



**Agenda Item No. 4.**

**Staff Report**

**Date:** February 13, 2019  
**To:** Mayor Kuhl and Council Members  
**From:** Joe Chinn, Town Manager  
**Subject:** Financial Forecast

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**Recommendation**

This report is information only.

**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 and Recreation Fund. The financial forecast projects revenues and expenses over the next fiscal years from Fiscal Year 2018-19 through 2023-24. 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.

For purposes of the financial forecast, the Town's Operating and Recreation Funds are combined to provide a more complete picture of the Town's financial conditions. The financial forecast includes a significant level of capital expenses coming from the Operating and Recreation Fund each year (average approximately \$475,000 yearly which includes average \$425,000 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 2020 (FYE20) show an estimated operating surplus of approximately \$200,000 on revenues of \$8.4 million and expenses of \$8.2 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 \$2,000 in FYE24, 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 and Recreation Fund Financial Forecast**

Item	Projected FYE 2019	Projected FYE 2020	Projected FYE 2021	Projected FYE 2022	Projected FYE 2023	Projected FYE 2024
Total Revenues	\$8,188,000	\$8,406,000	\$8,693,000	\$8,958,000	\$9,231,000	\$9,511,000
Total Expenses	\$7,928,000	\$8,204,000	\$8,557,000	\$8,863,000	\$9,180,000	\$9,509,000
<b>Net Surplus/(Gap)</b>	<b>\$260,000</b>	<b>\$202,000</b>	<b>\$136,000</b>	<b>\$95,000</b>	<b>\$51,000</b>	<b>\$2,000</b>
<b>Surplus/(Gap) as % of Expenses</b>	<b>3.3%</b>	<b>2.5%</b>	<b>1.6%</b>	<b>1.1%</b>	<b>0.6%</b>	<b>0.0%</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 FYE18 through the FYE24 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 65% of the Town’s revenue when including the public safety parcel tax (and 55% without the public safety parcel tax). The growth rate in FYE19 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 4.4% in FYE20, 4% range in FYE21, and 3.5% 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 1.5% to 2% 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 (\$60,000

budgeted this year) because there is little retail or other taxable sales occurring in Ross. Overall, total revenues are projected to increase by approximately 2.7% next fiscal year and then in the following years are estimated to range between 3.0% and 3.4% 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 FYE19 in the Operating and Recreation Fund are currently estimated to be \$7.9 million and growing to \$9.5 million by FYE24. The average growth rate of expenses is approximately 3.7% per year. Wages and benefits comprise approximately 42% of total expenses. Wages are estimated to increase at 3.5% to 4% per year from FYE20 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 officially announced it is lowering the discount rate it anticipates earning on investments from 7.5% to 7.0% per year. This change is being phased in over time with the first impact being to FYE19 rates and not being fully phased in until FYE25. This change along with CalPERS only earning 0.6% in FY15-16 versus the 7.5% target investment rate is anticipated to add approximately \$7 million costs to the Town over the next 30 years. The result of the CalPERS modification is that the Town's pension costs are estimated to go from \$425,000 in FYE18 to \$701,000 by FYE24 (a 9% average annual increase).

The Town has been aggressive in paying down the CalPERS UAL to reduce long-term costs of CalPERS. The Town has taken numerous steps to reduce our total PERS costs such as:

- 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.
- Currently, has \$200,000 in the FYE19 budget for additional paydown as well as \$200,000 in the Financial Forecast each year to pay a portion of the CalPERS UAL early to reduce the long-term annual interest charged and thus total CalPERS long-term costs. We will discuss whether to continue to pay directly to CalPERS or utilize a Section 115 Trust as a strategy option to diversify and reduce long-term pension debt.
- 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 FYE23 are approximately \$125,000 lower each year compared to last year's forecast due to the steps we have taken in the last two 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.

Town staff is continually reviewing strategies and options to reduce the overall costs over time. Staff will be recommending to the Town Council this fiscal year to consider utilizing a Section 115 Plan instead of directly funding through CalPERS to reduce our long-term debts in order to diversify the Town pension strategy.

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, 2017 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 16% of the Town's costs in FYE18. 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, this fiscal year the Town hired a Senior Building Inspector to perform building inspection and some building plan review services to both save the Town some money and to provide more responsive services to our customers. The forecast is showing 3.0% annual inflation on outside service costs in FYE20 through FYE24.

The Ross Valley Fire services are provided through the Ross Valley Fire Department JPA and at approximately \$2.0 million annually are 25% of total expenses. These costs increased over 6% each of the last two fiscal years due largely to a labor contract cost increases. Fire service costs

are anticipated to increase in the 4% to 5% annual range in the following years with a new labor contract, 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 sales tax measure (Measure K) in November 2016 stabilized the Town's funding of operations for the next eight year period.
- 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.
- Medical and pension 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 recent 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 over \$3 million by the end of FYE19.

### **Alternative actions**

Informational report only

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