



Agenda Item

City Council

Item #: 7.1.

3/25/2025

File #: 25-0121

TO: Honorable Mayor and Members of the City Council

THRU: Tom Kisela, City Manager

FROM: Trang Nguyen, Finance Director

1. SUBJECT

First Budget Study Session for the Fiscal Year 2025-26 General Fund Budget.

2. SUMMARY

This budget study session is intended to provide an analysis and assumptions of the proposed budget for the General Fund revenue and expenditure for Fiscal Year 2025-26.

3. RECOMMENDED ACTION

Provide direction to staff to prepare the Fiscal Year 2025-26 Preliminary Budget.

4. FISCAL IMPACT

Fiscal impact will be determined with final budget adoption.

5. STRATEGIC PLAN GOALS

Goal 2: Enhance Economic Development and Achieve Fiscal Sustainability

6. DISCUSSION AND BACKGROUND

Fiscal Year 2025-26 (FY 26) continues to be a challenging year to present a structurally balanced budget for the General Fund. The two largest revenue sources, Property Tax and Sales Tax, for the City are projected to remain flat in FY 26. Inflation is expected to continue to increase, impacting the cost of the City's contracts and material purchases. The City, once again, will need to implement several budget balancing measures totaling \$13 million, to balance the budget. The following measures are included in the proposed FY 26 budget, and are intended to limit the service impacts to the residents and community:

- leveraging one-time revenues,
- temporarily freezing and partially funding vacant positions,
- reducing funding for special events,
- deferring replacements and repairs,
- partially funding overtime,

- partially funding the City's Accrued Liability contributions,
- deferring contributions to the General Liability Fund and Workers' Compensation Fund, and
- use the estimated undesignated fund balance from FY 25.

Below are the details of the FY 26 General Fund proposed budget.

General Fund Revenues for FY 26

Based on current trends and analysis, the General Fund revenues are projected to remain flat for FY 26 at approximately \$149.4 million, a \$19,000 increase from the ending estimated revenue for Fiscal Year 2024-25 (FY 25).

Table 1 (below) is a summary of the General Fund revenues by source type, comparing the changes from the FY 24 actuals, the FY 25 year-end estimates, and the FY 26 proposed budget:

Table 1: FY 26 Proposed General Fund Revenue

Revenue Source	FY 24 Actuals	FY 25 Year-End Estimates	FY 26 Proposed	FY 26 Variance from Year-End Estimate
Property Tax	54,570,052	56,568,754	58,213,213	1,644,459
Sales Tax	50,610,366	51,116,470	51,632,216	515,746
Transient Occupancy Tax	6,092,658	6,211,195	6,315,000	103,805
Franchises	2,981,298	3,100,203	3,316,369	216,166
Licenses and Permits	7,206,692	6,805,024	6,930,106	125,082
Fines and Forfeitures	1,747,538	1,811,215	2,121,276	310,061
Use of Money and Property	4,742,556	2,789,348	2,814,157	24,809
Revenue from Other Agencies	3,580,197	2,653,399	1,350,800	(1,302,599)
Fees for Service	6,851,807	6,870,980	5,994,059	(876,921)
Miscellaneous Revenue	1,958,560	1,238,158	215,366	(1,022,792)
Interfund Revenues	3,635,631	7,050,201	7,000,000	(50,201)
Total Operating Revenues	143,977,356	146,214,947	145,902,562	(312,385)
Transfers In	2,629,049	3,176,328	3,508,000	331,672
TOTAL REVENUES	146,606,405	149,391,275	149,410,562	19,287

Provided below are some key assumptions used for the FY 26 General Fund revenues:

- **Property Tax:** This is the City's largest source of revenue, and is projected to be \$58.2 million in FY 26, an increase of \$1.6 million or 2.9% over FY 25 year-end estimates. Based on information from the City's property tax consultant, staff are projecting modest growth for FY

26. Despite the lower volume of home sales due to low inventory and higher interest rates, the annual increase in assessed property values and property tax in lieu of motor vehicle license fees are expected to be slightly above budget as this revenue is tied to property tax growth.

- **Sales Tax:** The FY 26 revenue is projected to remain flat at \$51.6 million, reflecting a \$515,000 or 1% increase over the FY 25 estimate. The City's sales tax, its second-largest General Fund revenue source, experienced an overall decline in actual sales for the quarter ending September 30, 2024. This decrease was driven by a 13.7% drop in the City's major business group, Fuel and Service Stations, mirroring the statewide trend as fuel and oil prices fell during the quarter. Updated sales and use tax data for the quarter ending December 31, 2024, is expected by early April. If necessary, this information will be used to revise the FY 26 projection for the Preliminary Budget presented in May.
- **Transient Occupancy Tax (TOT):** The projected TOT revenue for FY 26 is \$6.3 million, reflecting a slight increase of \$104,000 or 1.7% compared to the FY 25 estimate. Since the pandemic, consumers have been shifting their spending to experiences, travel, and leisure. While the U.S. Travel Association is reporting a positive year-over-year growth, they caution that some travel indicators are showing decline, underscoring this category's susceptibility to economic conditions.
- **Revenue from Other Agencies:** FY 26 revenue in this category is projected at \$1.4 million, a \$1.3 million or 49% decrease from FY 25 year-end estimate. This category is primarily comprised of revenue received from other government agencies, as well as one-time grants from sources such as the California Office of Traffic Safety, California Highway Patrol, and California State Library.
- **Fees for Services:** Staff is projecting a decrease of \$877,000 or 12.8%, compared to FY 25 estimate, for a total of \$6.0 million in FY 26. The decrease is primarily due to a decrease in the Intergovernmental Transfer (IGT) reimbursement for medical transport fees. The City received \$1.0 million from IGT fees in FY 25, which accounted for reimbursement of two fiscal years. Therefore, the FY 26 projection is reduced by \$500,000, in line with the historical average of reimbursement received from IGT.
- **Miscellaneous Revenue:** Miscellaneous revenue is projected to decrease by \$1.0 million or 82.6%, from an estimated \$1.2 million in FY 25 to a projected \$215,366 in FY 26. This category includes one-time expense reimbursements, donations, and other miscellaneous revenues. One-time reimbursements and donations are difficult to project and, therefore, has been excluded in the proposed budget.

Proposed General Fund Expenditure for FY 26

The proposed FY 26 General Fund expenditure amounts to approximately \$150.6 million. This reflects a \$1.3 million or 1% increase in expenditure over the FY 25 year-end estimate.

Table 2: FY 26 Proposed General Fund Expenditure

Expenditure Category	FY 24 Actuals	FY 25 YE Estimates	FY 26 Proposed	FY 26 Variance from YE Estimate
Salaries and Benefits	100,385,131	100,072,349	104,851,445	4,779,096
Contractual Services	15,545,853	15,883,557	15,373,375	(510,182)
Materials and Supplies	2,227,988	1,892,411	2,285,078	392,667
Miscellaneous Expenses	282,314	698,279	312,000	(386,279)
Capital Outlay	135,064	117,273	34,000	(83,273)
Internal Service Costs	23,636,031	28,951,219	26,051,219	(2,900,000)
Debt Service	1,711,460	1,714,700	1,715,400	700
Total Operating Expenditures	143,923,841	149,329,788	150,622,517	1,292,729
Transfers Out	-	-	-	-
TOTAL EXPENDITURES	143,923,841	149,329,788	150,622,517	1,292,729

Provided below are the budget assumptions impacting the FY 26 General Fund expenditures:

- **Salaries & Benefits:** The FY 26 proposed budget for salaries and benefits is \$104.8 million, an increase of about \$4.8 million or 5% above the FY 25 year-end estimate and \$4.5 million compared to FY 24. The increase is attributed to the following factors:
 - **Negotiated Salary Increase for Safety:** The current salaries and benefits budget includes a 2-3% increase for safety employees, varying by bargaining group. This accounted for over \$600,000 or 6% of the overall increase.
 - **Increase in Contributions to Accrued Liability, Workers Compensation, and Unfunded Liability:** The rates for these contributions have increased significantly, with most of the increase in unfunded liability. These costs contribute to an increase of \$7 million and accounts for 74% of the proposed increase to salaries and benefits for FY 26. The City has historically underfunded its Accrued Liability and Worker's Compensation programs significantly. Additionally, FY 26 is the second year that the City received an unfunded liability invoice from CalPERS. The FY 25 payment was \$3 million, and the projected payment for FY 26 is about \$5.1 million. Continuing to underfund this program will lead to compounding payments in future years. Due to budget constraints, the proposed budget will continue to underfund its unfunded liability contributions by 40%, resulting in a budget reduction of approximately \$2.1 million.
 - **Overtime:** Overtime budget is determined by the department's projected need annually. Similar to the item above, the City has historically underfunded this category. The FY 25 overtime budget in the General Fund is \$5.2 million and the year-end estimate is almost \$8.2 million, a shortfall of about \$3 million. Staff is projecting \$6.5 million for overtime next fiscal year. More than 70% or \$4.6 million of overtime is in the Fire Department and about 25% or \$1.6 million is in the Police Department. Again, due to budget constraints, the proposed budget will continue to underfund overtime by 40%, leading to a budget reduction of almost \$2.6 million.

- **Vacant Positions:** During FY 25, there were more than 70 vacant positions, including vacancies held due to budget constraints. These vacancies result from resignations, retirements, and/or separations that cannot be predicted, which partially contribute to the difference in FY 25 year-end estimates to FY 26 proposed budget.

While these factors have contributed to a proposed increase in salaries and benefits to the City, there have been several cost-reduction measures incorporated in the proposed budget within the salaries and benefits category:

- **Part-Time Staff Reduction:** Library and Community Services part-time employees have been budgeted at 50% funded due to the cuts in programming within both departments, resulting in a \$1.1 million reduction. These departments are maintaining a minimal level of staffing to cover the remaining programs such as the revised aquatics program and coverage for the reduced hours at the Library.
- **Full-Time Position Vacancies:** Holding positions vacant and partially funding vacancies will amount to about a \$4.3 million reduction from the proposed budget.

In summary, the total increase in salaries and benefits of \$14.9 million is offset by the cost-reduction of \$10.1 million for a net increase of \$4.8 million or 5% in FY 26.

- **Contractual Services:** FY 26 contractual services included two new contracts, crossing guards and parking enforcement, which were supplemented by one-time funding in FY 25. The reduction in special event contracts, one-time services, and other maintenance contracts attributed to the overall reduction of \$510,000 or 3% in this category.

Materials and Supplies: The proposed budget for this category has an increase of over \$390,000 or 21% when compared to the FY 25 year-end estimate. This accounts for the reinstatement of the Library department budget for books amounting to \$100,000, an increase of \$80,000 to Police and Fire uniform costs, and the rising cost due to inflation in materials and supplies.

- **Internal Service Costs/Allocations:** While the Cost Allocation Plan study is being conducted by the City's consultant, staff has made minor adjustments to the General Fund contribution for internal services based on the current available fund balance in the Internal Service Funds. These proposed adjustments provide a cost reduction of \$2.9 million in FY 26. The Cost Allocation Plan will be brought to the City Council for review in April. The approved changes will then be incorporated in the Preliminary Budget presentation scheduled for May.

Overall, the FY 26 operating budget increased by \$1.3 million or 1% compared to FY 25 and increased by \$6.7 million or 5% compared to FY 24.

Proposed General Fund Balance for FY 26

The proposed FY 26 General Fund budget includes a total revenue of \$149.4 million, including transfers and expenditures totaling \$150.6 million, including budget balancing measures, resulting in an operating deficit of approximately \$1.2 million. The projected ending fund balance at June 30, 2026 is almost \$25.8 million, a decrease of just under \$1.2 million from FY 25. Accounting for the

catastrophic reserve of 16.6% or \$25.0 million, the General Fund is projected to have an undesignated fund balance of just over \$790,000. Table 3 highlights the Proposed General Fund, fund balance, for FY 26:

Table 3: Proposed Fund Balance for the General Fund

	FY 2024-25 Year-End Estimate	FY 26 Proposed	Variance to YE Estimate
Estimated Beginning Fund Balance - 7/1/2025	26,910,980	26,972,467	61,487
Revenues	146,214,947	145,902,562	(312,385)
Transfers-In	3,176,328	3,508,000	331,672
Total Revenues	149,391,275	149,410,562	19,287
Expenditures	(149,329,788)	(150,593,824)	1,264,036
Transfers Out	-	-	-
Total Expenditures	(149,329,788)	(150,593,824)	1,264,036
Operating Surplus/ (Deficit)	61,487	(1,183,262)	(1,244,749)
Estimated Ending Fund Balance - 6/30/2026	26,972,467	25,789,205	(1,183,262)
Reserved - Catastrophic	24,788,745	24,998,575	209,830
Estimated Undesignated Fund Balance - 6/30/2026	2,183,722	790,631	(1,393,092)

It is important to note that without the one-time transfers of \$3.5 million, budget reduction measures of \$13.0 million, and using the estimated undesignated fund balance from FY 25, the deficit for FY 26 proposed General Fund budget would have been \$18.7 million. These cost reduction measures to balance the budget today will continue to have compounding effects in future years if not addressed.

The next study session is tentatively planned for April 22nd and will focus on the City's Capital Improvement Program. Staff will incorporate the City Council's directions and feedback received from both study sessions in the FY 26 Preliminary Budget for review during a regular City Council meeting in May.

7. ATTACHMENTS

- First Budget Study Session

Proposed Budget Reductions

Proposed Budget Reduction	Cost Reduction
Eliminate contribution to IT Operating Fund (780)	(\$2,000,000)
Eliminate contribution to Computer Replacement/IT Capital Fund (790)	(900,000)
Budget Overtime at 60%	(2,592,201)
Budget Contribution to Unfunded Accrued Liability (UAL) at 60%	(2,056,402)
Part-Time Positions Funded at 50%	(1,098,850)
Vacancies – Frozen and Partially Funded	(4,346,295)
Total Proposed Budget Reduction	(\$12,993,748)

Departmental Personnel Requests (included in the FY 26 proposed budget)

Department	Description	General Fund Cost
Community Services	Reclassify the Administrative Analyst I to Administrative Analyst II	\$20,000
Fire Department	Reclassify the Office Assistant to Administrative Assistant	18,000
Fire Department	Reclassify the Administrative Analyst I to Administrative Analyst II	20,000
Net Cost/(Savings) to General Fund:		\$58,000

Overtime – by department

Department	FY 26 Budget Request	FY 26 Proposed Budget (with reduction)
Fire	\$4,667,871	\$2,800,723
Police	1,633,132	979,879
Public Works	149,500	89,700
Community Development	30,000	18,000
Total Cost to General Fund:	\$6,480,503	\$3,888,302

Not currently included in the proposed budget are:

Department	Description	General Fund Cost
Fire Department	Reclassify one Plan Examiner to Senior Plan Examiner	\$20,000
Fire Department	Addition of a Training Battalion Chief	\$326,000
Fire Department	Addition of a Permit Technician	\$100,000

ATTACHMENT A

Information Technology	Addition of an Administrative Analyst I	\$120,000
Information Technology	Addition of a Network/Security Analyst	\$170,000
Information Technology	Addition of a Systems Analyst	\$150,000
Total Cost to General Fund:		\$886,000