise
- Before budget corrections

3. Test Alternative Outcomes

- Recession, revenue growth, cost of living adjustments (COLAs), staffing levels
- Costs not in baseline budget, but needed to make current level of service sustainable over time [e.g., internal service funds (ISF), reserves, deferred maintenance]

4. Sets Parameters for Sustainable Budget Over Time

- Not a replacement for budget process, which sets spending priorities

Current Fiscal Environment

Challenges in Common with Other Cities

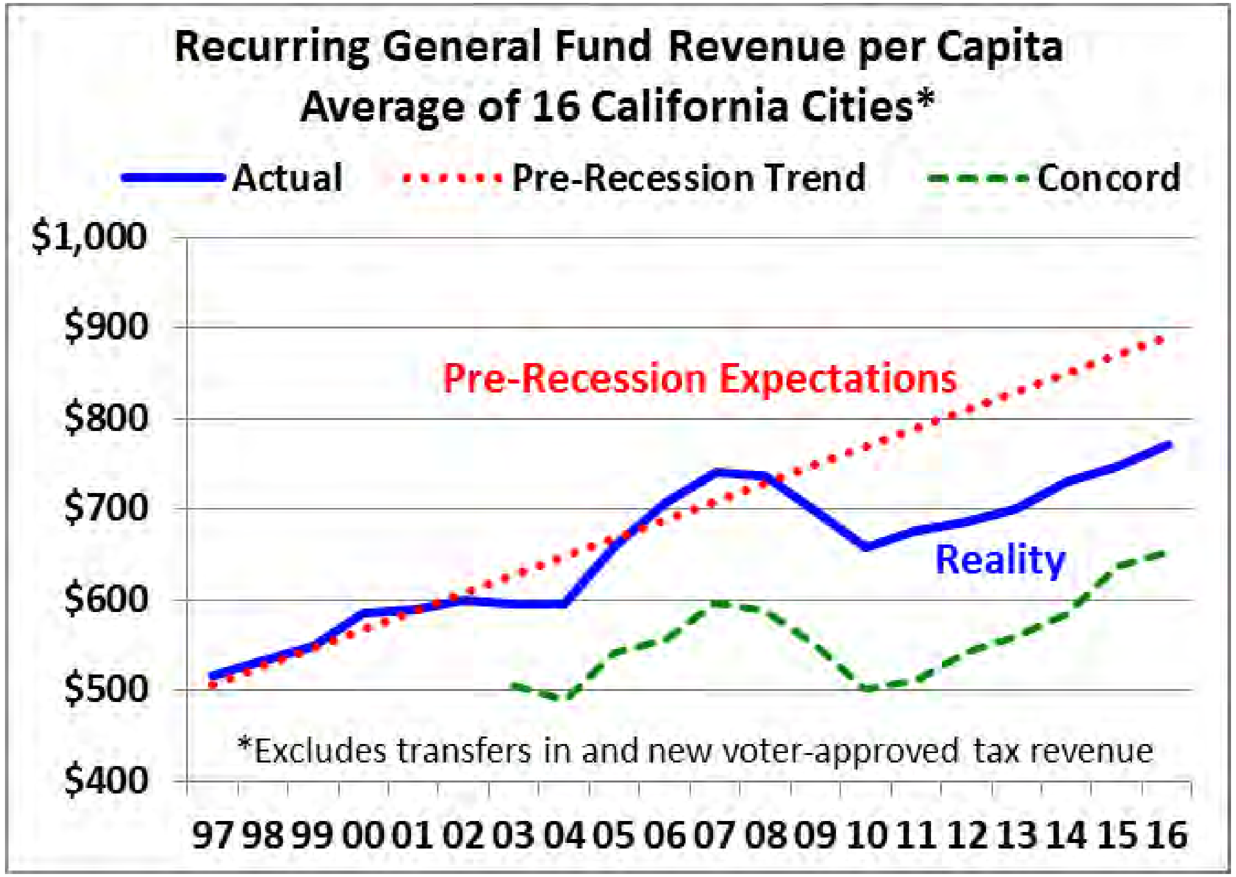
- Facing large pension cost increases
- Deferred infrastructure/facilities maintenance and internal service needs
- Significant reduction in staffing after Great Recession
- Labor market pressures

Concord Differences

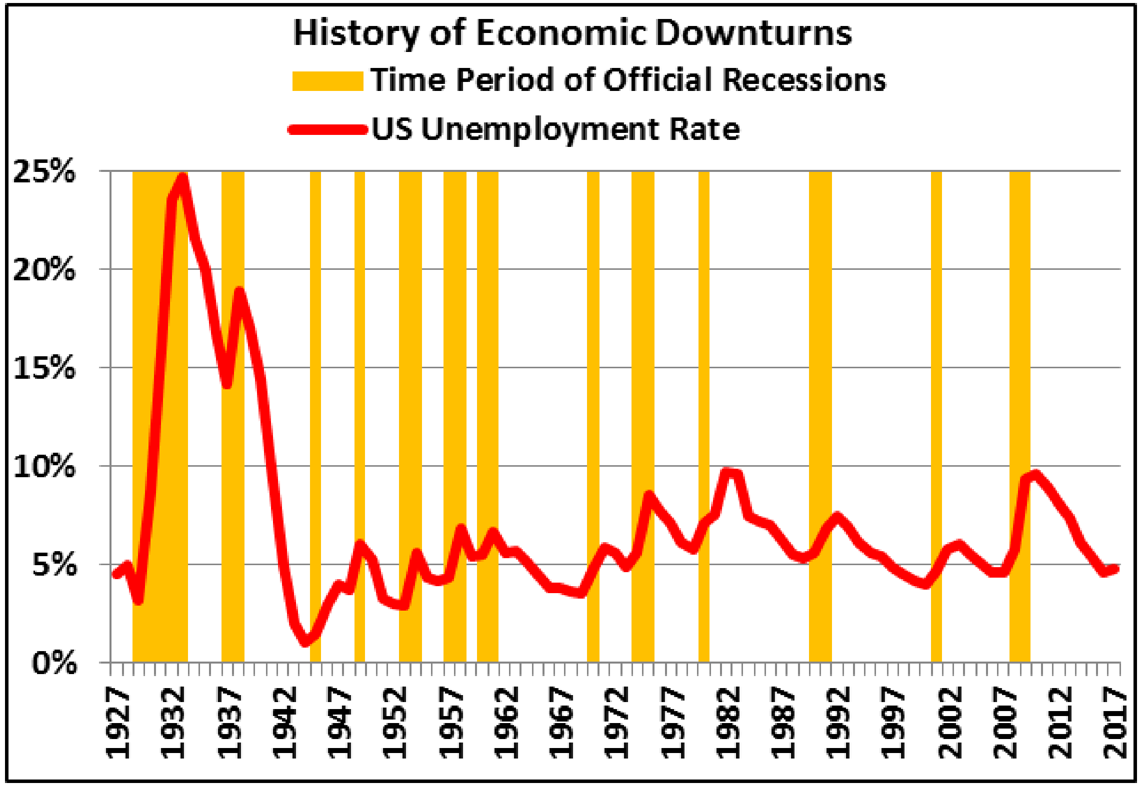
- Low property tax allocation (since Prop 13 in 1978)
- Measure Q sales tax (0.5% rate expires in 2025)
- Retiree medical one-third funded, annual contribution at required level
- Base Reuse (specific plan pending)

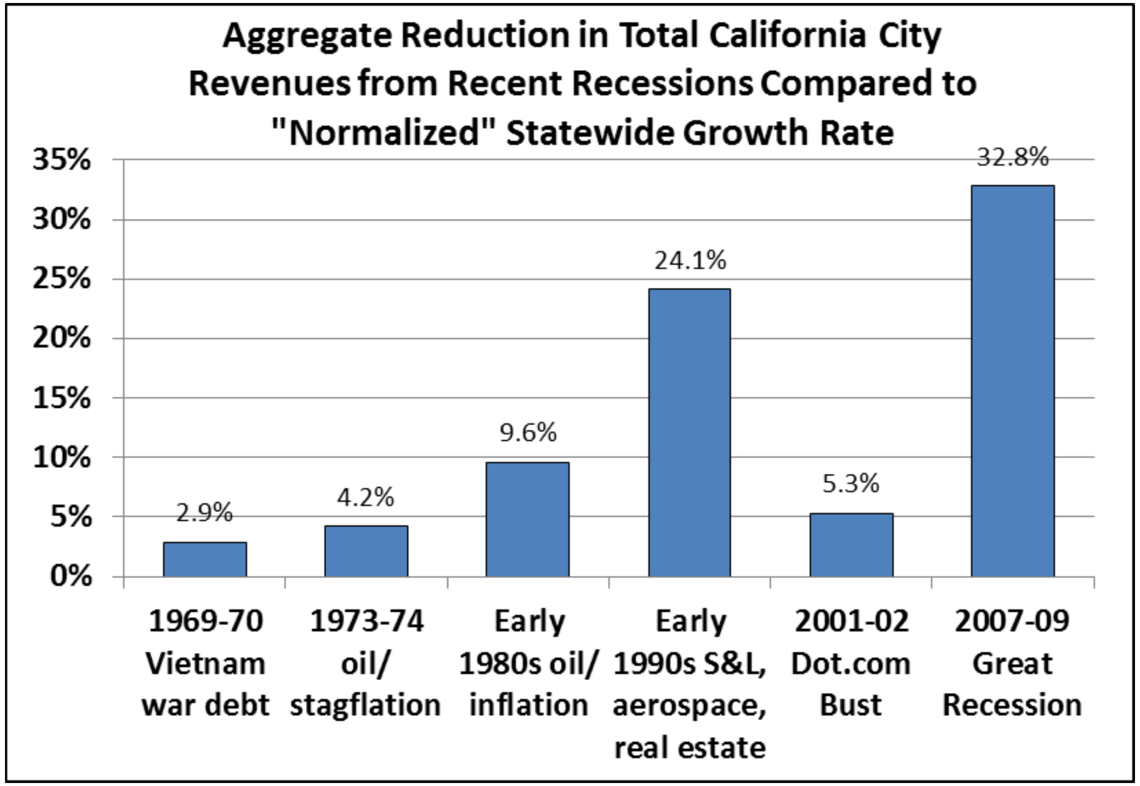
Revenue Gap Persists

- In general, cities have not recovered from Great Recession revenue losses
- Large gap between past expectations and current reality
- Without cuts, spending was on track to continue on pre-recession trend line
- Concord has the same revenue gap profile, but at a lower revenue level per capita (due to low property tax share)
- Many agencies looking to voter-approved taxes and bonds to help fill funding gap (72.4% approval rate of 2,382 revenue measures since 2005)



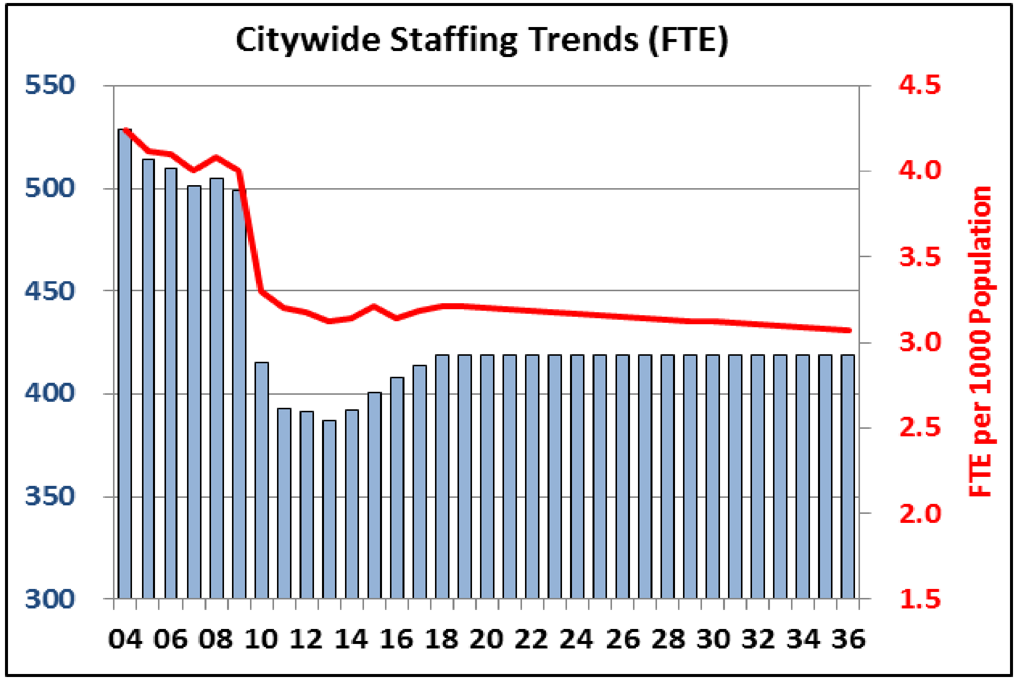
The Next Recession

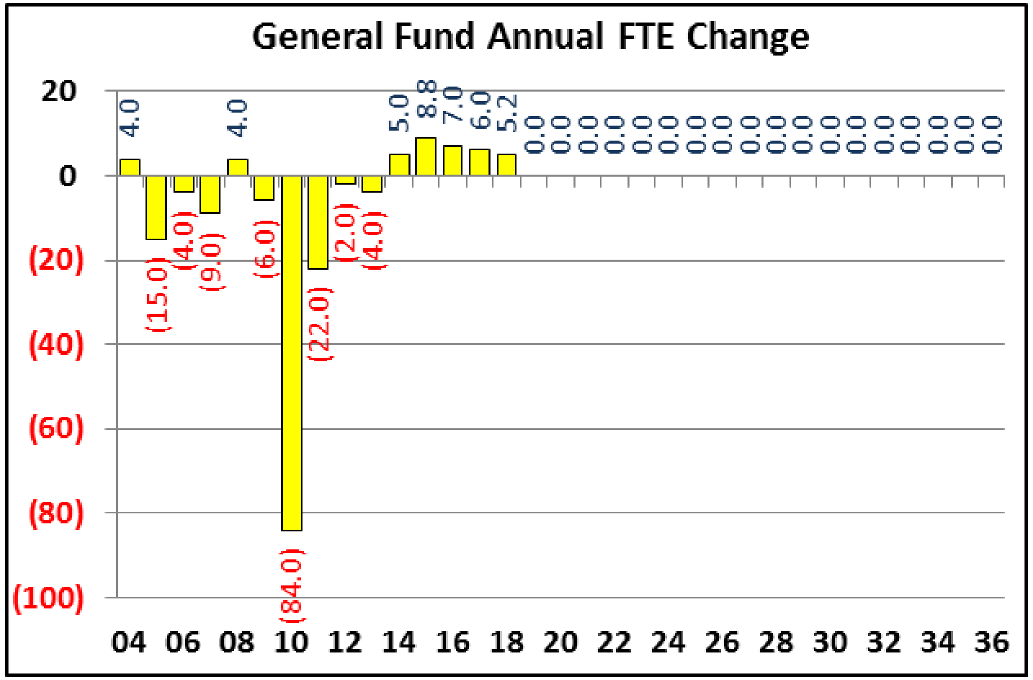




- Recessions have occurred an average of every 6.8 years since 1927
- Budget impacts often lag official recessions
- Causes of recessions vary, key issues are timing and magnitude
- Model assumes modest recessions every seven years starting FY 2019-20

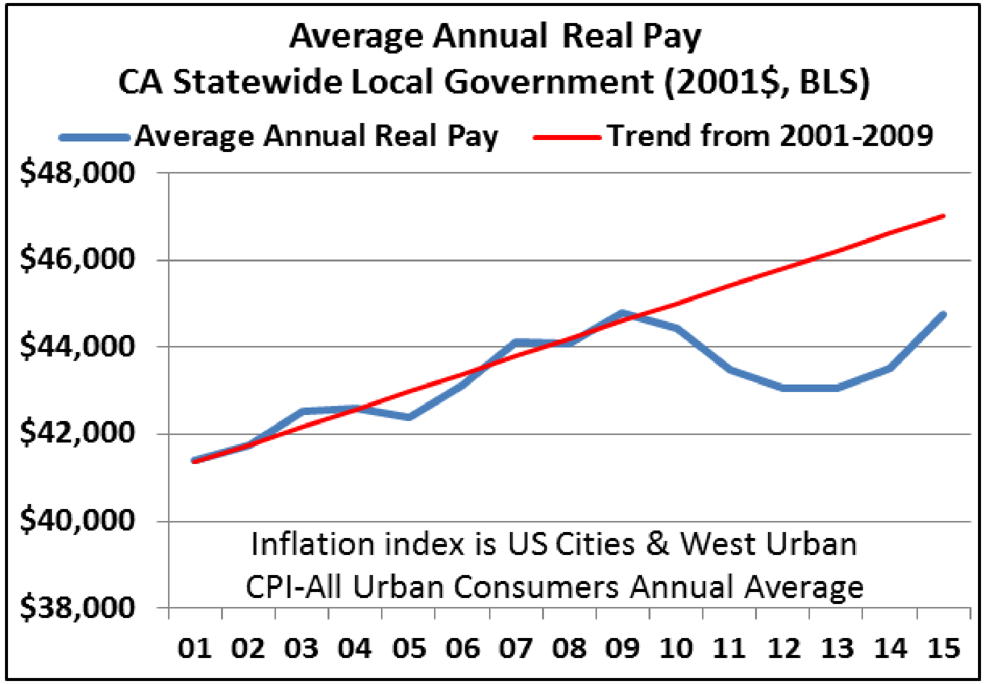
Staffing Levels



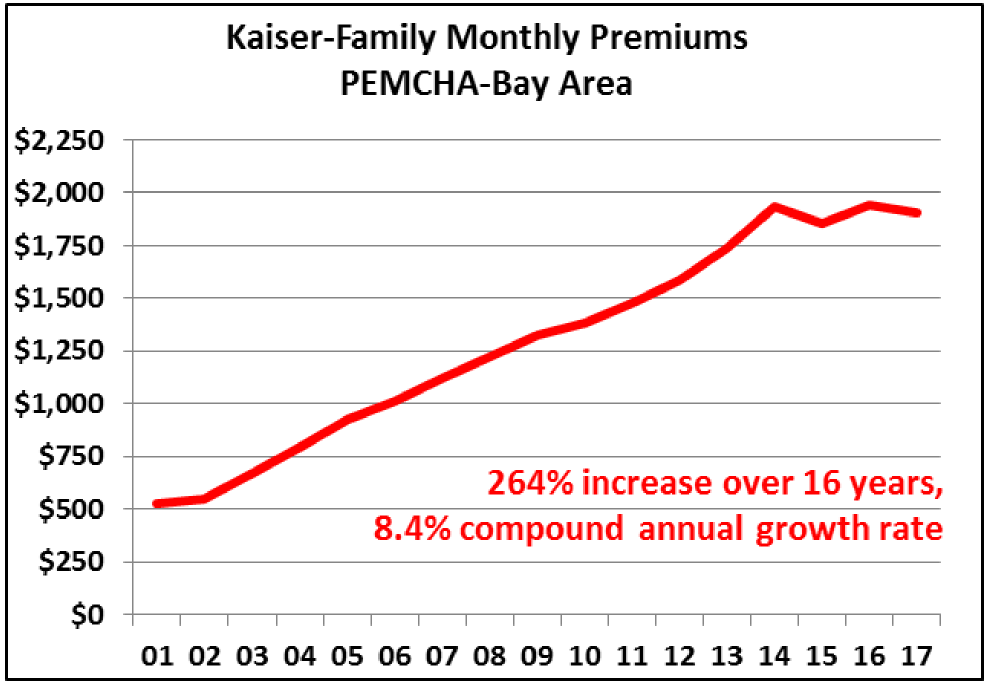


- Cut 118 FTE from FY 2009-10 to FY 2013-14, net gain of 32 FTE since then
- Staffing levels per 1,000 population will slowly decline without addition of FTE
- Workload issues and population growth will create pressure to increase staffing
- Forecast assumes no FTE change in future years

Wage and Health Cost Pressures

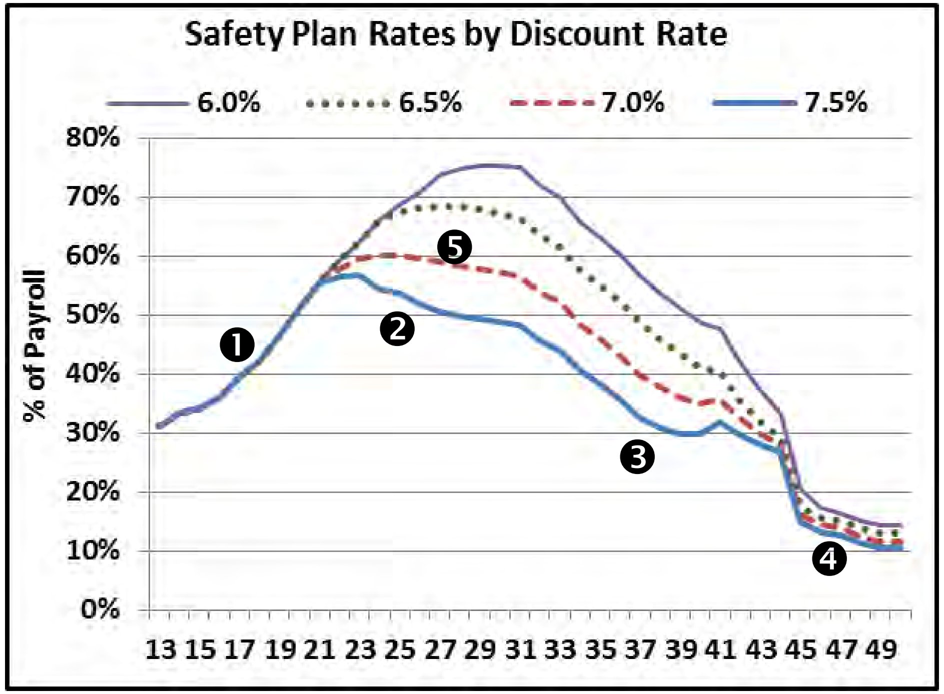


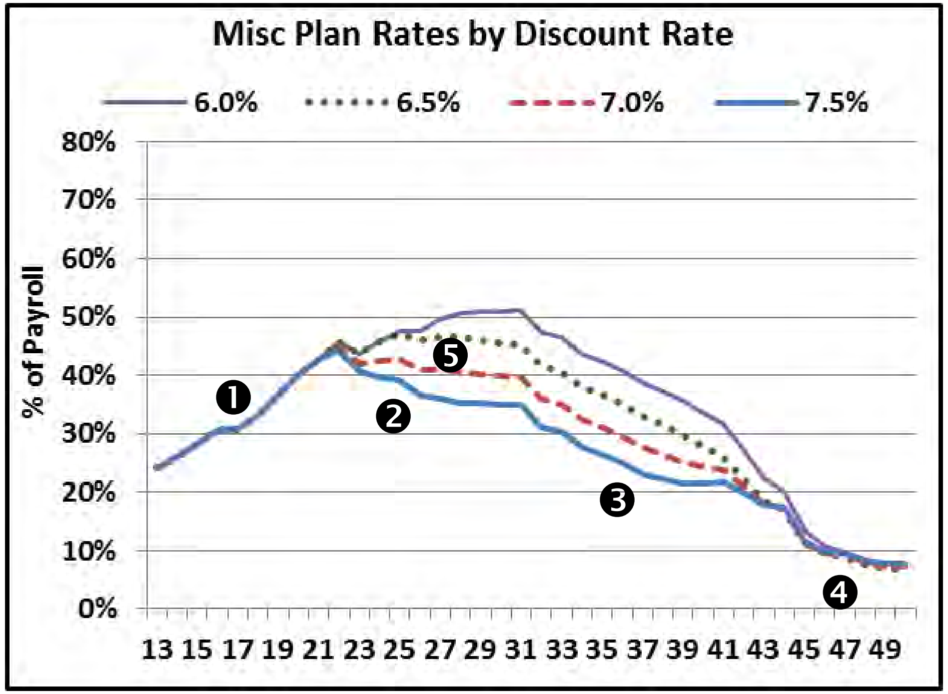
- Wage gap since end of Great Recession
- Lower PEPRA benefits add pressure to boost wages to compensate (Public Employees' Pension Reform Act in 2013 lowered benefit levels for new hires)



- Steady growth in health premium costs in region
- Impact of potential federal changes on health care costs are unknown at this time

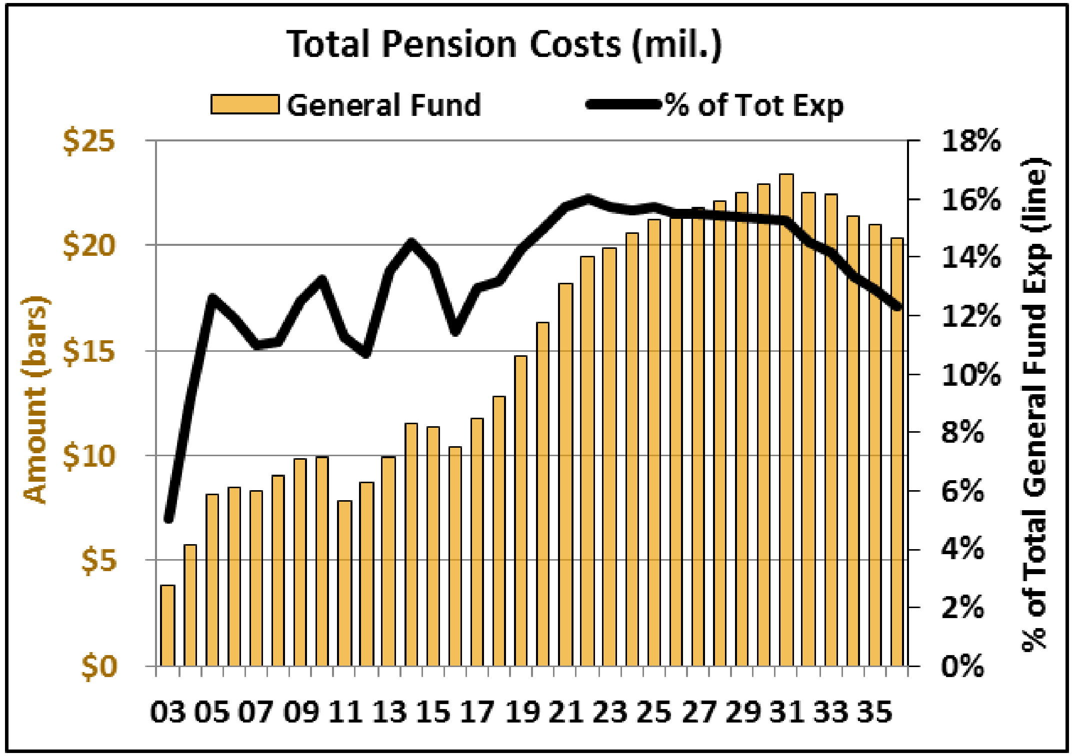
Pension Cost Life Cycle

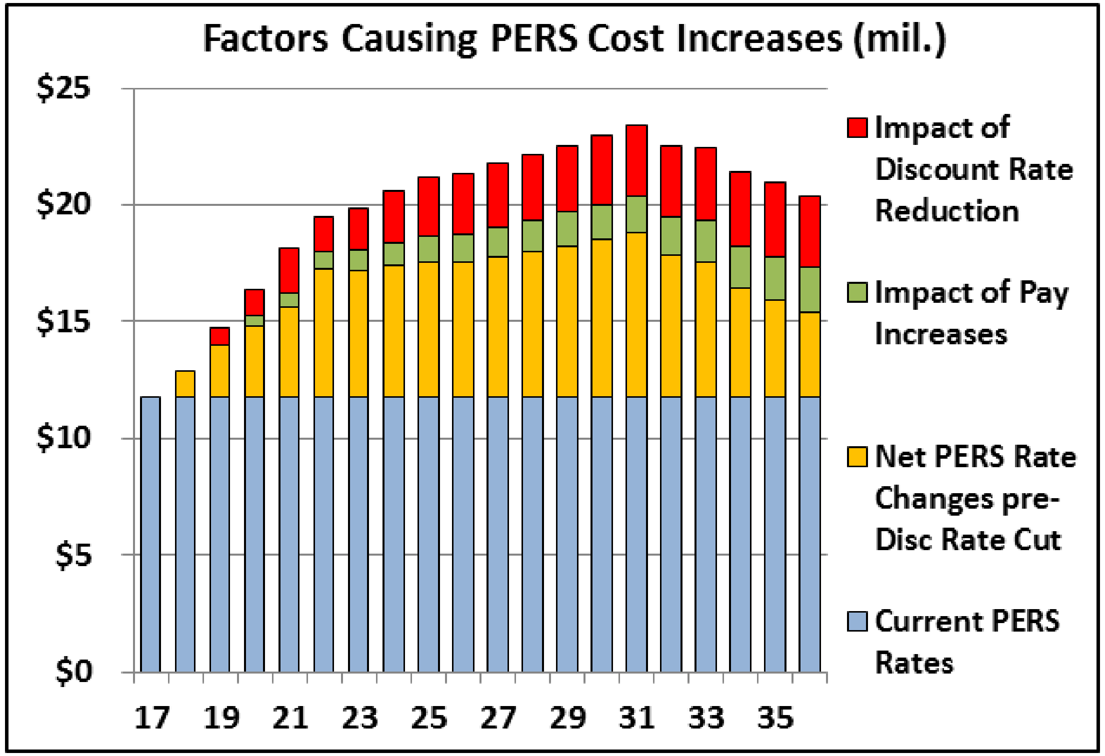




1. Planned rate increases through 2023 due to phase-in of CalPERS rate structure changes
2. PEPRA savings as new employees receive lower benefits (2013 to 2043)
3. Amortization of unfunded liability (most evident in 2030s and 2040s)
4. Normal costs are all that remain after unfunded liability is paid off
5. Discount rate (investment return) recently reduced to 7%, impact phased in over seven years; forecast assumes discount rate stays at 7%; risk is that discount rate will drop further

Evolution of Pension Costs





- Costs will double in 10 years
- Pensions peak at 16% of GF expense

- Shows portion of increase attributable to planned increases, COLAs, and impact of discount rate reduction

Key Forecast Assumptions

General

- **Recessions**: every seven years starting FY 2019-20, 2% property tax reduction, 5% sales/other taxes/permits; 90% of loss made up over next three years
- **Inflation**: 2% (same as Fed goal and recent history)
- **Fund Balance:** based on CAFRs through June 30, 2017 (only fund 100 and reserves from 130-136)

Revenues

- **Property Tax**: HdL data on ownership changes, $12M non-residential value/year, new housing units range from 50-150 per year over next five years based on 50% of proposed and approved multifamily units in the “pipeline”, and 10 infill units per year thereafter; excludes potential Base Reuse development (pending specific plan adoption)
- **Sales Tax**: HdL forecast by economic sector; assumes Measure Q expires in 2025
- **Other**: TOT growth 3%, BLT 2%, Transfer Tax 4%, Fees/Permits 2%, Intergovernmental 0%

Key Forecast Assumptions

Expenditures

- **Staffing levels**: no change (implications for future population/workload growth)
- **Wage Adjustments**: current MOUs through FY 2018-19, 2% growth annually thereafter; combination of merit increases and turnover savings adds net 0.25% per year; vacancy savings rate increased to 2%
- **Health**: employee cost growth at 3.5%; retiree costs per October 2017 Bartel Associates actuarial forecast (General Fund share of cash subsidy benefits at 6.75% discount rate)
- **Pensions**: based on six-year CalPERS forecast (2016 valuation) with continued transition of employees from Classic to PEPRA benefit levels; assumes discount rate remains at 7%; CCRS annual contribution of $2.7M through FY 2034-35 per Bartel actuarial study
- **Other Services and Supplies**: averages 2% annual growth

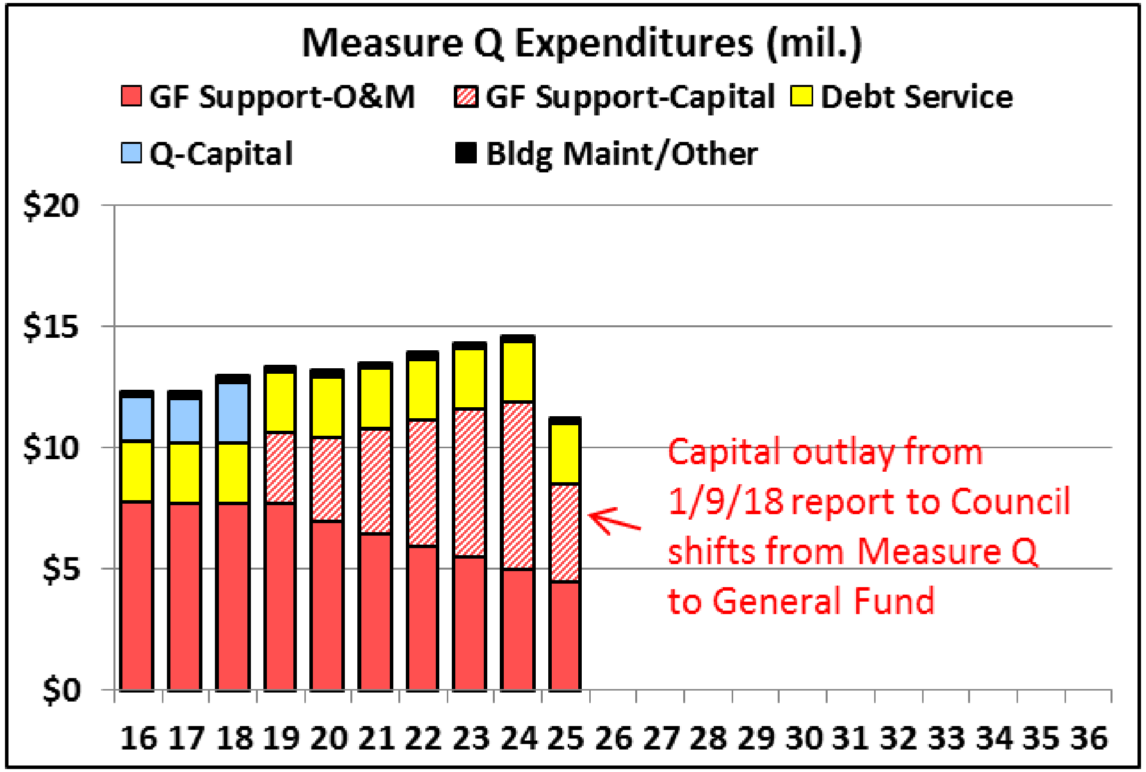
Key Forecast Assumptions

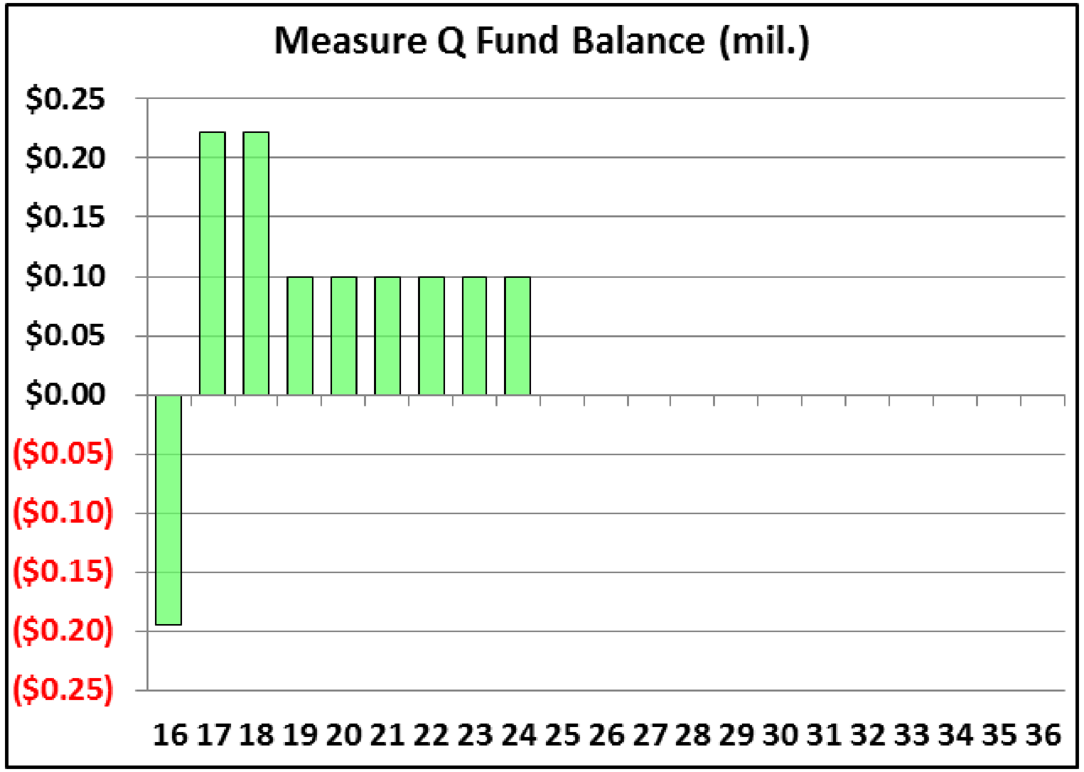
Expenditures

- **Unmet Needs**: based on the costs identified in the January 9, 2018 staff report to Council on unfunded liabilities; previously, roadways and other projects funded by Measure Q:

($ in millions)	FY19	FY20	FY21	FY22	FY23	Ongoing
Roadways	11.00	11.00	11.00	11.00	11.00	11.00
Parks/Medians	1.90	1.90	1.90	1.90	1.90	1.90
Facilities	0.50	0.50	0.50	0.50	0.50	0.30
Signs	0.10	0.10	0.10	0.10	0.10	0.10
Furniture/Equip	0.20	0.20	0.20	0.10	0.10	0.10
Safety Equip	0.36	0.36	0.36	0.26	0.26	0.26
Accrued Leave	0.62	0.62	0.62	0.62	0.62	0.62
Totals	14.68	14.68	14.68	14.48	14.48	14.28

Measure Q Sales Tax

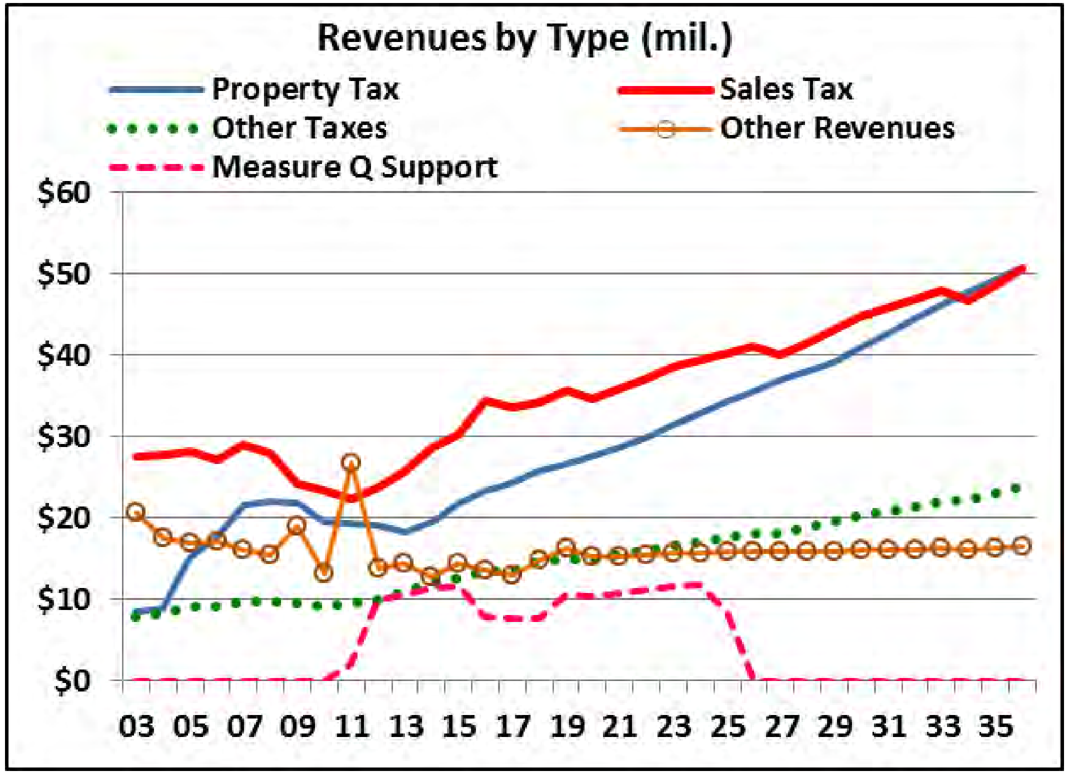


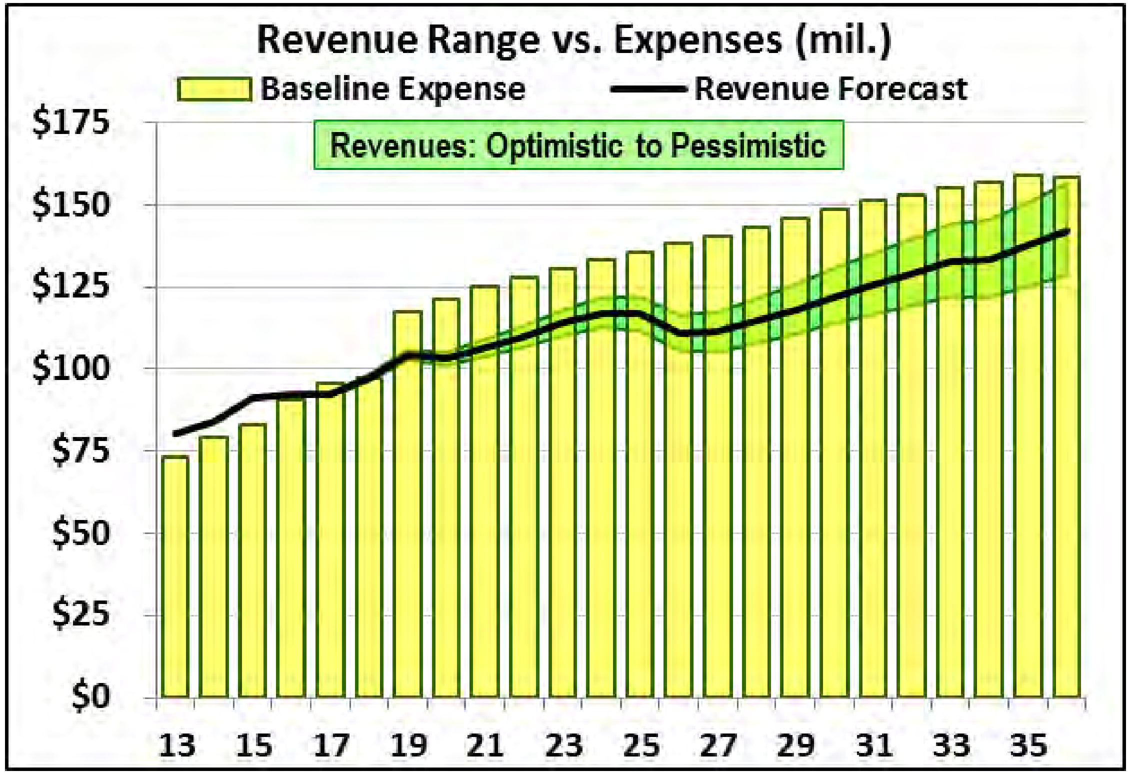


- Assumes tax expires in 2025; debt service (Roadway Lease Rev Bonds) ends in 2025
- Continued phase-out of GF support for O&M; remainder for capital outlay for unfunded liabilities to be paid by GF

- Assumes ongoing annual balance of $100K until tax expires

Projected Revenues and Expenditures

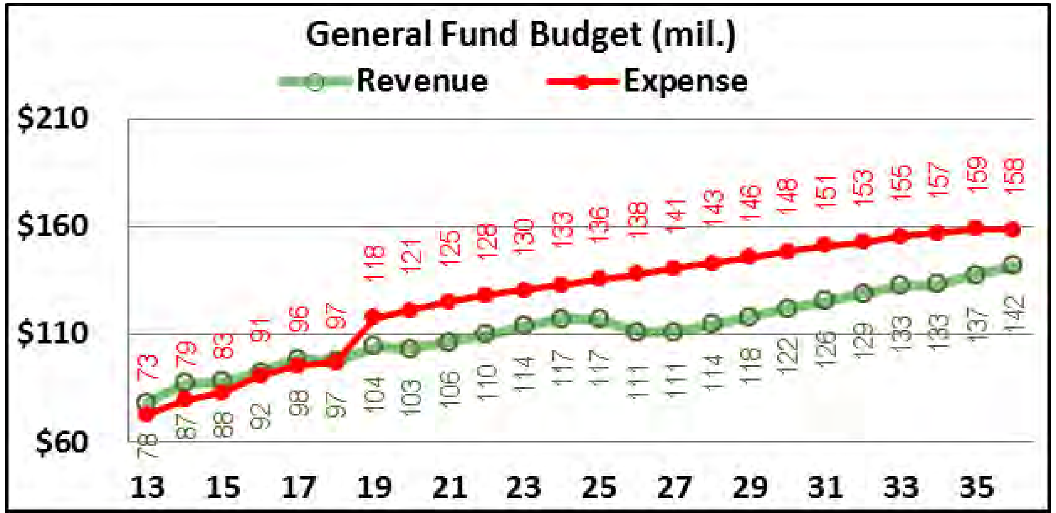


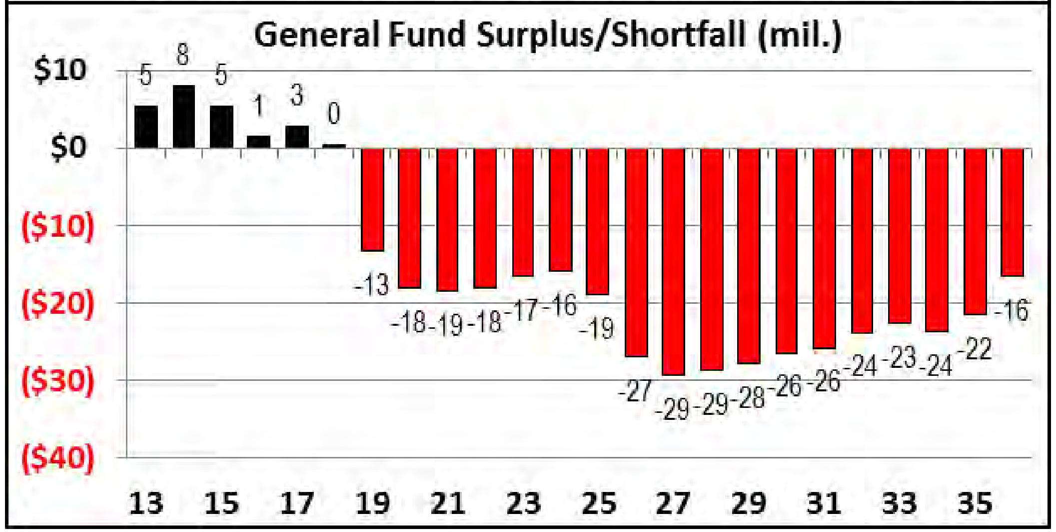


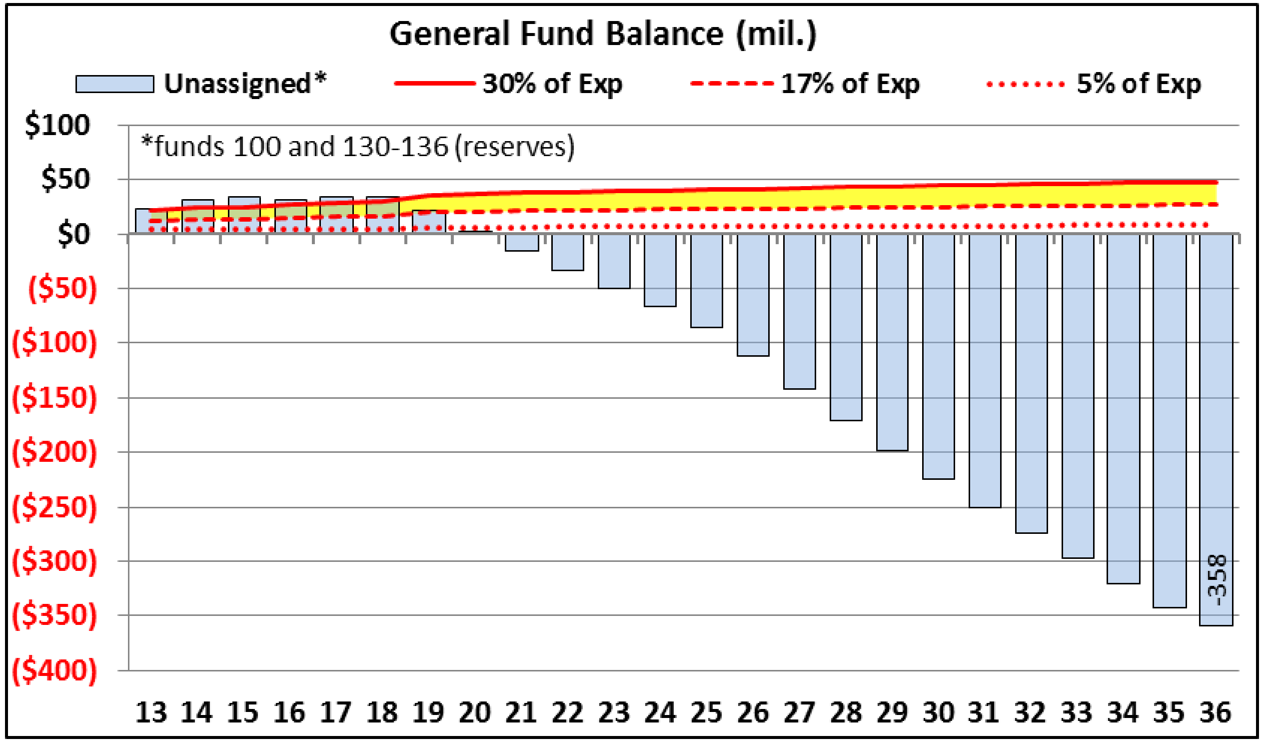
- Recession impact pronounced for property and sales tax
- Measure Q support for O&M plus capital ends in 2025, assuming tax expires

- Even with optimistic forecast (high end of green band), existing revenues are not adequate to support projected expenditures

Result is Structural Imbalance and Deficits Without Corrective Actions

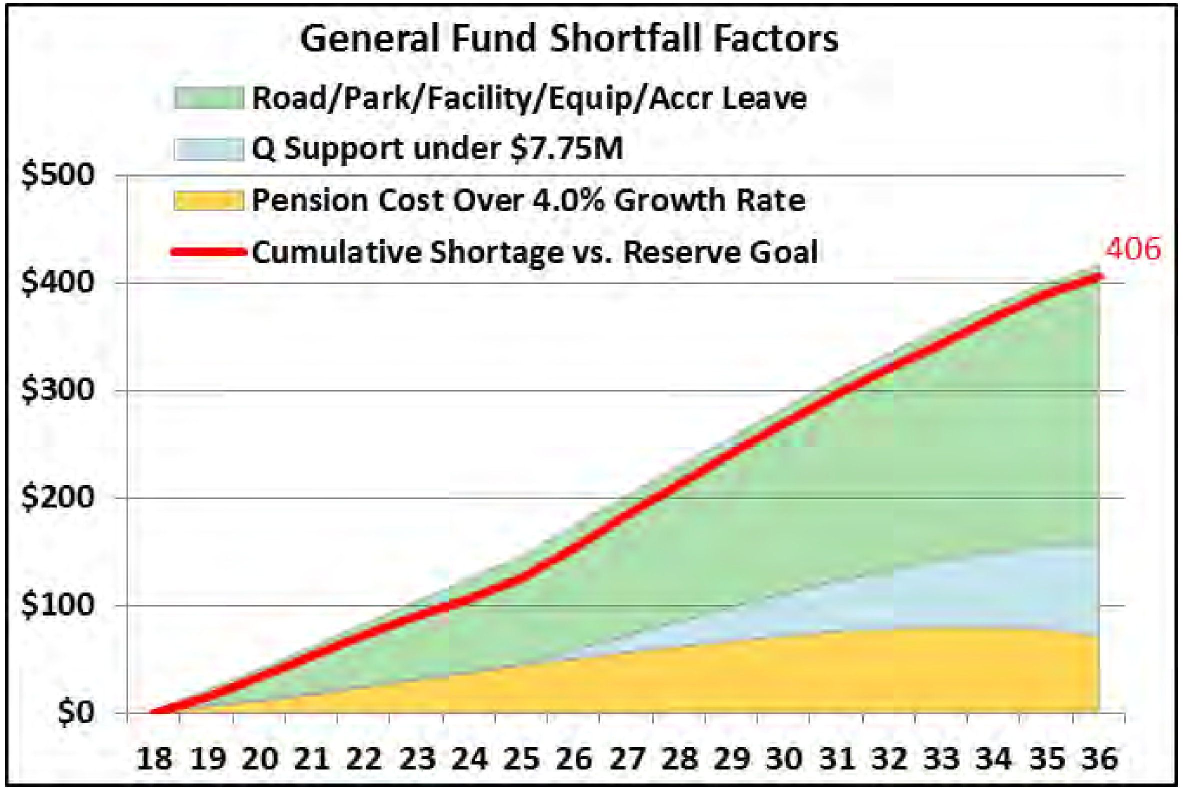






- Annual shortfalls rise to $29M, with General Fund in deficit by FY 2020-21 without corrective actions; shortfall declines as PERS costs slow, but deficit accumulates

Three Primary Causes of Shortfall



- Cumulative shortfall rises steadily to $406M by FY 2035-36; this is the total gap that has to be closed over the entire forecast period, including restoration of reserves
- Major contributing factors:
  - Loss of Measure Q support below current $7.75M of the total $13.2M tax revenue (after tax expires)
  - Over $14M in ongoing costs for roadway, park, and facility maintenance, accrued leave, and equipment, which are not in current budget
  - The portion of pension costs in excess of a 4% growth rate (largely due to discount rate impact)

Alternative Outcomes

Potential Outcomes that Would Improve Forecast

- Higher employee vacancy rates
  (more vacant positions or vacancies for longer periods of time)
- Delayed or weaker recessions
- PERS investment gains
- Cannabis tax
- Measure Q renewed/increased
- Stronger economic development
- Repayment of $7.5M Base Reuse Loan

Potential Outcomes that Would Worsen Forecast

- PERS investment losses
  (or additional discount rate cuts)
- Weaker sales tax growth
- More severe recession losses
- Higher COLAs approved
- Staffing levels increased
- Extreme events

Develop Budget Strategy Options

- **Revenue increases**
  - New taxes require voter approval
  - Budget model shows impact of new sales tax or other options
  - Allocate more Measure Q revenue to General Fund
  - Economic development/Base Reuse
- **Alternative service delivery, cost efficiencies**
  - Requires case-by-case analysis of potential for savings
  - Intent is to maintain service levels

Next Step: Budget study session on February 24 to consider budget strategies

- **Expenditure controls and cost shifts**
  - Compensation changes require meet and confer labor negotiations
  - Model can simulate impacts by labor unit for COLA, PERS cost-sharing, health contribution changes, or cost shifts to other funding sources
  - Intent is to maintain service levels by reducing cost of services
- **Service level reductions**
  - Within Council budget authority to enact
  - Budget model computes potential savings from cuts by attrition or other budget reductions
  - Lower staffing affects service levels

Thank You!
Questions?

Contact Information

Andrew Belknap | (805) 320-1702 | abelknap@managementpartners.com

Steve Toler | (650) 918-7017 | stoler@managementpartners.com

Robert Leland | (530) 219-5812 | rleland@managementpartners.com