The Strategic Scan is meant to inform the financial planning process by providing an overview of important statistical information that provides trends and patterns pertaining to social, economic, and environmental factors. This will help set the stage for an overview of the City's services and how the budget is allocated.

In making resource allocation decisions, the City must balance numerous considerations to provide the highest possible level of service to our community. These considerations are visualized below:

At this time, there are three major factors influencing development of the 2025-27 Financial Plan. These include: 1. Changes to state laws and mandates that impact delivery of services; 2. macroeconomic conditions that influence our revenues and continue to drive up the cost of doing business; and 3. the cost to serve the community as it grows.

Regulatory Environment: State legislation and mandates

The State of California signs into law hundreds of bills each year, many of which have a direct impact on cities. Staff presents a summary of these bills in the annual State Legislative Briefing. This report will focus on those legislative items with the greatest impact on City budgets.

While this report focuses on the budgetary implications of implementation, these investments often provide meaningful community benefit and in the case of ballot initiatives are enacted based on approval from a majority of voters.

The costs to comply with new legislation are not always readily apparent, but all new requirements impose some cost. Even simple changes require time to implement, taking scarce resources away from other priorities. Significant changes may necessitate adding or repurposing existing resources.

Planning and Building related legislative changes

The State of California continues to pass legislation that directly impacts planning and project permitting, especially housing projects. While the legislation is meant to streamline the approval process for projects and remove barriers to housing production, a number of regulations require a significant amount of up-front work from Community Development to ensure compliance. This work includes ongoing updates to processes and procedures, creation of new programs, and amendments to the municipal code. In some cases, the City will be required to address the mandated changes through technological updates that include Community Development, Finance and IT staff as well as consultants. For example, some of the recent legislation that was passed will require:

- Strict adherence to review timelines for housing projects, with potential legal and fiscal consequences for non-adherence, this could result in the need for additional reviewers, or updated practices, if the case levels remain as high as they have been in the past (AB 1893).
- Increased transparency and requirements surrounding fees. This will require the City to develop new tools for the public to estimate fees, and provide additional information online about the fee program, and change our fee processes. In addition, improvements are necessary to the fee program and technology used to facilitate the fee program in order to ensure compliance with these new state laws (SB 937, AB 2663, AB 3012 and AB 1820).
- Changes to ADU law, SB 9 laws regarding lot splits and duplexes, as well as SB 628, which will allow subdivision of single-family lots to accommodate up to 10 units. In addition to the increased penalties for non-compliance with review timelines, the state has made changes to ADU law, SB 9, and SB 628 regulations that will likely require updates to the city codes and standards as well as additional education and process improvements to facilitate projects. (SB 1211, AB 2533, SB 450)

- Development of a pre-approved ADU process, which will require staff to develop and implement this new program (AB 1332).

Depending on the impact of these changes, it may be necessary to consider additional or supplemental staff to facilitate these changes and/or review projects within required timelines set by the State.

It can be challenging to plan ahead for the fiscal and time impacts that implementing these changes can present, as the legislation is usually unknown at the time of budget development, and new laws are signed every year. For this reason, it is important to ensure that some staff capacity is reserved to address the needs that arise from the annual changes in state law. For the purposes of this discussion, staff anticipates that the new planning and development related laws will take a significant amount of staff time to address in the beginning of the budget cycle, with the most significant impacts to Planning, Building and Safety, IT, and the City Attorney's Office. Staff also recommends retaining staff capacity throughout the budget cycle to ensure the City is able to address ongoing changes required by state law and changes in interpretation of state law.

In addition, the Building and Safety Division will facilitate the adoption of the 2025 Building Code, which will primarily begin in July 2025 when the state publishes the updated standards. This update requires a significant amount of effort from the Building and Safety Division, with assistance from the Fire Department and City Attorney's Office. The time involved in this effort should be considered when determining staff capacity for work program items.

Limitations on Property Tax Increases – Propositions 13 & 19

Proposition 13 was approved by voters in 1978 and, among other things, capped the property tax rate at 1% of assessed value and limited increases in assessed value to 2% per year, regardless of market value appreciation. Prop 13 allows reassessments only when properties are sold or otherwise change ownership. The official name of the ballot initiative was the "People's Initiative to Limit Property Taxation" and part of the intent was to prevent displacement of retired homeowners living on fixed incomes.

According to the All-Transactions House Price Index for California published by the Federal Reserve, California housing prices have increased at a compound annual growth rate of 8.1% since 1978 and are now 13 times higher than when Prop 13 was passed.

The City of San Luis Obispo has historically seen growth in property tax revenues well in excess of the 2% limitation. This has generally been attributed to changes in ownership of properties that have benefited from years or decades of below market assessment increases. When homes are sold in San Luis Obispo, new homeowners on average pay substantially higher property taxes based on the new assessed value at the transaction price.

Proposition 19, also known as "The Home Protection for Seniors, Severely Disabled, Families, and Victims of Wildfire or Natural Disasters Act," was approved by California voters on November 3, 2020, and places additional limitations on reassessments. Specifically, Prop 19 created new reassessment exclusions for inherited properties and allows residents aged 55+, the severely disabled, and victims of natural disasters to transfer their lower assessed values to new properties when they move. The intent of this bill was to prevent the displacement of those inheriting valuable properties and to allow greater mobility within the state.

While precise data on the demographics of home buyers is not readily available, based on the 2023 County Assessor's report, the county as a whole realized a net assessed value loss of $106.8 million as a result of Prop 19 value transfers. The 2024 countywide loss was $74.7 million, which, based on a reasonable allocation, would result in a roughly $13,000 revenue impact to the City. Going forward, the assessed values of properties within the City and County are expected to be impacted by Prop 19, though overall decreases to assessed value and property tax receipts are not expected due to continued growth of assessed value in line with Prop 13.

The Taxpayer Protection and Government Accountability Act

This California Business Roundtable (CBRT) sponsored initiative qualified for the November 5, 2024 ballot, but after strong opposition from Cal Cities and a broad coalition of local governments and advocates including the Governor, it was removed from the ballot by the California Supreme Court.

The Act would have severely limited local control and specifically would have placed significant limitations on Cities' ability to assess fees for services provided. Staff caution that while the Act was struck down from the most recent ballot, the CBRT may pursue other avenues to pass legislation with the same goal and the same detrimental impact to cities.

Diablo Canyon Power Plant Relicensing

The Diablo Canyon Power Plant (DCPP) is the last active nuclear power plant in California and provides roughly 9% of the state's energy. The plant was originally planned for closure beginning in 2024. Based on increasing demand for clean energy and the closure of other plants, the California Public Utilities Commission (CPUC) granted a five-year license extension that allows PG&E to operate the Unit 1 reactor until October 31, 2029, and the Unit 2 reactor until October 31, 2030. During this time, the Nuclear Regulatory Commission (NRC) will consider a 20-year license extension for DCPP. If the NRC approves the license renewal, Diablo Canyon could continue operating until the 2040s.

The closure or continued operation of the plant would have significant economic implications for both San Luis Obispo County and the state as a whole. If the plant closes, the local economy would face job losses (1,500+ high-paying positions), reduced tax revenues, and broader negative effects that would ripple through the regional economy. However, if the plant remains open, the community also faces risks and liabilities, including the potential for costly accidents or safety concerns, ongoing challenges with long-term waste storage, and limited future uses for the site. Additionally, under California Senate Bill 1090, PG&E's unitary tax for DCPP will gradually decrease to zero by August 2025. For context, in 2023, the County received $14 million in property tax revenue from the plant. Without a new property tax agreement after 2025, the County could face budget shortfalls that impact its ability to fund vital services for the community. The City will need to stay engaged and work closely with other local governments and PG&E to help mitigate the impacts.

State Debt Capacity:

In the last 12 months voters approved $26.4 billion in new state bonds:

- Prop 1 from March 5, 2024 ballot added $6.4B to be repaid over 30 years for affordable housing and behavioral health treatment facilities
- Prop 2 from November 5, 2024 ballot added $10B to be repaid over 35 years to repair and modernize K-12 and community college facilities
- Prop 4 from November 5, 2024 ballot added $10B to be repaid over 40 years for safe drinking water, wildfire prevention, and protection from climate change

According to the State Legislative Analyst's Office, the state had $70.9B outstanding and another $23.6B authorized but unissued general obligation bonds as of January 1, 2024. The newly authorized debt is equal to 37% of the current outstanding amount, a considerable increase for a single year.

Summary of California Bond Debt[a]

In Billions, as of January 1, 2024

	Outstanding Debt	Authorized but Unissued Debt	Total
General Obligation Bonds	$70.9	$23.6	$94.5
Lease-Revenue Bonds	$7.8	$6.5	$14.3
Total	**$78.7**	**$30.1**	**$108.9**

[a] Excludes self-liquidating bonds.

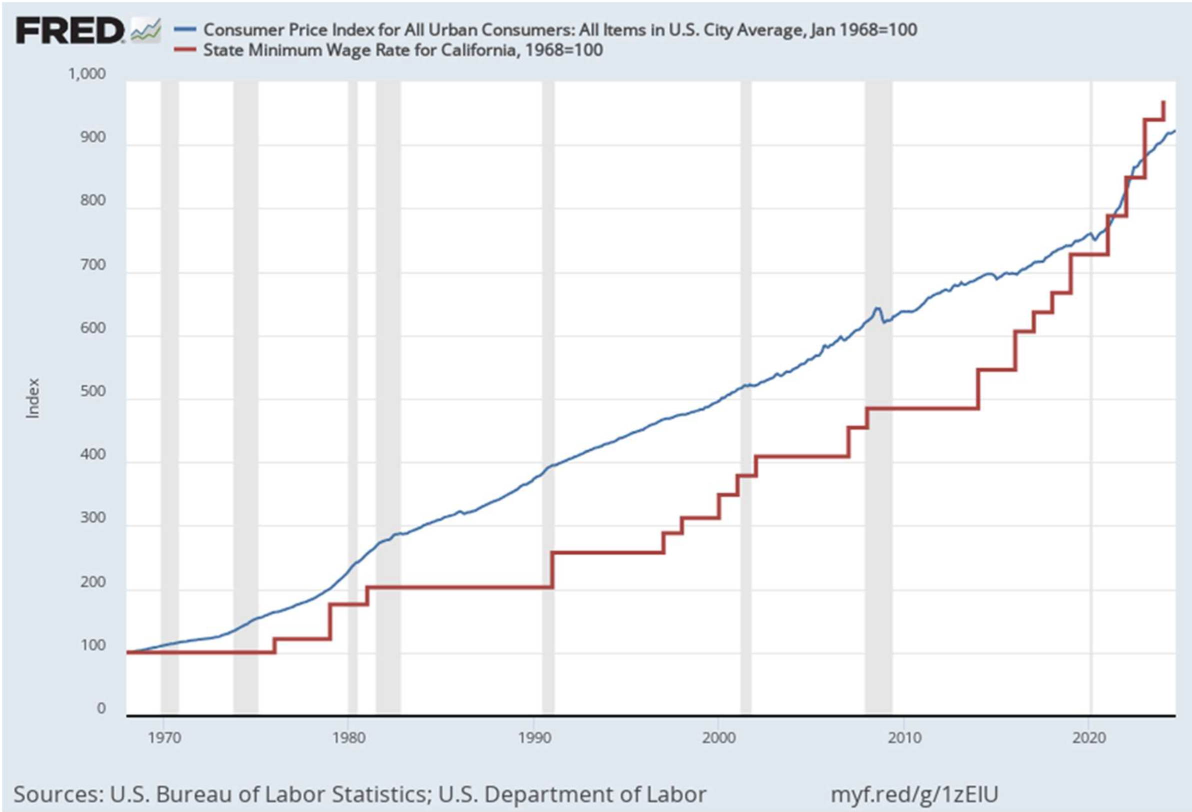
https://lao.ca.gov/LAOEconTax/Article/Detail/798

While there is no direct impact to the City from these bond issuances, staff note two possible takeaways. First, California voters are certainly willing to invest in improving their communities and address the needs of the day with debt financing. A less optimistic conclusion is that the state will have limited capacity to address the challenges of tomorrow by the same means.

Minimum Wage:

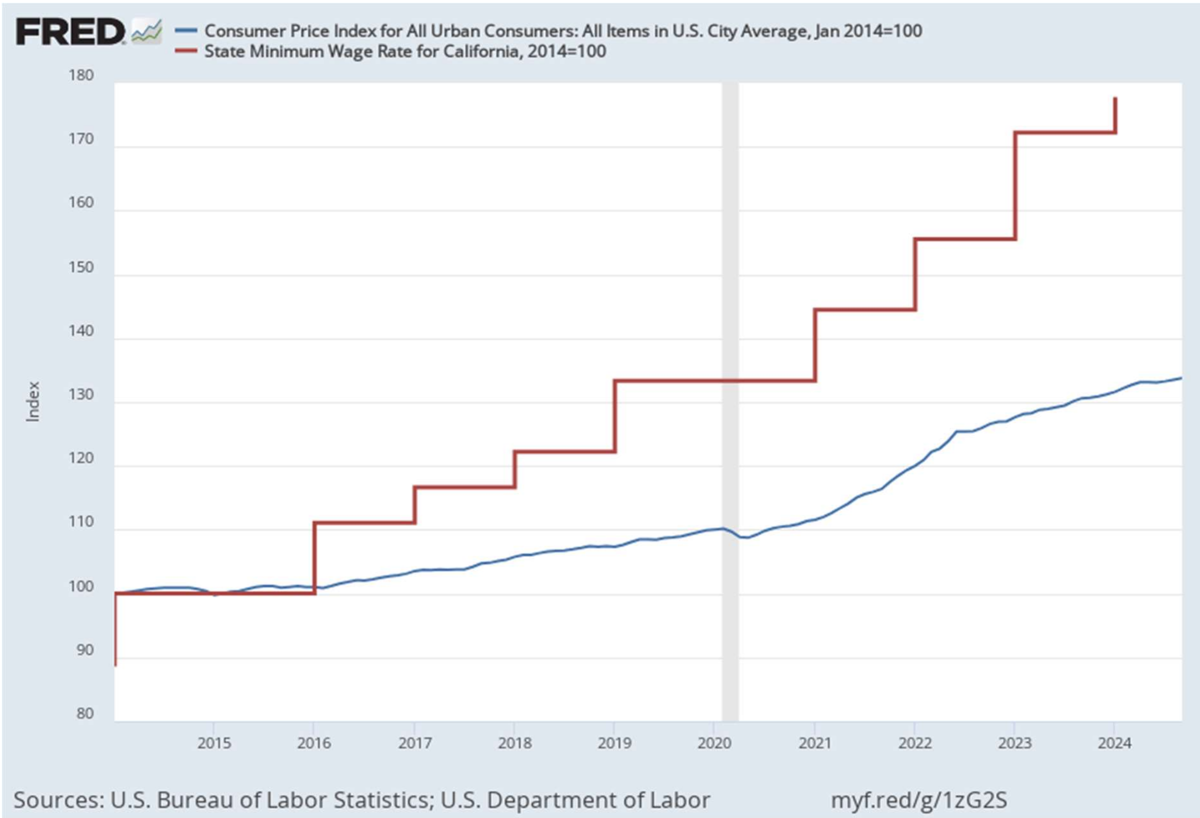
For much of the 20th century, California's minimum wage increases did not keep up with inflation. In 2016, Governor Jerry Brown signed a bill to correct that with phased increases from $10.00 per hour up to $15.00 by 2022. The minimum wage has since been further increased to $16.00 and will increase again to $16.50 on January 1, 2025.

The chart below compares increases in California's minimum wage (in red) and the Consumer Price Index (in blue) going back to 1968, the earliest date that the Federal Reserve publishes California minimum wage data. By 2023, minimum wage finally caught up to cumulative cost of living increases.



https://fred.stlouisfed.org/graph/?g=1zFQt

While this change was necessary to address historical inequities, the increase over the last ten years has been dramatic. Since 2014, the minimum wage has increased by 78% while the consumer price index increased 32%.



https://fred.stlouisfed.org/graph/?g=1zG2Z

On November 5, 2024, voters narrowly rejected Proposition 32, a ballot measure to increase the minimum wage to $17.00 immediately and $18.00 on January 1, 2025. Many supplemental and intern positions at the City are paid the minimum wage or at an hourly rate indexed to the minimum. The annualized cost to increase wages for these employees without creating compaction issues was estimated at roughly $250,000. Implementation of the immediate increase would have created significant operational challenges for the Human Resources and Finance departments and especially payroll staff.

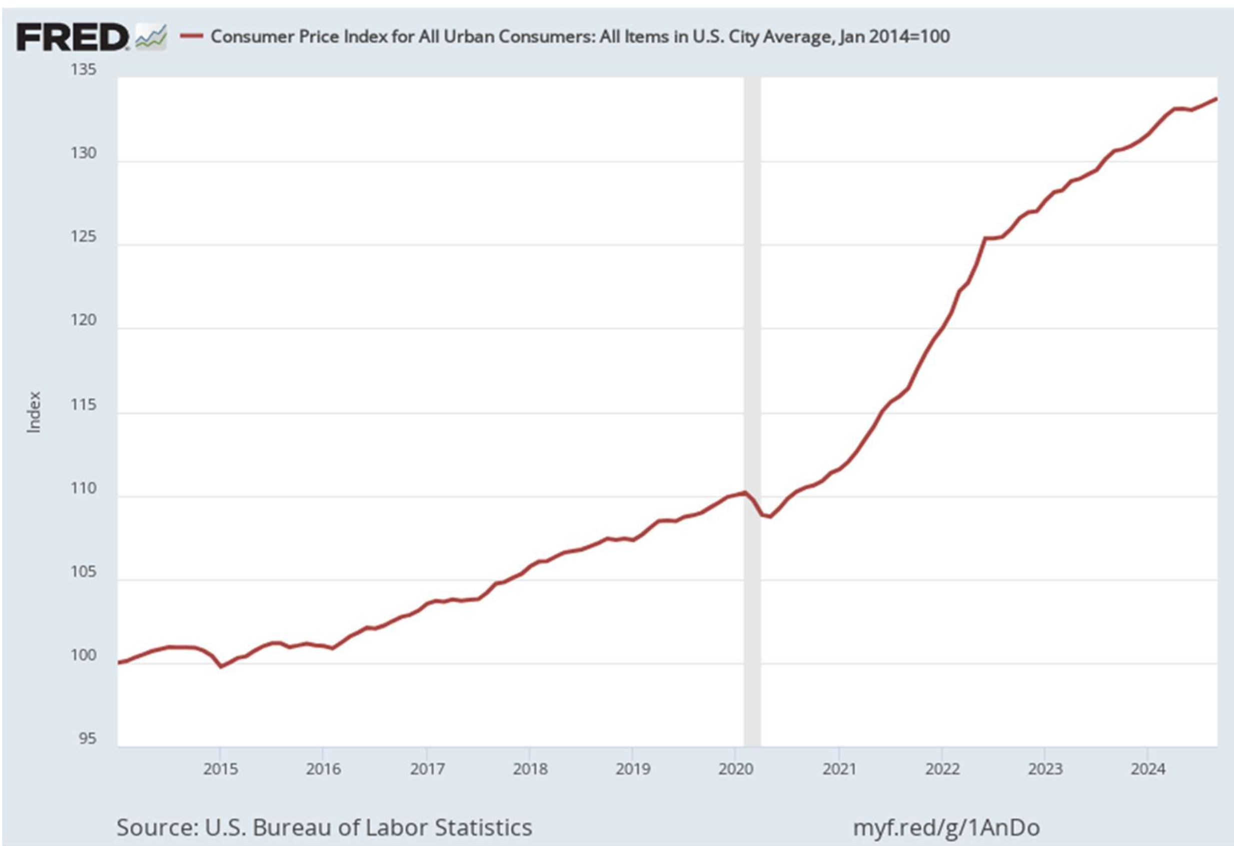
Macroeconomic Conditions: Increased cost of doing business

Inflation

Inflation generally refers to the annual increases in the Consumer Price Index (CPI), Personal Consumption Expenditures Price Index (PCE), and other measures of household spending. These indices are based on the cost to purchase a basket of goods consumed by the typical US urban household.

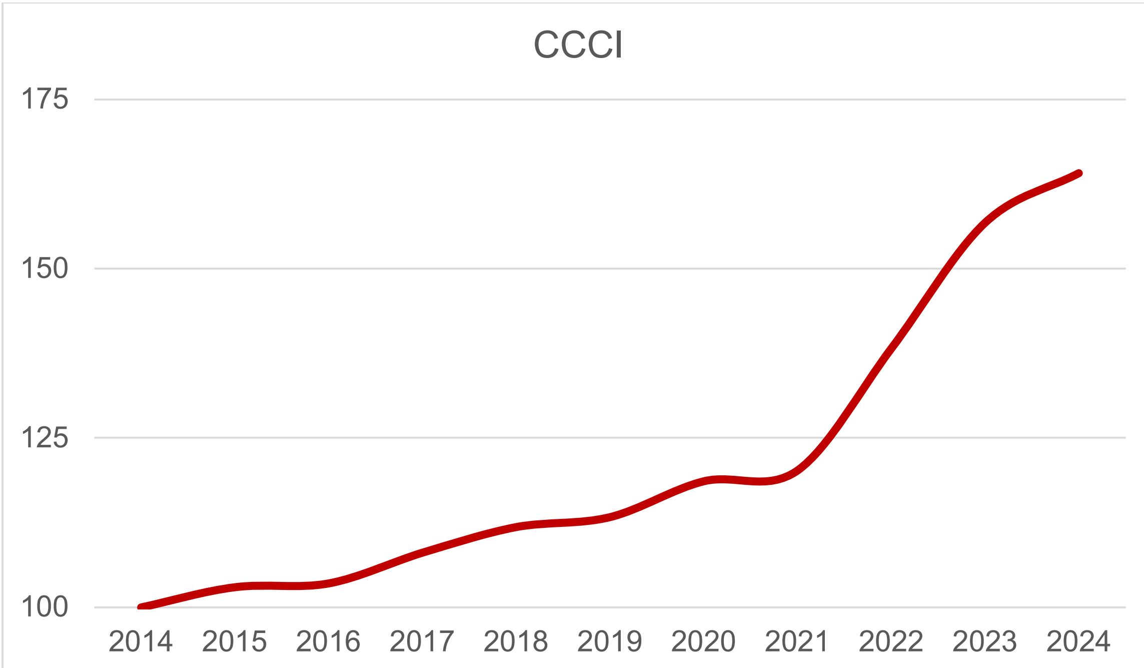
These and other, similar metrics are useful to measure increases in the cost of living over time and, in line with the City's labor philosophy, pay a competitive wage to attract and retain high quality employees. They do not, however, accurately measure price increases in the City's non-staffing expenditures.

According to data from the Federal Reserve, the Consumer Price Index has risen 33% in the last ten years at a compound annual growth rate of roughly 3%. Most of that increase is attributable to the post-COVID inflationary period, when year over year CPI increases peaked at 9% in June 2022.



https://fred.stlouisfed.org/graph/?g=1AnDA

The California Construction Cost Index (CCCI) is published by the California Department of General Services and reports cost trends for specific construction trade labor and materials in the California market. This index is more representative of the costs to complete our Capital Improvements Program than the CPI.



https://www.dgs.ca.gov/RESD/Resources/Page-Content/Real-Estate-Services-Division-Resources-List-Folder/DGS-California-Construction-Cost-Index-CCCI

While the CCCI has followed the CPI's trend of sharp increases post-pandemic, the overall increase has been much more drastic. In the last ten years the CCCI increased 64% in total at a compound annual growth rate of over 5%. This difference in price increases for different goods and services helps illustrate the challenges the City is experiencing in delivering its Capital Improvement Program within engineer's estimates and budgets.

Actual costs

Indexes are useful tools for estimating price changes for a broad variety of purchases, but they rely on numerous assumptions. They assume consumption of a basket of goods in ratios intended to align with the purchasing patterns of the most typical consumer. The City may purchase a drastically different selection of goods and services from the index. Some examples of specific goods and services purchased by the City and the price increases observed in the last ten years are included in the table below.

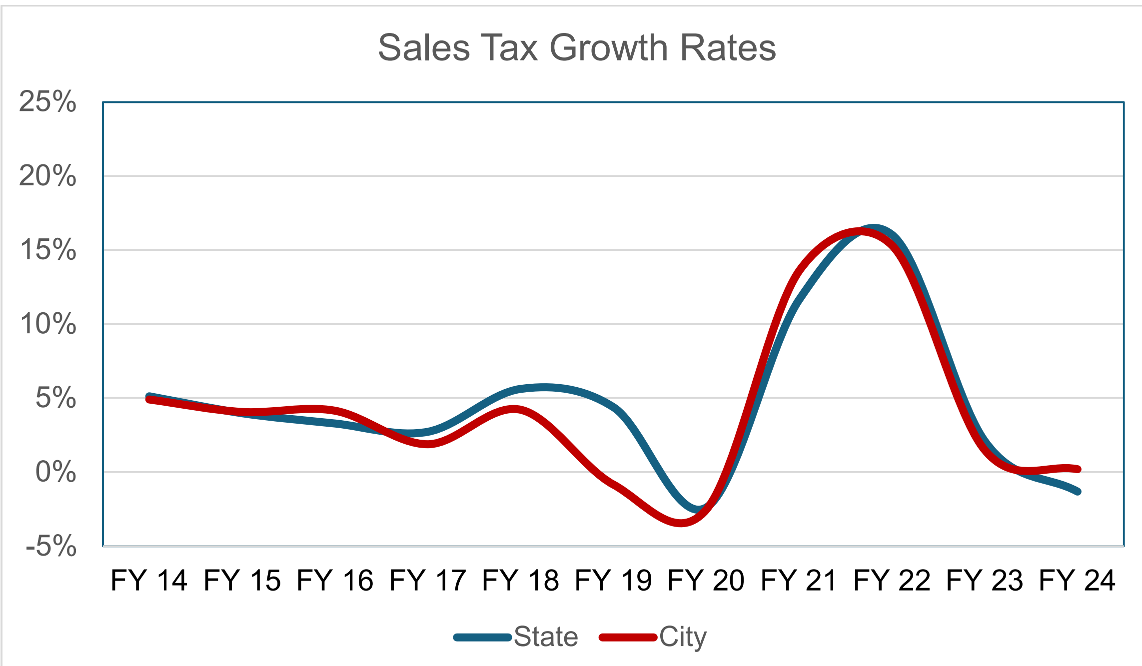
Item	Unit	2014 Price	2024 Price	% Change
Maintenance access cover	Each	$11,499.00	$13,500.00	17%
Slurry Seal	Sq Yd	$1.70	$2.20	29%
Electricity	$/kWh	$0.16	$0.28	78%
Roadway Signs	Each	$85.00	$225.00	165%
OSHA Compliance (low cost)	Per Project	$1,100.00	$2,990.00	172%
OSHA Compliance (high cost)	Per Project	$15,127.00	$30,300.00	100%
CalTrans Compliance	Per Project	$1,000.00	$3,500.00	250%

These costs impact the level of service the City is able to provide, and for fee funded programs, the cost that is charged to the community.

Sales Tax Revenue

Sales tax is the City's largest source of revenue and benefited greatly from post-pandemic consumer trends. With limited options to travel and direct stimulus, consumers increased spending on taxable goods. As inflation took hold, this spending plateaued.

While current revenue levels are high as community members and visitors continue to spend while prices are elevated, near zero growth rates present a challenge for the next financial plan.



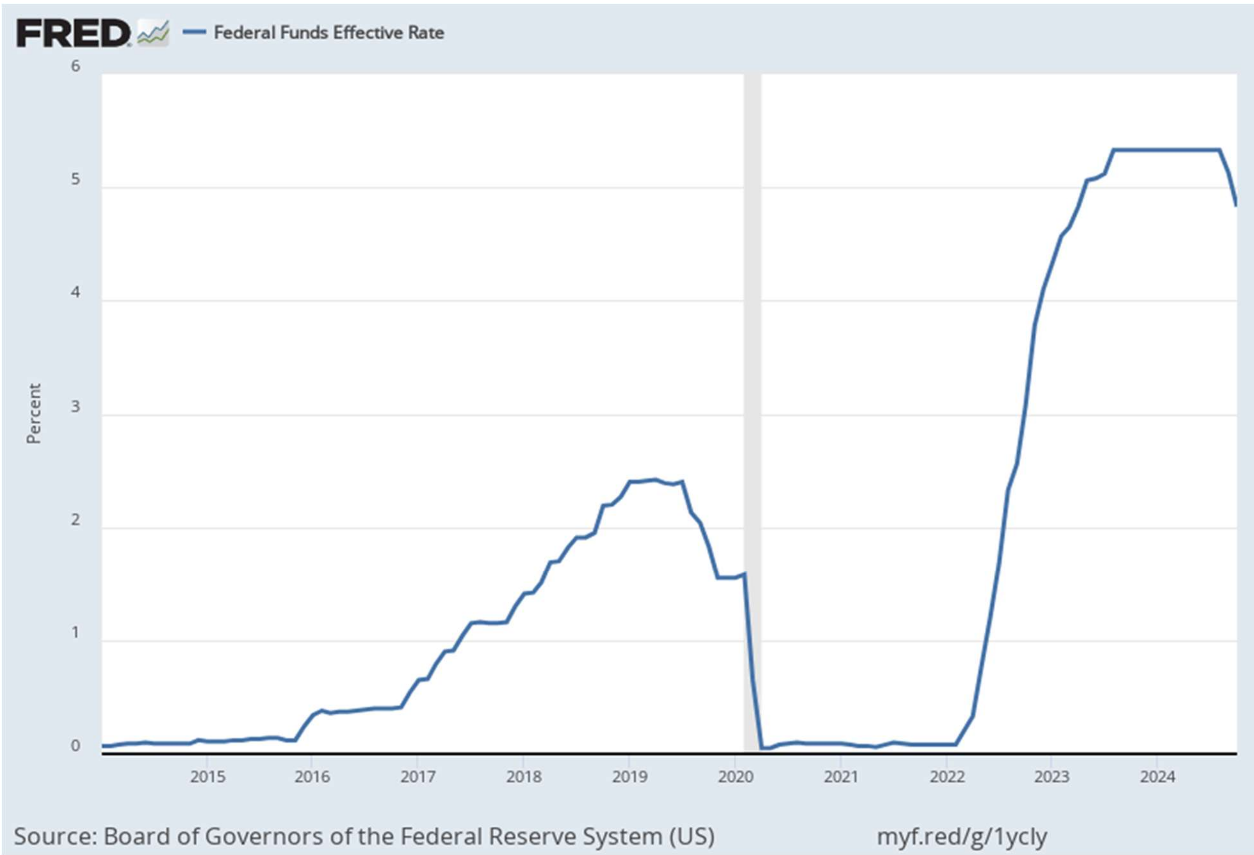
Source: HdL Companies

Interest rates

To combat record inflation, the Federal Reserve increased its policy rates in an effort to reduce aggregate demand and cool the economy. Higher interest rates have since reverberated throughout the markets. The City invests its cash balances in low risk, short duration securities which benefited greatly from these market conditions.

Since the end of the last fiscal year, the Federal Reserve has reduced its benchmark interest rate by 75 basis points and has signaled further reductions. The future course of interest rates is highly uncertain. Still, rates are high compared to recent years and should market rates follow the Fed's projections, the City will continue to benefit from higher investment income.

While the City benefits from higher investment income, we also see negative impacts from higher interest rates. Development activity is highly sensitive to borrowing costs and we have observed a slowdown in development and fee revenues since interest rates began to increase. There is also some evidence that higher interest rates are weighing on sales tax earned on rate sensitive purchases like new cars and building materials. The City may also see higher borrowing costs if debt financing is needed for future infrastructure projects and rates remain elevated.

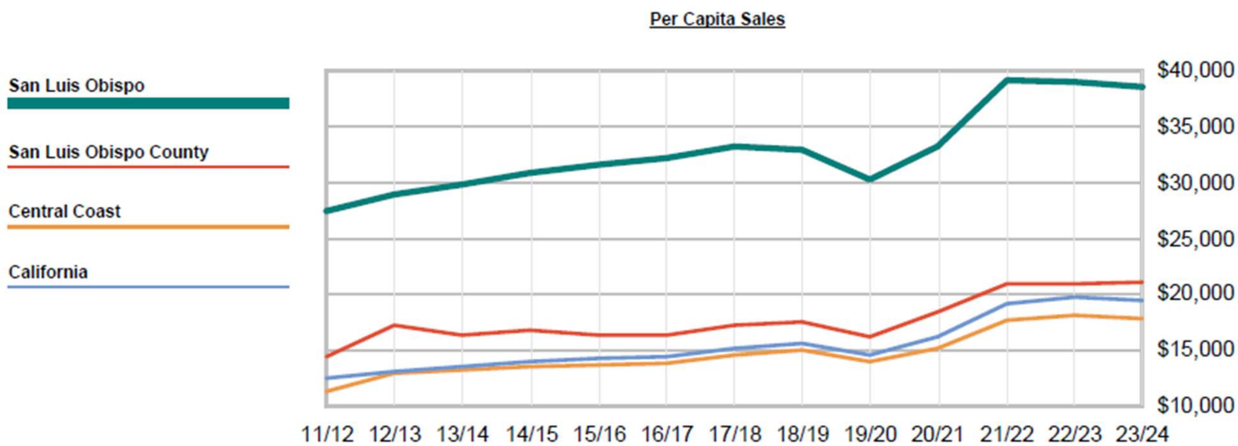


https://fred.stlouisfed.org/graph/?g=1AADx

Costs Associated with a Growing Community

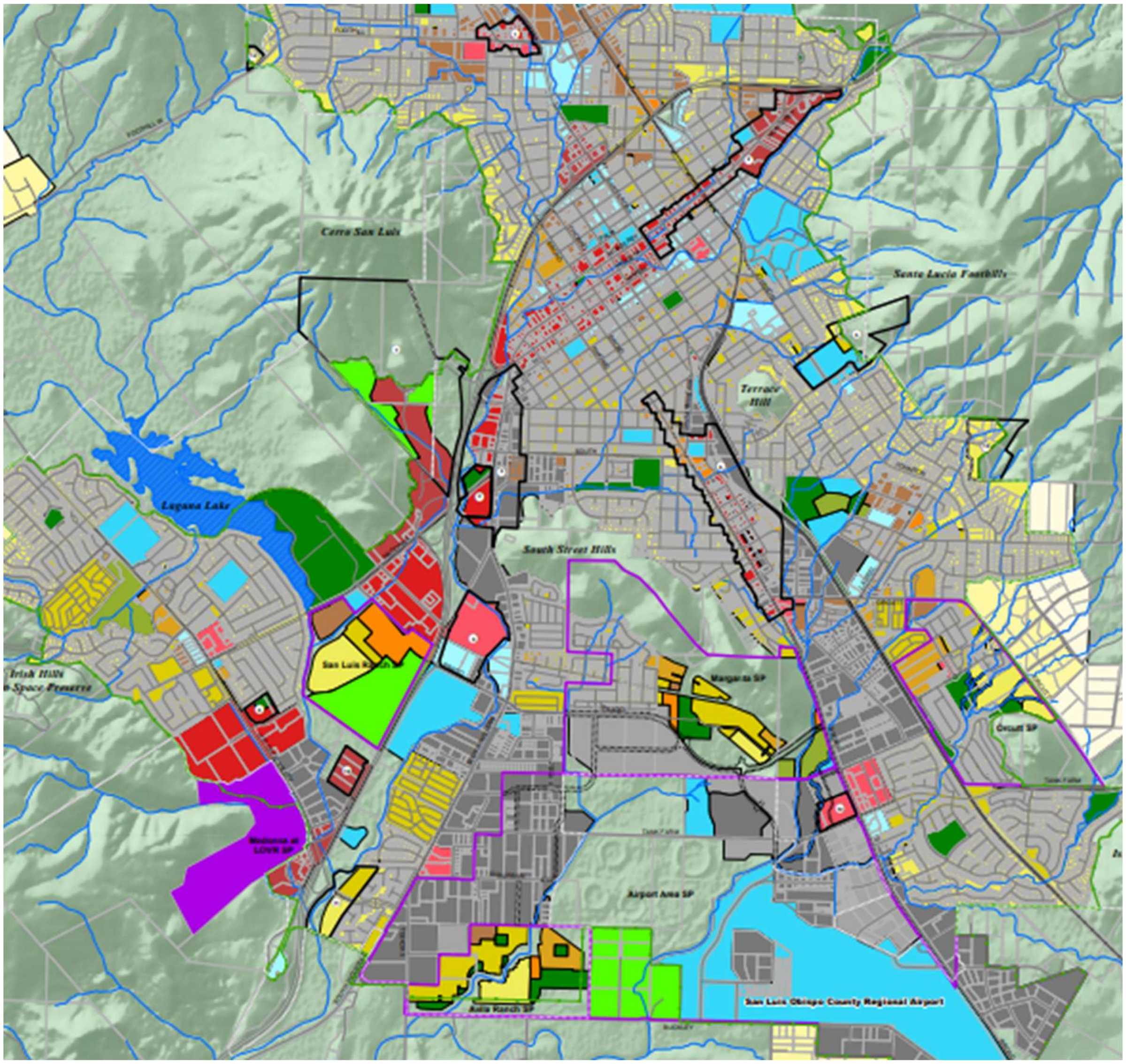
The City offers a high level of service to its residents. This is possible at least in part because of the tax revenue generated from out of town visitors who come to San Luis Obispo to vacation, enjoy the downtown, shop in big box stores, or purchase cars.

As a result, our City sees per capita taxable sales of nearly double the statewide average:



Source: HdL Companies

According to Census data, the City's population grew 4% in the ten years from April 1, 2010, to April 1, 2020, and grew another 5% from April 1, 2020, to July 1, 2023. Many of the new community members welcomed in recent years moved into our specific plan areas bordered in purple in this map, which can also be accessed in high resolution at the link below:



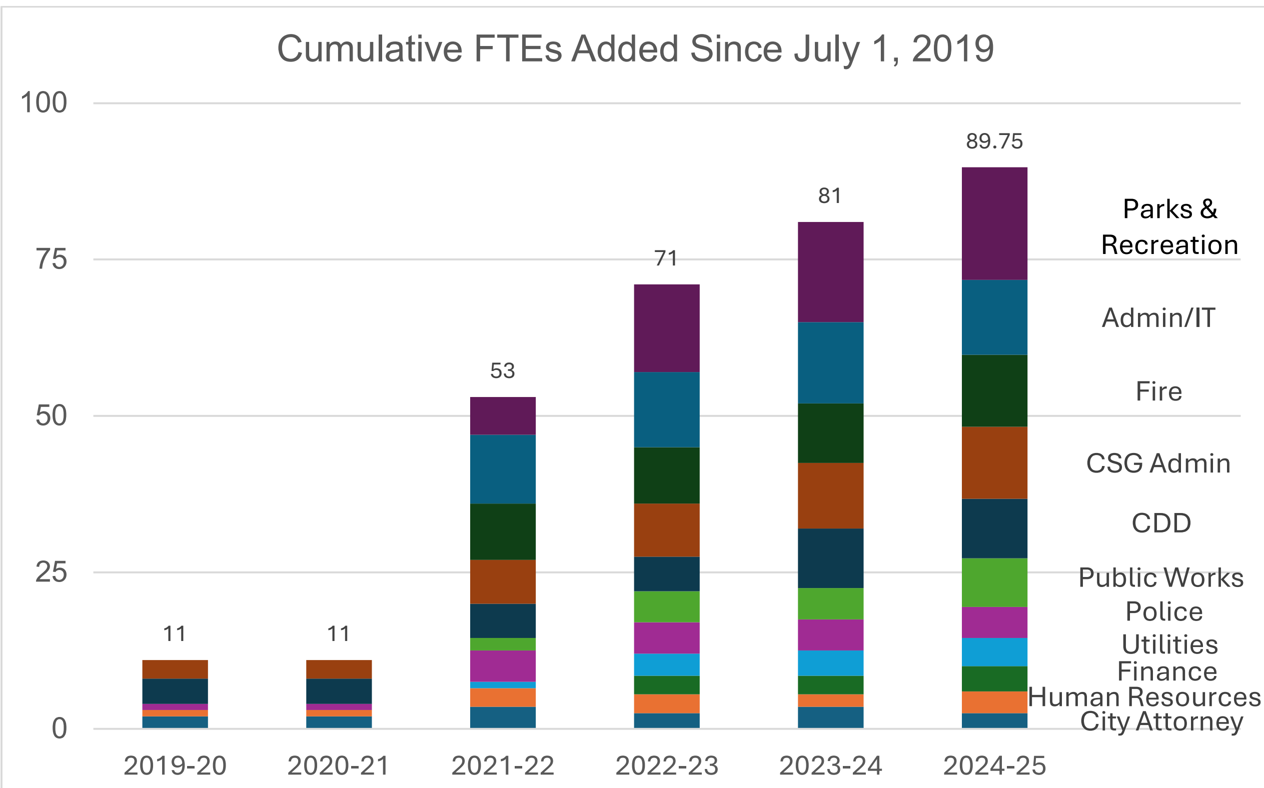
https://www.slocity.org/home/showpublisheddocument/5857/637371427716100000

Much of this development activity has occurred at the perimeter of the city. This can increase the need for additional infrastructure construction and maintenance. For instance, development on the City's Southern border will necessitate construction of a fifth fire station, and development in the Western portion of the City, when combined with regional trips, contribute to the planned construction of an interchange over Highway 101 at Prado Road. These two projects are projected to cost several times our annual capital expenditures budget.

Community growth also contributes to demand for basic services provided by the City like public safety, recreation opportunities, and more. Data suggest that residents are in fact engaging with the City more often and using more of the services we provide. Over the last ten years, demand for a broad variety of services has grown more quickly than the population:

	2014	2024	% Change
Public Safety Calls for Service	34,659	41,683	20%
Fire Service Responses	5,192	7,119	37%
Building Inspections	8,996	9,948	11%
Youth Athletics Participants	1,200	1,368	14%
Open Space Acres	3,510	4,040	15%
Trail Mileage	49	67	37%

The community has also shown its willingness to pay for these services, as evidenced by the passage of Measure G-20 in November 2020. Since passage, the City's Capital Improvements Program budget has tripled and the City has hired a number of Full Time Employees (FTE) to provide increased service levels and add new programs.



These investments in the capital budget and staff have enabled the City to keep up with increased demand for its services over the last few years. As the City develops the next Financial Plan, it will be necessary to moderate expenditure growth in order to hold space in the budget for the significant infrastructure investments that the City has committed to. Staff expects that reprioritization of existing resources will be needed in order to fund any new programs or services.