City of San Leandro
Long-Term Financial Forecasting Model

Presentation to City Council

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Management Partners

January 28, 2019

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Extensive Forecasting Expertise

Experience in state and local government finance

- Over 44 years in government finance
- 26 years as Fairfield's Finance Director, 3½ years Asst Director in Sacramento
- 6½ years as tax policy consultant to California Legislature, on team that implemented Proposition 13 in 1978
- 8 years consulting on local agency budget and finance issues, including 3 years on Stockton bankruptcy

Credibility in field of long-range forecasting

- 30 forecast models created for cities, counties and districts
- Stockton model vetted in Bankruptcy Court against creditor challenges

Forecast Model Project

1. Identify Factors Driving Forecast

- Pressures on revenues and spending levels over next 10 to 20 years
- Focus on General Fund

2. Create Baseline Forecast

- Long-term projections under current service levels and known increases, using realistic growth assumptions, and before corrective actions

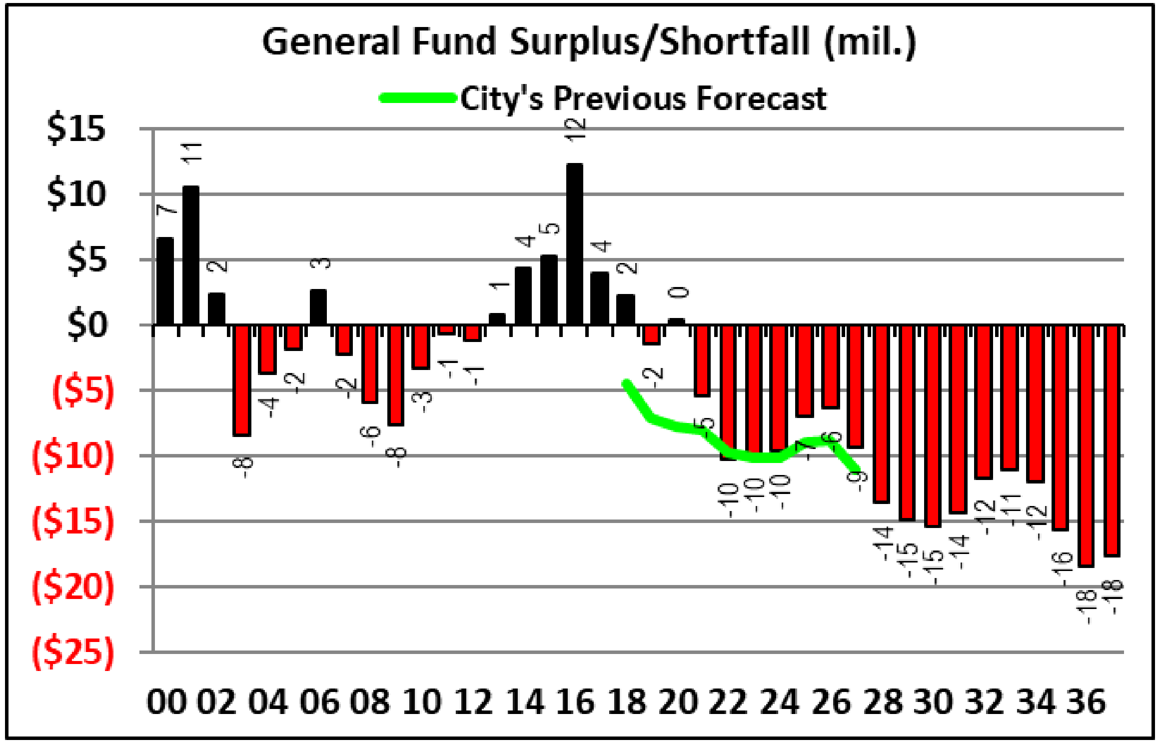
3. Test Alternative Outcomes

- Recession, revenue growth, cost of living adjustments (COLAs), staffing levels
- Costs not in baseline budget needed to make current level of services sustainable over the long-term

4. Develop Budget Strategies *(optional)*

- Impact of spending cuts or revenue increases needed to balance forecast

"Most Likely" Scenario Similar to City Forecast



Scenario:
Moderate Spending and Moderate Economy

- Similar to previous City 6-year forecast with the following updates:

City
  - FY18 actuals (revenues were higher, and costs lower)
  - FY19 revenue estimates increased
  - New bond debt service

MP
  - Includes moderate recessions every 7 years starting FY21
  - Property tax higher
  - Overtime higher
  - Health costs lower
  - Pension costs higher due to assumed lower discount rate in future years
  - Capital higher with added street funding

Forecast Model

- Advantages
- Features
- Assumptions

No Two Forecast Models are Alike

- **San Leandro has much in common with other agencies**
  - Staffing loss, wage pressures, doubling of pension costs
- **Model is tailored to each agency's unique issues**
  - Policies and priorities, accounting system, tax structure, unmet needs
- **Forecast model provides foundation for future budget strategies**
  - Not a replacement for annual budget, which sets detailed spending priorities
  - Identifies available resources under given set of assumptions
- **Numbers will change!**
  - Different assumptions = different forecast
- **City owns the model**

New Forecast Model Advantages

- Can run numerous scenarios to test sensitivity of city finances to economic or spending changes
- Assumptions spelled out clearly
- Dynamic and easy to update
- Dashboard provides visual impact of outcomes as assumptions are changed
- Early warning of adverse trends
- Promotes long-term sustainable solutions

Major Revenue Features

- **Revenue Growth -** sales tax projections based on expertise of City's outside tax consultant/auditors; growth rates set by component of property tax and business sector for sales tax; other revenues have own growth rates
- **Recessions -** adjustable timing and magnitude for recessions to "stress test" forecast (most models omit recession impacts or just use more conservative estimates)
- **Revenue Options -** shows impact of adding new revenues, or loss of current sources
- **New Development -** uses projected new housing and hotels or other development to be consistent with Planning forecasts

Major Expenditure Features

- **Base Costs -** starts with detailed costs for all current employees/authorized positions using position control
- **Labor -** aggregates payroll costs by fund and bargaining unit to aid in labor negotiations
- **Wage Impacts -** COLAs, merit increases, savings based on historical turnover rates (most models do not address issue of turnover)
- **Attrition -** shows impact if vacant positions are eliminated upon turnover
- **Service Levels -** add/reduce positions or spending levels to show impact of unmet needs or budget cuts (part of alternate scenarios)
- **Pensions -** projects normal costs and each Unfunded Accrued Liability (UAL) amortization base for all plans and tiers through 2050 per 2017 CalPERS valuation; shows impact of lower benefit levels under state law, lower discount rates, and prepayment options

Key Assumptions

- <u>What City Can Control</u>

  Spending

  - Salaries
  - Staffing Levels
  - Capital Spending

- <u>What City Does Not Control</u>

  The Economy

  - Recessions
  - Inflation
  - Pension Obligations and Discount Rates
  - Sales Tax Growth

Not best- and worst-case scenarios, but range of "reasonable" outcomes

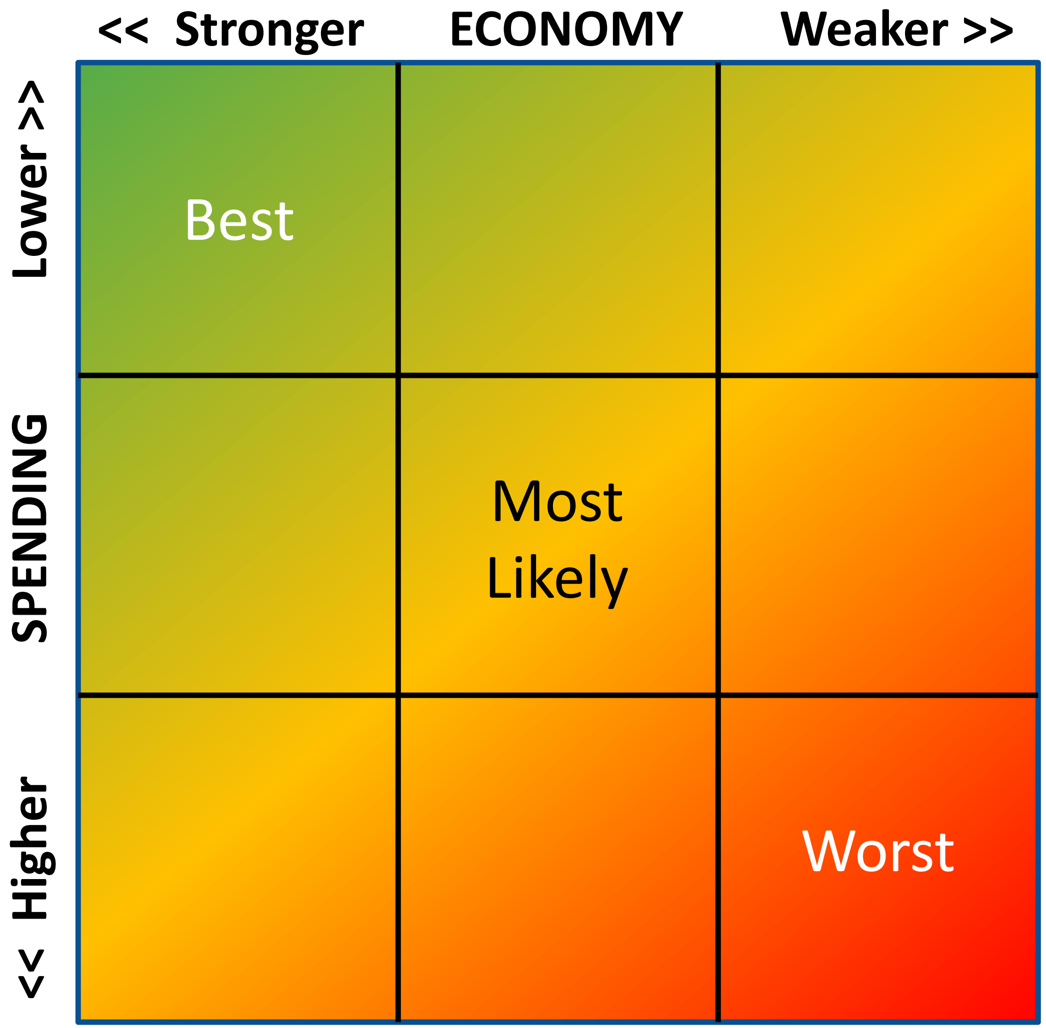
Assumptions Combine to Create 9 Scenarios

Spending Levels

- Higher Spending
- Moderate Spending
- Lower Spending

The Economy

- Stronger Economy
- Moderate Economy
- Weaker Economy



Spending Factors

- COLAs
- Staffing
- Capital

Recent Wage Increases by Labor Unit by Fiscal Year

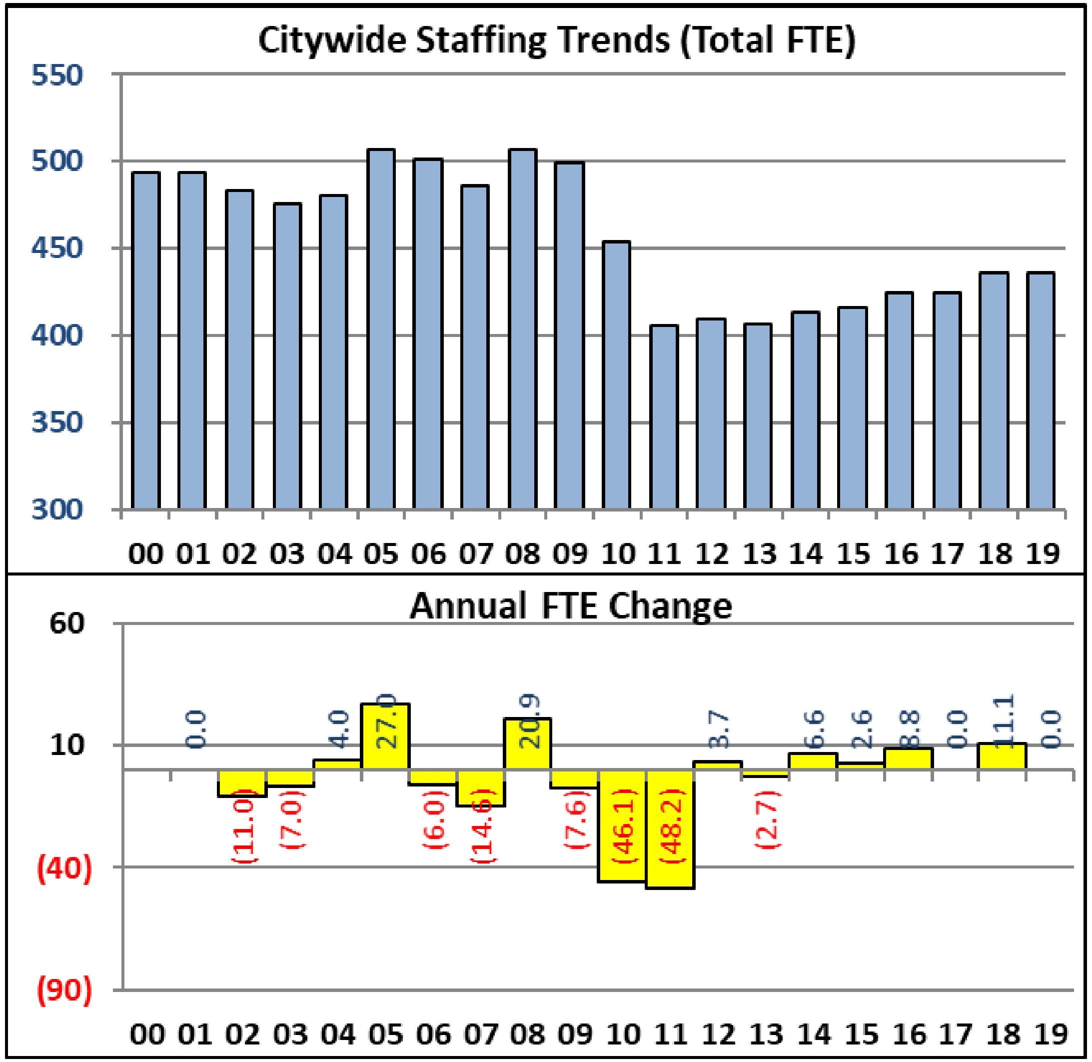
Unit	FY14	FY15	FY16	FY17	FY18	FY19	FY20
SLPOA	4% 1/1/14	3% 1/1/15 Add 6th step (5%)	3% 1/1/16	$4000 retro pay 3% 12/1/16	3% 7/1/17	3% 7/1/18	2% 7/1/19 2% 10/1/19
SLPMA	3% 7/1/13	4% 7/1/14 5% 6/1/15	3% 1/1/16	3% 1/1/17	3% 1/1/18	3% 1/1/19	
SLCEA	3.5% 10/1/13	3.5% 7/1/14	3% 7/1/15 3% 1/1/16	3% 1/1/17	3% 1/1/18	3% 1/1/19	3% 1/1/20
SLMO	2.5% 10/1/13	3.5% 7/1/14 4% 6/1/15	3% 1/1/16	3% 1/1/17	3% 1/1/18	3% 1/1/19	3% 1/1/20
Conf.	2.5% 10/1/13	3.5% 7/1/14 4% 6/1/15	3% 1/1/16	3% 1/1/17	3% 1/1/18	3% 1/1/19	3% 1/1/20

- Significance:
  - COLAs are a major driver of personnel costs
- Context:
  - Personnel accounts for 54% of General Fund spending
  - COLAs generally above inflation

Salary COLAs

Scenario	Assumption	Rationale
Higher Spending	3.0%	• Recent Labor Memorandums of Understanding (MOUs) have averaged around 3% annual COLAs, higher for safety
Moderate Spending	2.0%	• Federal Reserve's core inflation goal is 2%
Lower Spending	1.0%	• Half of the Federal Reserve's core inflation goal of 2%

Staffing Levels

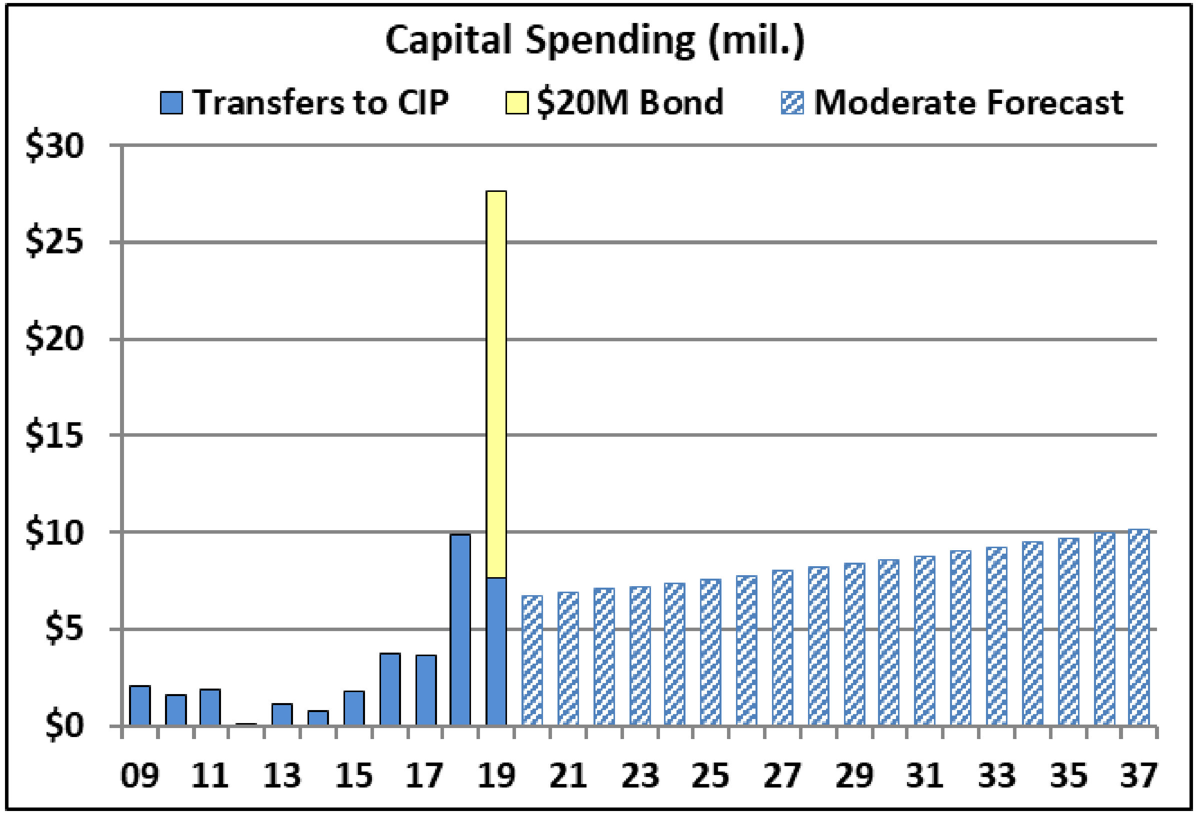


- Significance:
  - Determines level of service, ability to respond to growth and higher workload demands
- Context:
  - Initial loss of 20% (-102 Full Time Equivalents) from pre-Great Recession peak for all funds
  - General Fund has added back 33 positions, an average of 4.2 FTE/year, over past 8 years
  - Approximately 4% of General Fund positions are currently vacant

Staffing Levels

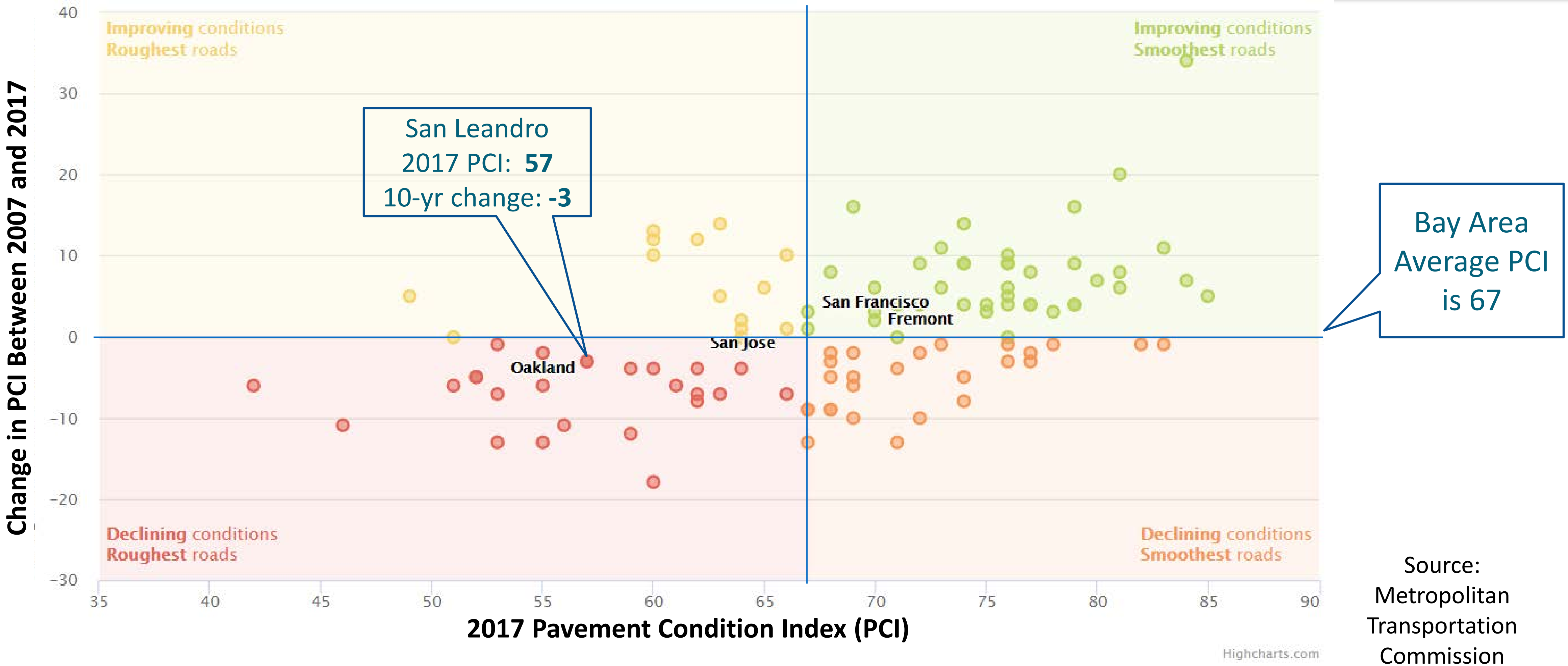
Scenario	Assumption	Rationale
Higher Spending	Add 2 FTE annually	• Half of 8-year average of positions added per year (which does include recession recovery)
Moderate Spending	Add 1 FTE annually	• City added 1.0 FTE in FY19 (most recent experience)
Lower Spending	No Change in FTE	• Maintains status quo staffing levels

Capital Spending



- Significance:
  - Determines ability to maintain and improve City's investment in its infrastructure
- Context:
  - Previous City forecast projected an average of $3.5M for annual General Fund contribution to Capital Improvement Program (CIP)
  - Additional funding should be considered for street resurfacing due to City's low Pavement Condition Index (PCI)

City's Pavement Condition Index is in At-Risk Category



Source: Metropolitan Transportation Commission

- City's General Plan goal for street resurfacing is to maintain a PCI of 76, while the current PCI is only 57 (a score of 50-59 is regarded as "at-risk" by MTC)

Street Maintenance Funding Needs

- According to staff, $23M annual investment in streets is required to achieve PCI of 76 over 10 years
- Current ongoing funding totals $7.3M, including $1.4M in ongoing SB 1 Gas Tax funds
- Unless another funding source is obtained, the General Fund will need to make up the funding gap; contribution level depends on the PCI goal

(mil.)	FY20 Funding	General Fund	Total Funding	Outcome
HUTA	$2.2			
VRF	0.4			
Measure B	1.7			
Measure BB	1.6			
SB 1 RMRA	1.4			
Total	7.3	3.2	10.5	maintain PCI at current 57
Total	7.3	6.4	13.7	improve to PCI=62 over 10 years
Total	7.3	9.5	16.8	improve to PCI=66 over 10 years
Total	7.3	15.7	23.0	improve to PCI=76 over 10 years

HUTA=Highway Users' Tax Account (Gas Tax)
VRF=Measure F Alameda County Vehicle Registration Fee Program
RMRA=Road Maintenance and Rehabilitation Account

Capital Spending

Scenario	Assumption	Rationale
Higher Spending	$9.9M annually	• Equal to $3.5M average capital funding in City forecast, plus $6.4M dedicated for street resurfacing (improves PCI)
Moderate Spending	$6.7M annually	• Equal to $3.5M average capital funding in City forecast, plus $3.2M dedicated for street resurfacing (maintains current PCI)
Lower Spending	$3.5M annually	• Equal to $3.5M average capital funding in City forecast, with no added funding dedicated to street resurfacing (current PCI will decline)

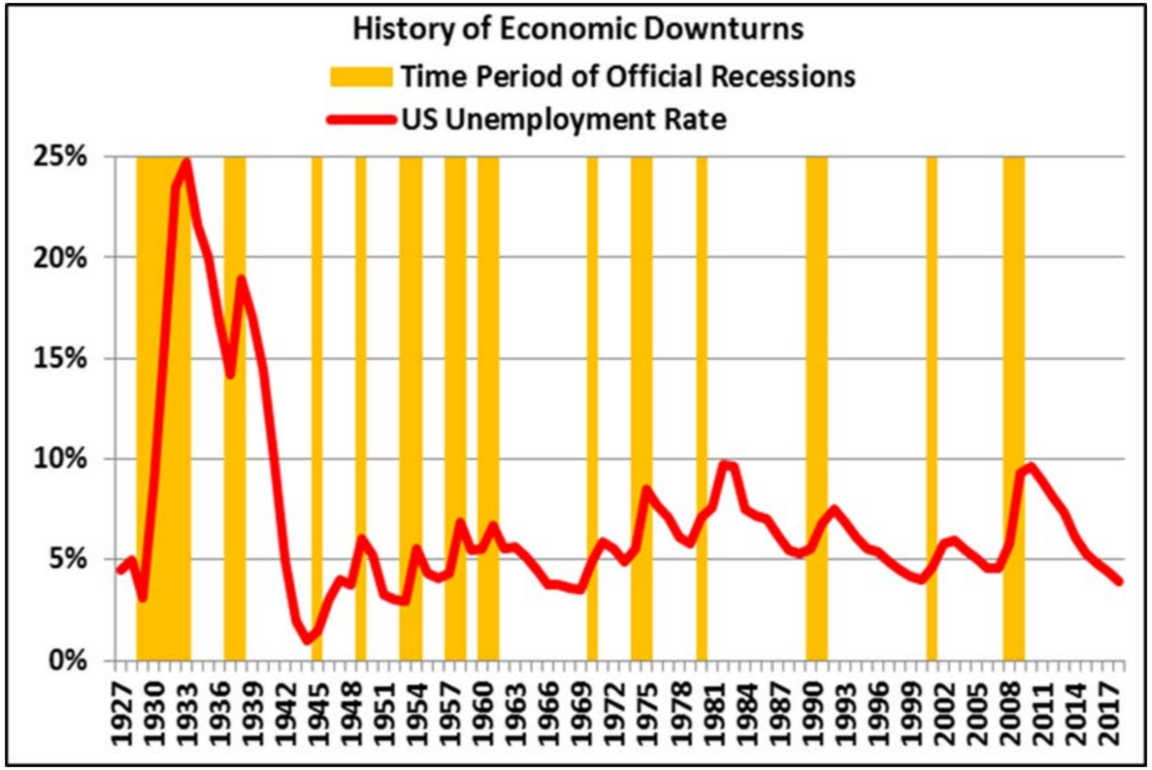
Funding level is for FY20; funding grows at CPI thereafter; a portion of the $3.5M general CIP allocation may also be spent on streets in certain years

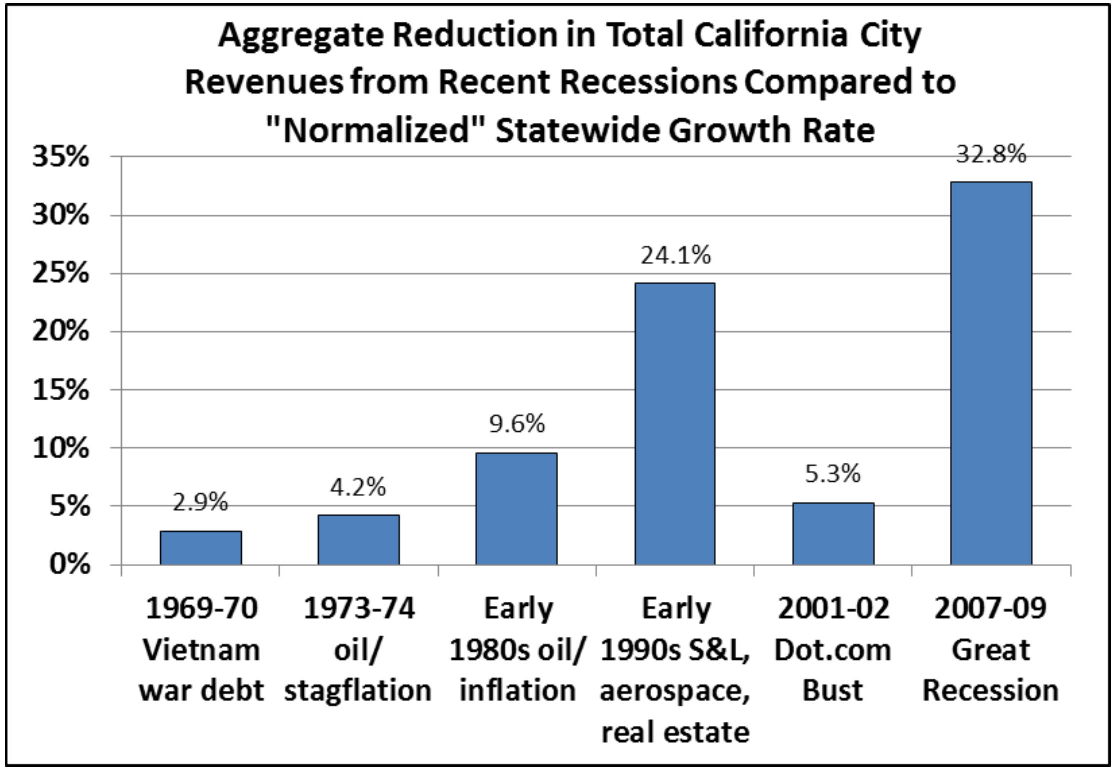
Economic Factors

- Recessions
- Inflation
- Pensions
- Sales Tax

Recessions

- Significance: Economic downturns can have significant adverse impact on major General Fund revenues



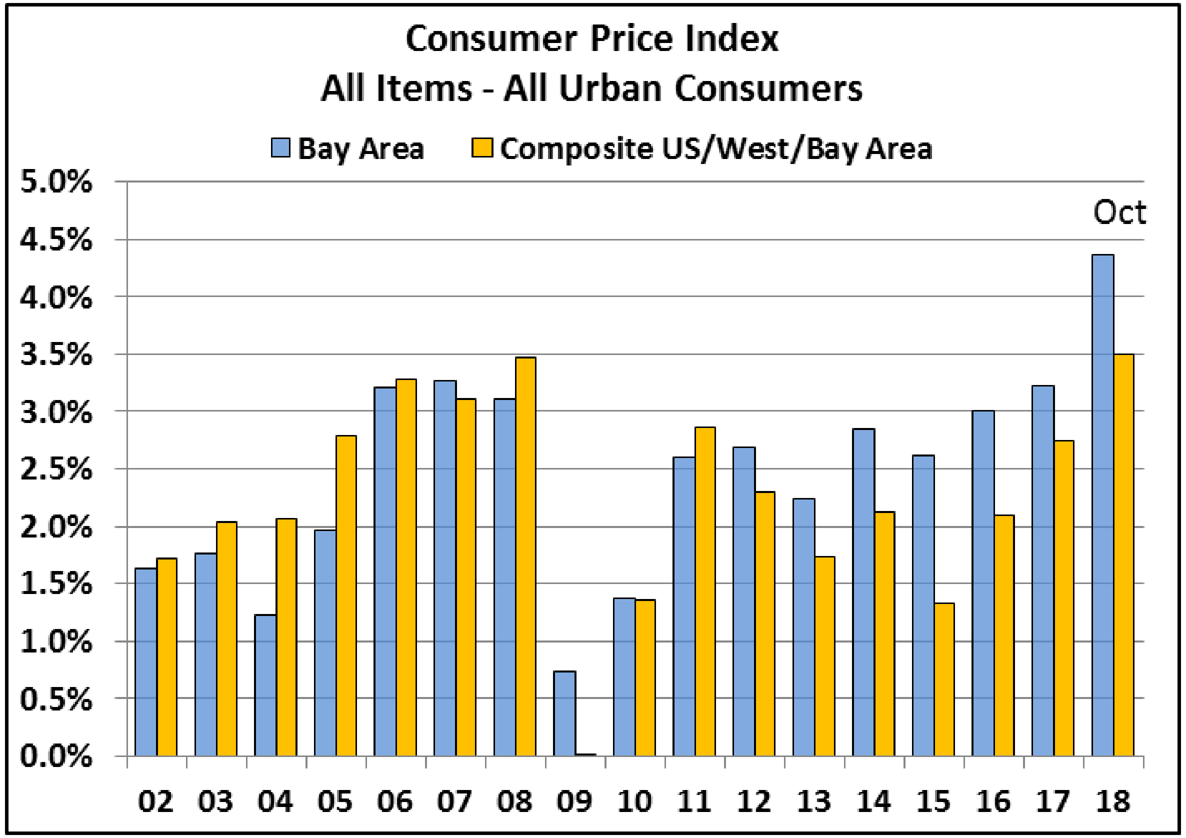


Recessions

Scenario	Assumption	Rationale
Stronger Economy	-2% prop tax, -5% sales tax, over 12 months	• Equivalent to average impact of Dot.com Bust recession of 2001-02
Moderate Economy	-3% prop tax, -7.5% sales tax, over 18 months	• Average of two middle-impact recessions of the six since 1960's (Dot.com Bust and early 1980's)
Weaker Economy	-4% prop tax, -10% sales tax, over 24 months	• Equivalent to average impact of recession in early 1980's

All scenarios assume next recession starts in FY21 and on a 7-year cycle thereafter, with a 3-year recovery period

Inflation

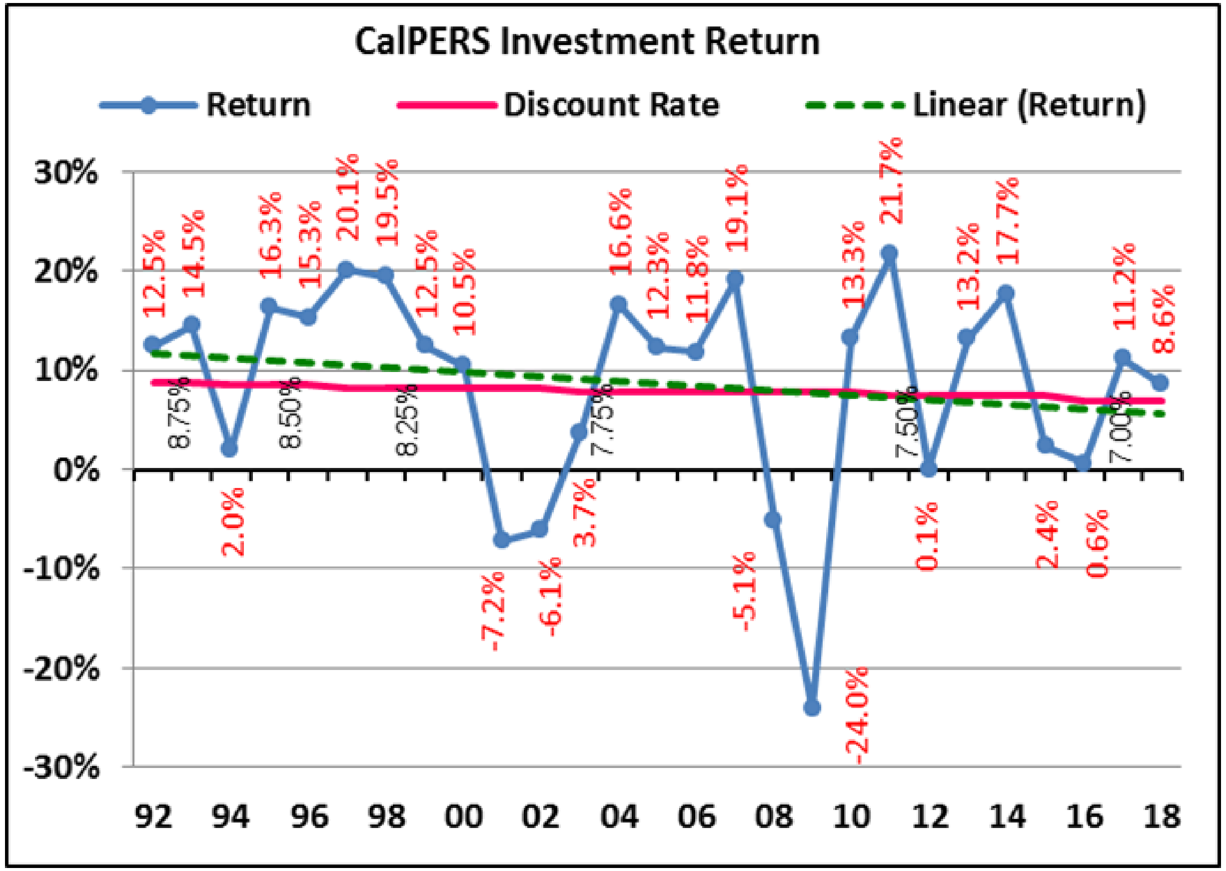


- Significance:
  - Affects growth of many revenues as well as expenditures; major influence on labor negotiations
- Context:
  - CPI often used as a benchmark for annual cost of living adjustments in labor MOUs
  - Bay Area index higher due to housing prices
  - Federal Reserve long-term inflation target has been 2.0% since the 1980s
  - Average growth: 2.46% for Bay Area and 2.27% for composite measure

Inflation

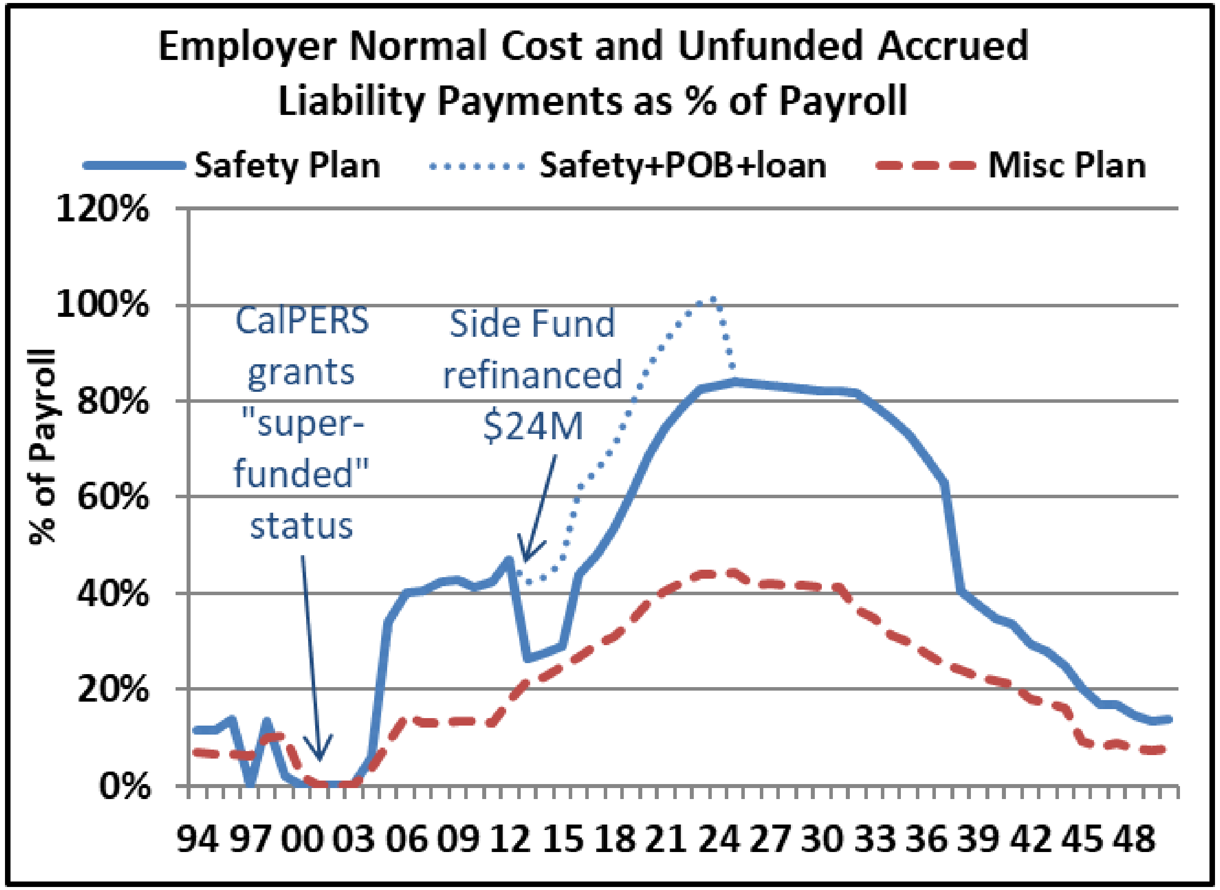
Scenario	Assumption	Rationale
Stronger Economy	2.0%	• Federal Reserve's core inflation goal is 2%
Moderate Economy	2.5%	• Bay Area CPI has averaged 2.46% over the 17 years since 2002 (end of Dot.com Bust)
Weaker Economy	3.0%	• Bay Area CPI has averaged 3.05% over the past 6 years

Pension Discount Rate



- Significance:
  - Greatest impact on the level of CalPERS' normal cost pension rates and level of unfunded liability
- Context:
  - Discount rate has dropped from 8.75% to 7.0% over 27 years
  - In Nov-2016 Wilshire Associates, a key CalPERS investment advisor, predicted a 6.2% return over the next decade
  - Lower rates remain a risk in the future

City Pension Rate Forecast

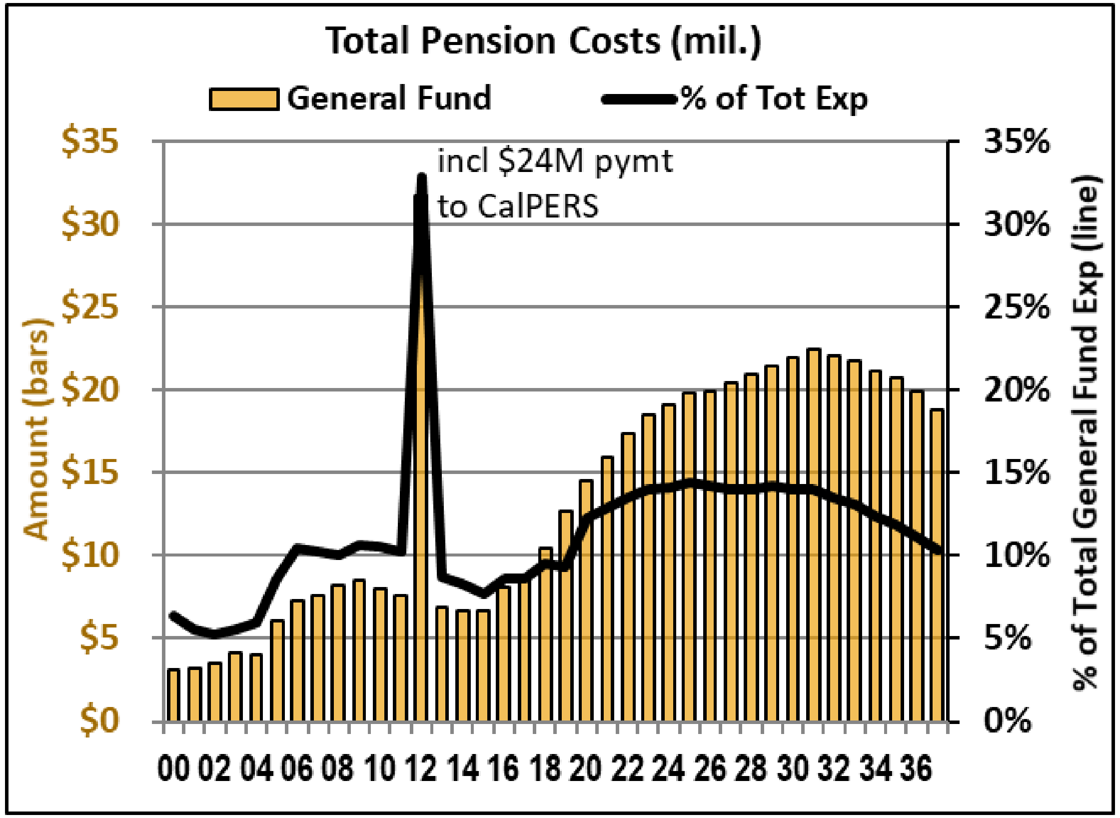


PEPRA=Public Employees Pension Reform Act of 2013; reduced retirement benefits for new hires

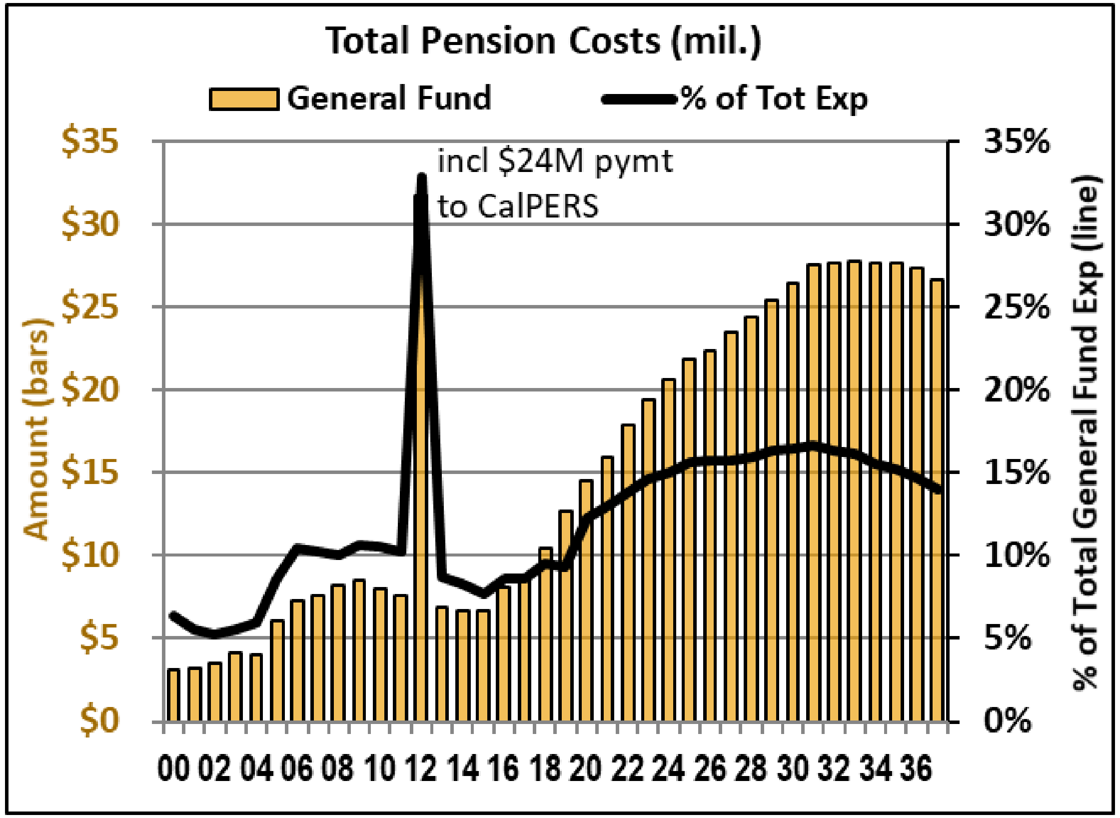
- Forecast starts with 2017 CalPERS valuation (updated annually)
- Includes planned rate increases due to phase-in of CalPERS rate structure changes
- Rates would be higher without Pension Obligation Bond (paid $18M of $24M total special contribution in FY12); ultimate success depends on CalPERS investment returns
- PEPRA savings as new employees receive lower benefits, and amortizations of unfunded liability paid off
- Normal costs are all that remain after unfunded liability is paid off
- Assumes 7% discount rate

General Fund Pension Costs

Assumes discount rate continues at 7.0%



Assumes discount rate declines to 6.0%



A 6% discount rate phased in over 20 years adds $68M in costs through FY37

Pension Discount Rates

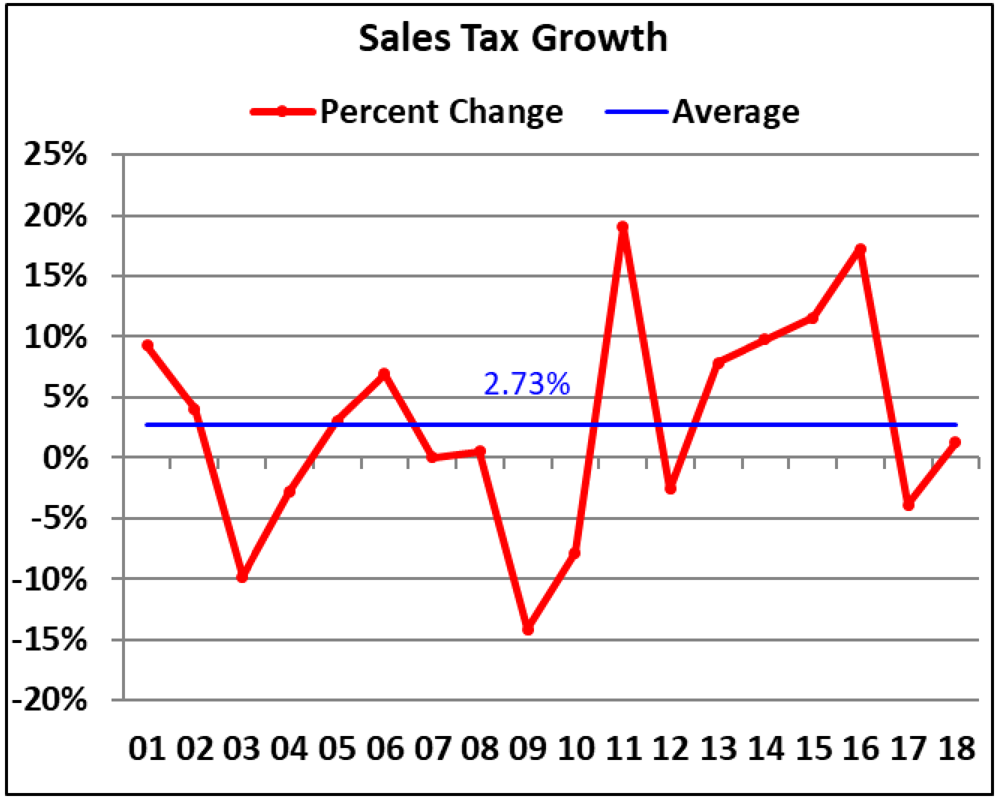
Scenario	Assumption	Rationale
Stronger Economy	Maintain current 7.0% rate	• 7.0% is the status quo (but CalPERS efforts to reduce rate volatility will require less investment risk and thus lower returns)
Moderate Economy	Phase-in to 6.0% over 20 years	• Investment advisors forecast 6.2% average return over next decade; John Bartel projects decline to 6% over 20 years
Weaker Economy	Phase-in to 6.0% over 10 years	• Extending trend of discount rate decline over past 27 years yields 6% in 10 years

Sales Tax Growth

- Significance: Sales Tax is the largest revenue source and most affected by economic cycles, retail trends and technology

AVENU INSIGHTS "MOST LIKELY" SALES TAX GROWTH	FY18	FY19	FY20	FY21	FY22	FY23
Business Sector	2.1%	3.4%	4.2%	3.2%	3.1%	3.0%
General Retail	-0.4%	1.8%	2.6%	3.4%	3.3%	3.2%
Food Products	4.5%	1.9%	1.0%	1.6%	1.5%	1.5%
Transportation	2.1%	9.1%	4.1%	5.1%	4.8%	4.6%
Construction	4.7%	-1.4%	-1.7%	3.6%	3.5%	3.4%
Business to Business	-5.4%	13.2%	7.9%	5.2%	5.0%	4.7%
State & County Pools	0.0%	1.2%	4.6%	3.8%	3.2%	3.1%
Totals	2.6%	2.2%	2.2%	3.3%	3.1%	3.0%

Growth rates are pre-recession



Growth rate varies widely, averaged 2.73% over 18 years

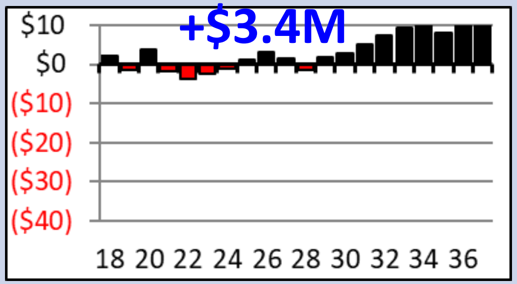
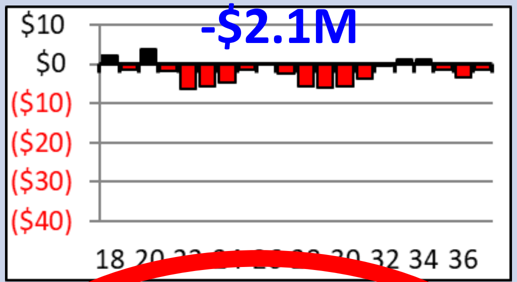
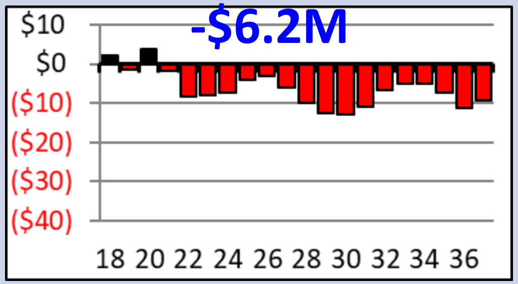
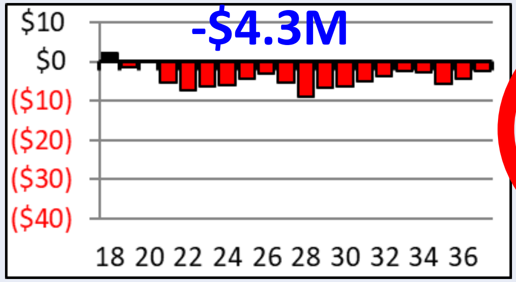
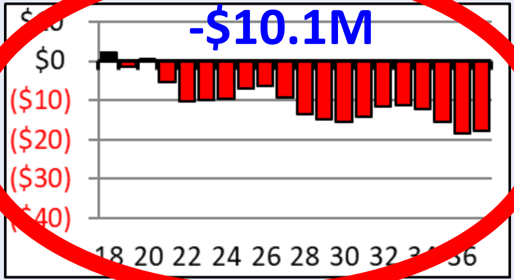
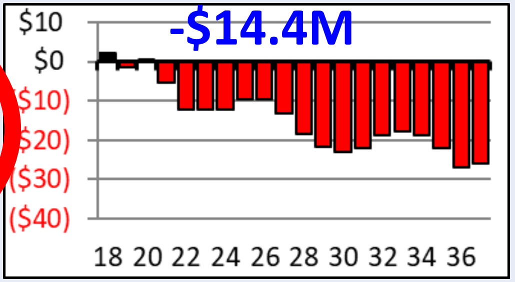
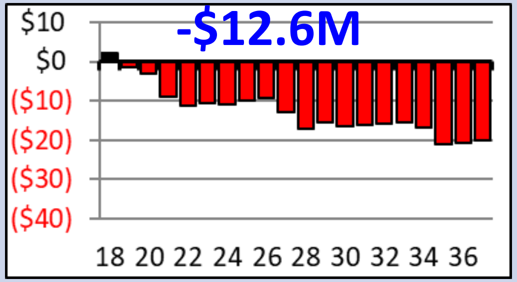
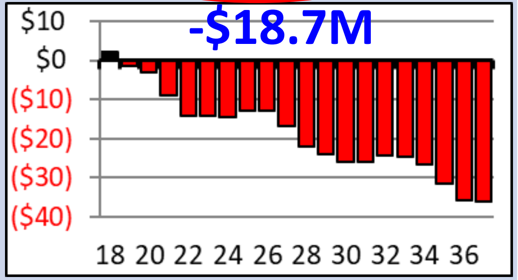
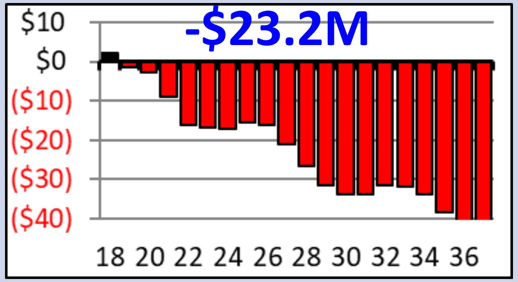
Sales Tax Growth

Scenario	Assumption	Rationale
Stronger Economy	3.2% average growth	• Raises Avenu Insights' growth estimate for pooled allocations from 2.9% to 5%
Moderate Economy	2.9% average growth	• Avenu Insights' *most likely* forecast through FY21 (pre-recession)
Weaker Economy	2.6% average growth	• Lowers food to 2.5%, building to 2%, and auto to 1%

Forecast Summary

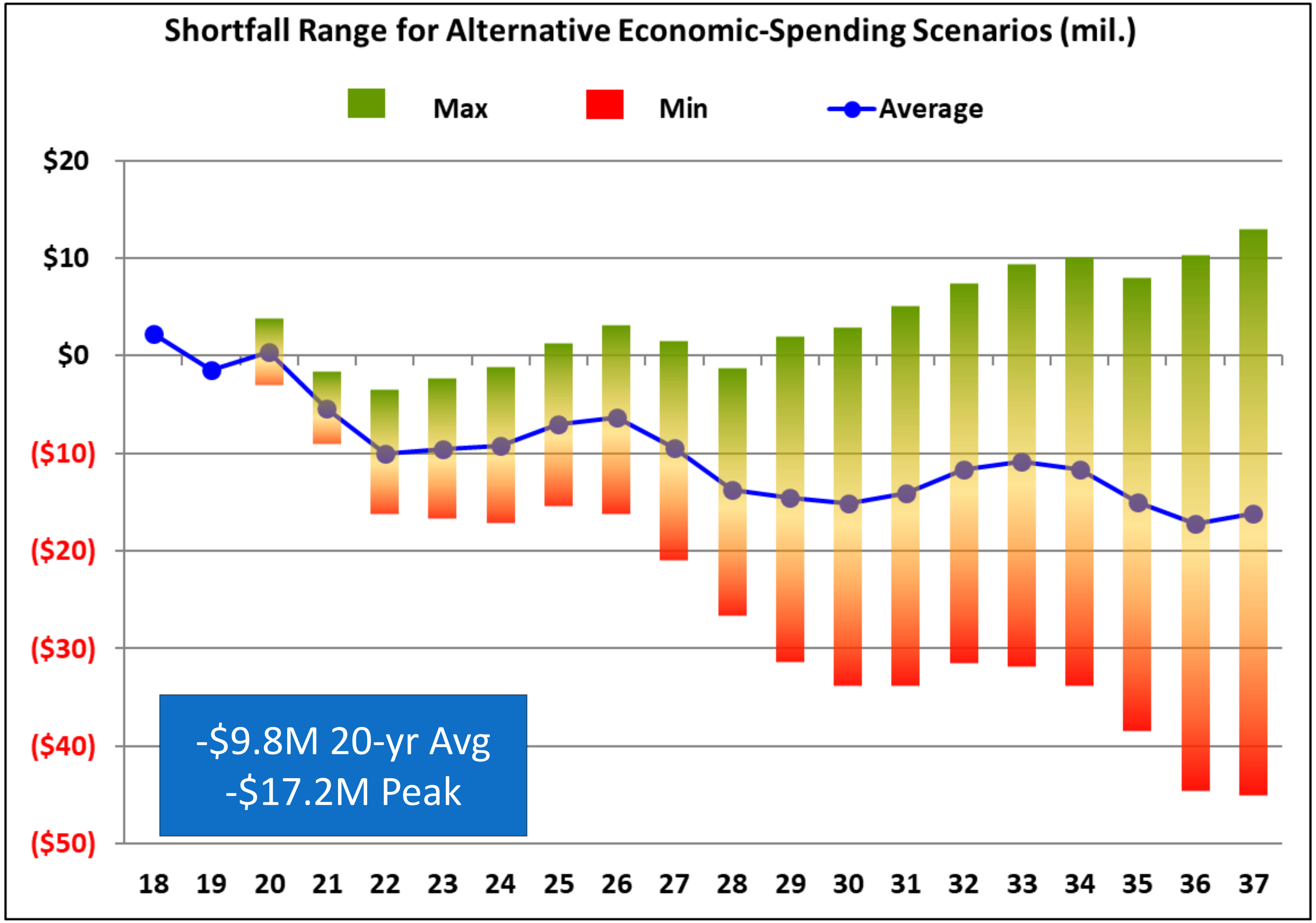
- Shortfall Matrix
- Most Likely Outcome
- Shortfall Range
- Fund Balance
- Forecast Sensitivity
- Timeline for Action

Economy-Spending Shortfall Matrix

	Stronger Economy	Moderate Economy	Weaker Economy
Lower Spending			
Moderate Spending			
Higher Spending			

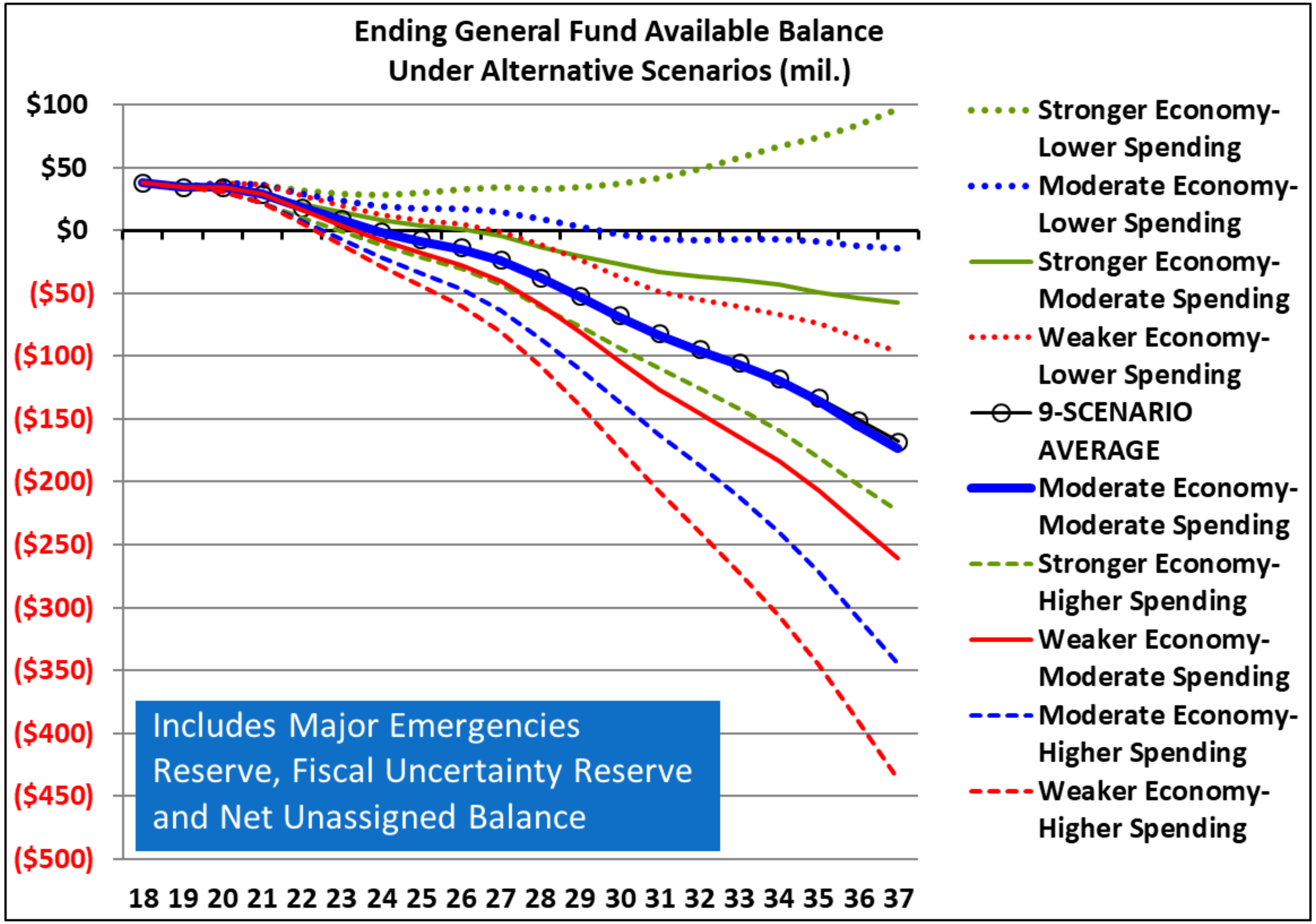
Average annual shortfall from FY19-37 in blue

Range and Average Shortfall



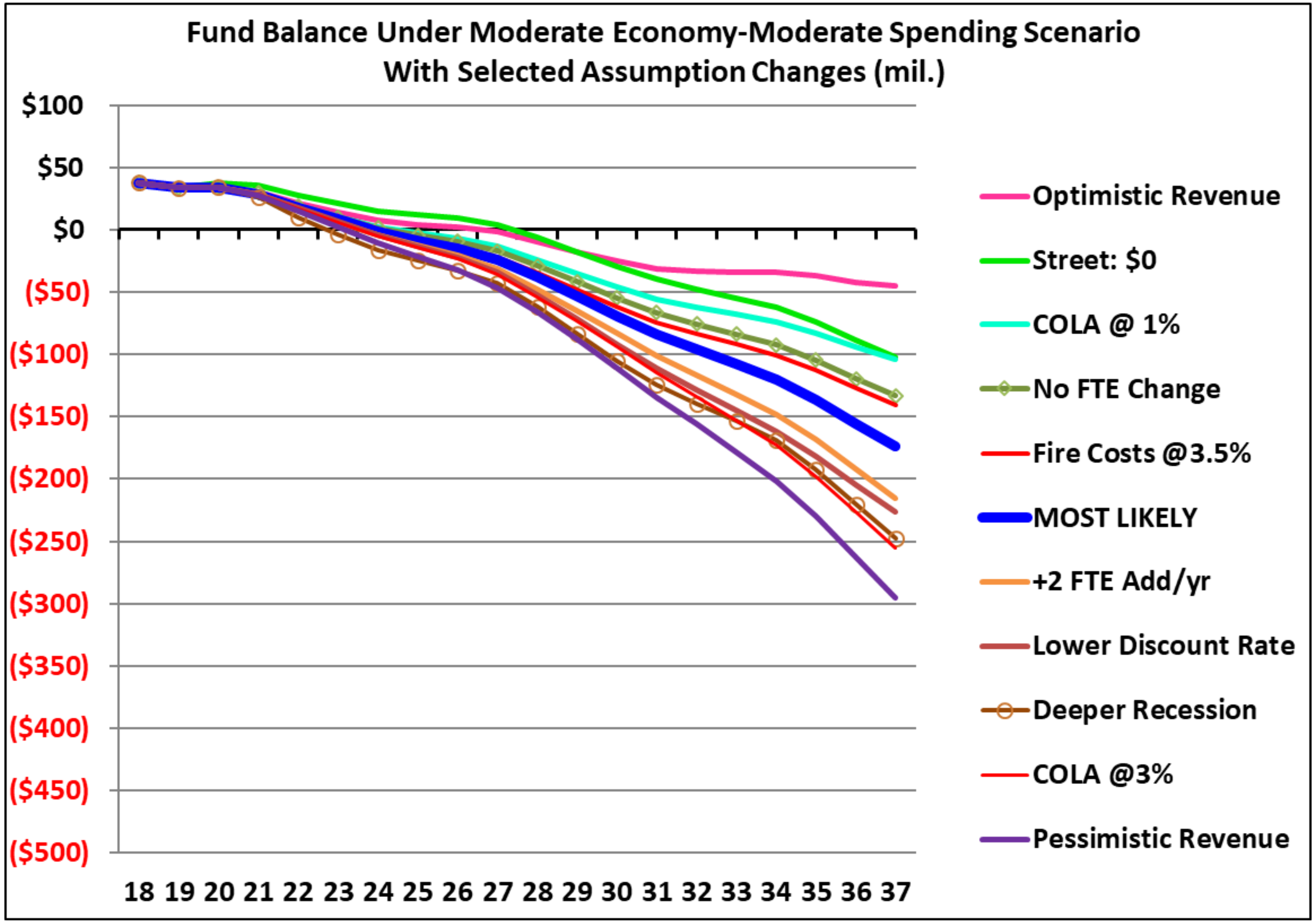
- Shows range of shortfalls from all nine scenarios
- Range of outcomes widens over time due to impact of compounding
- Average shortfall represents 9% of total average expenditures

Economy-Spending Fund Balance Comparison



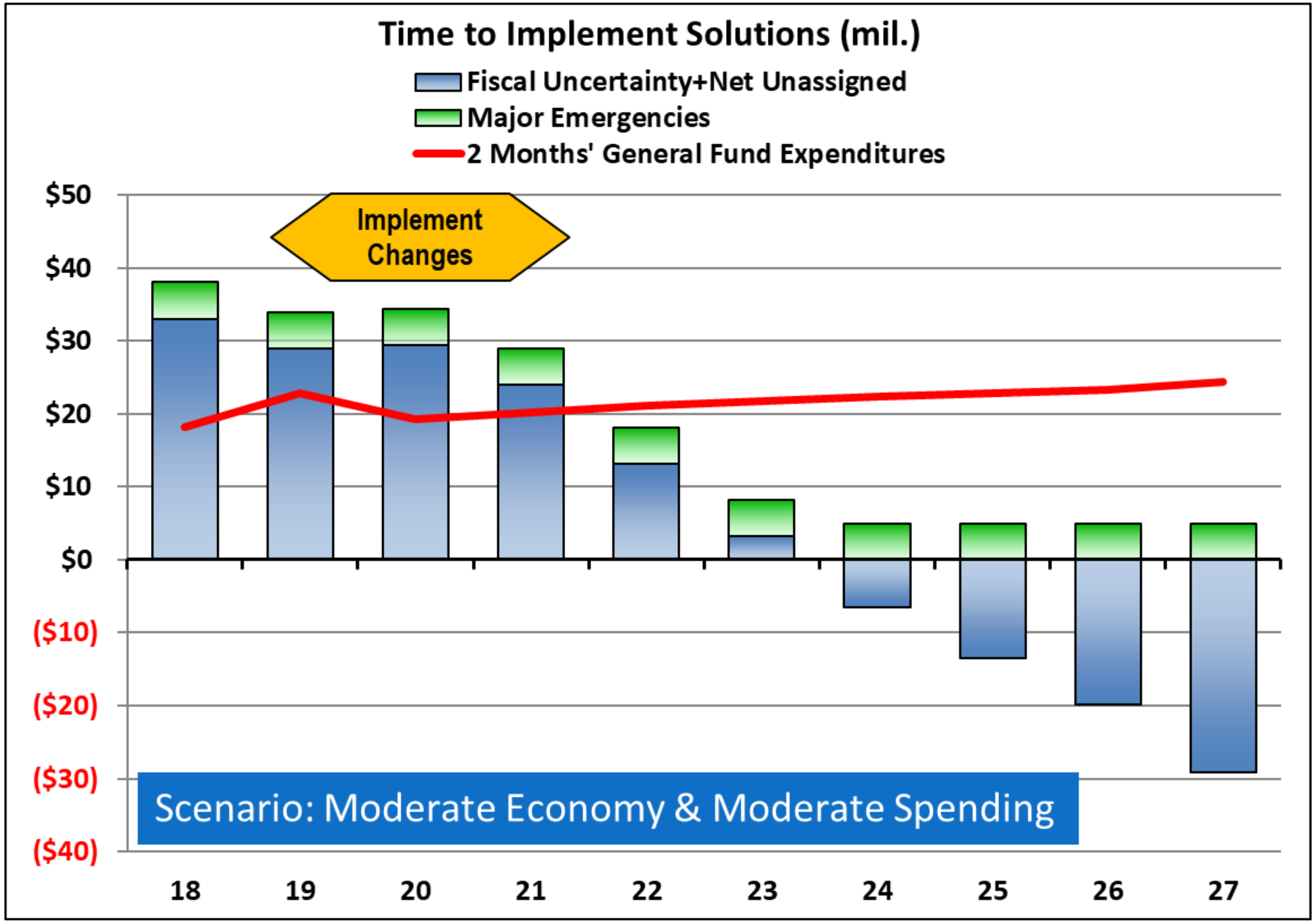
- Economy Scenarios
  - Stronger (*green*)
  - Moderate (*blue*)
  - Weaker (*red*)
- Spending Scenarios
  - Higher (*dashes---*)
  - Moderate (*line—*)
  - Lower (*dots····*)
- Available balance excludes nonspendable and committed funds

Forecast Sensitivity to Variable Changes



- Each line shows ending General Fund balance given just <u>one</u> change to the Most Likely forecast
- Shows relative impact of different individual assumption changes
- Budget model can combine multiple assumption changes into any given alternate scenario

Timeline for Action



- Corrective actions needed within next three years to:
  - maintain available reserves of over two months' operating expenditures
  - preserve Major Emergencies Reserve
- Current reserve levels allow some time to phase in solutions

Summary

- Forecast is not Fate
  - Data collection in ongoing, and new information may indicate a more (or less) favorable outcome
  - City will undertake actions that reduce expenditures or increase revenues, that will change the course of the forecast
- City not limited to these nine scenarios
  - Assumptions can be mixed and matched among scenarios, and new assumptions can be created
  - A consensus baseline forecast should be adopted, with the assumptions the City deems most appropriate
- Fiscal model is a valuable budgeting tool
  - Include forecast in the two-year budget
  - Use it to develop and track implementation of sustainable budget strategies

Next Steps

- Phase I – Develop Budget Model
  - Jan 28: Presentation to Council
  - Feb 2: Council Study Session on Forecast, hands-on with the fiscal model
- Phase II – Develop Action Plan

Thank You.

Questions?