# Council Agenda Correspondence

**DATE:** February 6, 2024

**TO:** Mayor and Council

**FROM:** Emily Jackson, Finance Director

**VIA:** Derek Johnson, City Manager

**SUBJECT:** ITEM 6A - FISCAL YEAR 2023-24 MID-YEAR BUDGET REVIEW & RESOLUTION TO AMEND THE BUDGET

Staff received several questions from Council in advance of the 2023-24 Mid-Year Budget Review. The questions are below with staff's response shown in *italics*:

1) **The City's portion of Bradley Burns sales and use tax revenue from July – September 2023 decreased by -0.3% year over year, while total sales & use tax plus Local Revenue Measure (LRM) G-20 revenues increased by +1.7% during the same period. Why are the growth rates for these two revenue streams different?**

   *The growth rates are different because Bradley Burns is a "Sales and Use Tax" and LRM is a "Transaction and Use Tax" and they are applied in different ways. Under the Bradley-Burns Uniform Local Sales and Use Tax Law, cities receive revenue equal to 1.0% of all purchases where the sale was negotiated, or the order was taken within city limits. The City's LRM generates revenue (1.5%) from transactions where the goods are delivered or placed into use within city limits.*

   *The difference between where the sale was negotiated, or the order was taken and where the goods are delivered or placed into use is subtle but impactful. Particularly for sales of big-ticket items like automobiles or online purchases where the City may receive revenue from only one tax. The quarterly growth rates can vary based on the types of sales that occurred during the quarter. Based on the make-up of the City of San Luis Obispo, our LRM is very successful when it comes to Business & Industry and General Consumer Goods.*

   *The reason the City sometimes combines them is to try and show overall growth in sales and transactions, despite where the sales are coming from or going to. However, the Bradley Burns tax is the best to use when comparing to State and County growth rates.*

*To learn more about the nuances of Sales, Use, and Transaction tax collection, see the [Local Government Guide to California Sales, Use and Transaction Tax] published by the HdL Companies (the City's sales tax consultant). The table below illustrates the third quarter growth for calendar year 2023 (July-September 2023) by region and type of tax.*

| *Revenue Region/Type* | Growth |
|---|---|
| *a. State of California (Bradley Burns)* | *-1.5%* |
| *b. County of SLO (Bradley Burns)* | *0.0%* |
| *c. City of SLO Sales Tax (Bradley Burns)* | *-0.3%* |
| *d. City of SLO Transaction Tax (LRM)* | *+3.2%* |
| *e. City of SLO Total Sales, Use & Transaction Tax (c & d)* | *+1.7%* |

2) **Along the lines of Sales Tax, on Budget Report page 3, it shows that Sales Tax revenue from Building and Construction was -7.7%. Do we know why that was?**

*Although the City has not met with HdL to discuss its City-specific Q3 results, the State was down in this category also (-2.6%) and there are some notable trends. One of the main reasons being that high interest rates and low affordability lead to less home sales and housing stock turnover. Less turnover can be correlated to less remodels and home improvement projects. Additionally, workforce and labor availability are a huge challenge for contractors. The threat of another El Niño wet winter also seemed to have impacted people's decision to start construction projects last fall.*

*Here is an excerpt from the HdL's latest [California Consensus Forecast] (December 2023) which projects an overall 0.8% decline in this category for 2023/24:*

> *Cement and asphalt batch plant activity appears to be growing because of heightened infrastructure work around the state in addition to delayed repair projects related to last year's storms. Roofing supply houses and roofing contractors also saw large sales increases this fall. Lumber prices have plateaued, but most other commodity rates are still increasing. Big-box home improvement centers are drawing fewer customers as shoppers forego appliances and other big-ticket outlays. Recent mortgage interest rate declines did little to benefit new development but with rates expected to move toward their new base by the middle of 2024, new home and commercial development are expected to accelerate, sparking gradual growth in overall sales that stabilizes in fiscal year 2026-27.*

3) **Budget Report page 7 references that the future CalPERS unfunded liability payments were increased significantly to reflect the Foster and Foster assessment for May 2023. How significant was the variance? Can you provide the original vs. updated assumptions?**

*The table below shows the original unfunded liability assumptions (all funds combined) for the original fiscal forecast as presented in the 2023-25 Financial Plan (line 1) and the new forecast included in the mid-year budget (line 2). The variance reaches over $3 million by 2026-27. These numbers are dependent on the actual annual rate of return that CalPERS achieves (goal is 6.8%). Forecasting for unfunded liability will continue to be adjusted based on the performance of CalPERS investments. The City's one-time additional discretionary payments (ADP) do help in the long run and the impacts of these payments are not forecasted at this time in the five-year forecast.*

| | *(in thousands)* | 2024-25 | 2025-26 | 2026-27 | 2027-28 |
|---|---|---|---|---|---|
| 1 | Original Unfunded Liability Forecast | $ 13,409 | $ 13,140 | $ 12,940 | $ 12,560 |
| 2 | Updated Unfunded Liability Forecast* | $ 14,242 | $ 15,062 | $ 16,074 | $ 16,881 |
| **3** | **Variance (or increase)** | **$ 833** | **$ 1,922** | **$ 3,134** | **$ 4,321** |

**The forecast included on Budget Report Page 10 – Table 8 (within line 25 - Staffing)*

4) **Budget report page 4 of the packet references the Development Services Designation Fund. Why was this fund removed with the 23-25 financial plan and this policy taken out of use?**

*Since the time that the Development Services Designation was established in 2015, the way permit fee revenue was budgeted has been more predictable with the end of the Great Recession. The Community Development Department added significant resources, and the new policy language was developed to ensure the cost of contracting out work was commensurate with forecasted revenue. The current Building Permit Plan Check services policy reads "City of San Luis Obispo offers building permit plan check services through consultants at a set price, not to exceed 65% of the City's fee for the service. Building Permit Plan Check Services are offered by the City on a 100% cost-recovery basis, and the service is provided after the fee is paid in full."*

*Both policies were included in the 2021-23 Financial Plan. Staff recommended removing the development services designation policy because it was duplicative with the new budgeting policy. Additionally, for the last several years, the department has not over-realized revenue and the policy did not adequately address what would happen in that circumstance.*

5) **Budget report page 5 points out that, at mid-year, we are 56% spent compared to budget. Do we anticipate this being a problem for the second half of the year?**

   *No, this is not a problem because this 56% includes purchase orders that were set up in the beginning of the year in addition to any annual payments that were made in the first half of the year. For example, the City's CalPERs unfunded liability payment is paid in full in July which saves the City over $300,000/year as opposed to if it were paid monthly. It is expected that the overall percentage spent would be higher than 50% as of December 31, 2023.*

6) **Budget Report page 13 describes the recommended line items for use with the $8.3 million unassigned fund balance. Separate from the $220,000 recommended to purchase the David statue and to support other local arts projects around the city, can you please summarize the funding currently budgeted in 2023-24 to support public art projects and contracts with SLOMA or other groups? What funding is set aside in 2024-25 for the same purposes?**

   *In addition to the proposed $120,000 to purchase the "David" sculpture and $100,000 to enhance additional public art projects in support of the community, the 2023-25 Financial Plan has allocated the following funds in support of the Public Art Program:*

   *FY 2023-24:*
   - *a) $30,000 for Annual Asset Maintenance*
   - *b) $175,000 for Small Public Art Projects*
   - *c) $20,000 for Utility Box Beautification program*
   - *d) $100,000 for Roundabout Public Art Projects*

   *FY 2024-25:*
   - *a) $30,000 for Annual Asset Maintenance*
   - *b) $150,000 for Small Public Art Projects*
   - *c) $20,000 for Utility Box Beautification program*
   - *d) $100,000 for Roundabout Public Art Projects*

   *These funds contribute to the capital funds carried over which will support the deliverables outlined in the SLOMA partnership agreement (including their annual management fee), annual asset maintenance needs, and other public art installations.*

7) **On Budget Report page 31 of the packet, can you please explain the increase in projections for line 4 of Table 30? Why does the projection go up by $70K in 2024-25 and then back down the following year?**

   *The long-term parking revenue line includes programs like 10-hour meter permits, merchant validations, structure prox cards, and reserved parking for construction vehicles. The variety of programs results in fluctuations in revenue based on individual commute patterns, construction downtown, and businesses' subsidization of their employees' parking. Long-term parking revenue is forecasted using an average of the prior three years to account for individual program revenue variances. The 2024-25 budget was updated; however, the outer years of the forecast were not, thus explaining the decline. Staff will be adjusting the forecast for this as part of a more comprehensive forecast update for the 2024-25 Supplemental Budget.*

8) **On Budget Report page 52, we see department updates for Code Enforcement. Can you please provide more detail on what the proposed changes mean for the Code Enforcement Division and their work on safe housing?**

   *The department hired a Safe Housing Specialist in November 2023, and we have been working with them to develop enforcement and outreach strategies that are aligned with Council's feedback from the October Study Session. This includes focused efforts in reaching tenants and working with tenant rights groups and student groups. We have participated in various events such as the Cal Poly off-campus housing fair, a Cal Poly hackathon that focused on safe housing, and invited members of SLO Rent Coalition to meet with staff for a brainstorming session. We have also launched a couple of educational outreach campaigns. These campaigns were conducted on large rental complexes when we were made aware of a code violation. We notified all tenants of the complexes of the unique violation in a neighboring unit, informed them of the process to report any violations they may be aware of, and provided our tenant rights pamphlet. The Code Enforcement Tech I position was just filled in the middle of January, and our new employee is still in training.*

9) **Regarding the Police Department performance measures on Budget Report page 68 (screenshot below): are these grant-funded enforcement efforts? Is the reason so few enforcement efforts have occurred a result of low staffing levels?**

| | | |
|---|---|---|
| Traffic Enforcement Operations: 13 | Traffic Enforcement Operations: 14 | 1 |
| Distracted Driving Enforcement:5 | Distracted Driving Enforcement: 5 | 1 |

*These columns are low due to the timing of the grant period (October 1 – Sep 30). 35 Targeted enforcements at mid-year appears low, however the grant period only started on October 1st and additional grant operations will occur in 2024. This is typical, as most of the grant activities are planned in the subsequent year of the grant due to fall events such as Halloween, holidays etc. Additionally, the City just completed a DUI checkpoint this last weekend, after this document was completed and not during the mid-year reporting time period.*

**10) On Page 108 of the packet, the following statement is included:**

the Nacimiento pipeline caused by the 2023 winter storms. Staff has been notified that electricity will increase an additional 14% for bundled customers and 25% for Community Choice Aggregation (CCA) customers beginning January 2024. Staff anticipate that this will be partially offset by the newly implemented Tesla Backup Battery which is calculated to reduce electricity costs by approximately $15,000 per month. The anticipated electricity savings resulting from the use of this battery are not fully

**What is the cause is of the rate increases and why is it going to be 25% for CCA customers?**

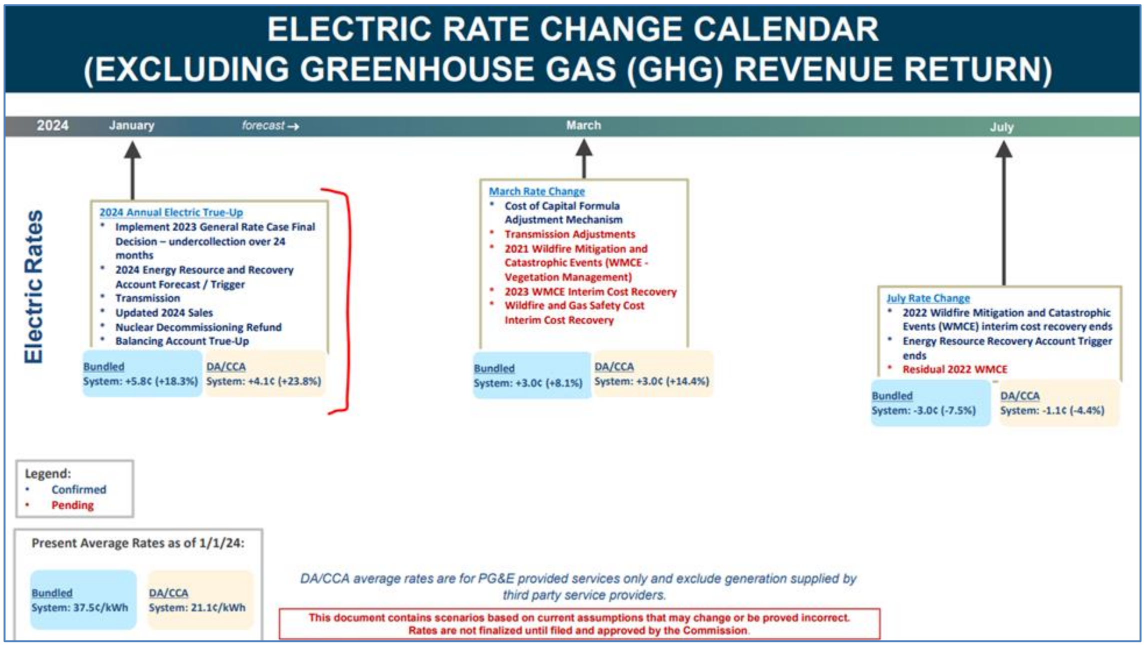
**In addition, why is Unreserved Working Capital projected to go up for another year and then down after that?**

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| 24 | Change in Financial Position | $ 5,308 | $ (24,499) | $ (24,486) | $ 1,506 | $ 3,152 | $ (1,788) | $ (1,357) |
| 25 | Working Capital - Year End | $ 40,033 | $ 15,534 | $ 15,547 | $ 17,053 | $ 20,205 | $ 18,418 | $ 17,060 |
| 26 | Operating Reserve (20%) | $ 4,260 | $ 5,061 | $ 5,088 | $ 5,268 | $ 5,485 | $ 5,756 | $ 5,935 |
| 27 | Rate Stabilization (10%) | $ 2,237 | $ 2,508 | $ 2,508 | $ 2,694 | $ 2,903 | $ 3,039 | $ 3,179 |
| 28 | Other Reserves (115 Pension Trust Fund) | $ 176 | $ 176 | $ 176 | $ 176 | $ 176 | $ 176 | $ 176 |
| 29 | Unreserved Working Capital Year End | $ 33,361 | $ 7,789 | $ 7,776 | $ 8,915 | $ 11,642 | $ 9,446 | $ 7,771 |

1 Includes Loan Proceeds for Santa Rosa Project and Grant Funding in FY2025-26

***Electricity Rate Increases***

*There were a number of items that were considered in the January 2024 electric service rate increase. These are summarized in the image provided by PG&E highlighting the rate change drivers:*




*The major drivers were wildfire mitigation and catastrophic events (WMCE) infrastructure and inflation. These costs, and other ancillary drivers, are outlined in a lengthy General Rate Case and a webinar conducted by PGE. What we have recently seen is PG&E proposing rate increases that impact the City first, with some of these costs passed along to the CCA, such as the distribution costs associated with vegetation management.*

***Water Unreserved Working Capital***

*The unreserved working capital goes up in 2025-26 because of forecasted debt financing. The unreserved working capital goes down in 2026-27 because of infrastructure costs corresponding to capital expenditures associated with that debt.*

*The 2025-26 forecast for unreserved working capital includes anticipated debt financing for the 30-inch Waterline Replacement on Santa Rosa from Stenner Creek to Highland. This assumes a project cost and financing of about $8.2 million. Staff reflected the inflow of cash occurring all in 2025-26, but the project expenses occurring in 2025-26 and 2026-27."*