



Agenda Item

Orange City Council

Item #: 9.1.

6/9/2026

File #: 26-0356

TO: Honorable Mayor and Members of the City Council

THRU: Jarad Hildenbrand, City Manager

FROM: Trang Nguyen, Finance Director

1. SUBJECT

Fiscal Year 2026-2027 City of Orange Operating Budget and Five-Year Capital Improvement Program

2. SUMMARY

The City Council affirmed the Fiscal Year 2026-2027 preliminary operating budget and capital improvement plan at the May 26 Regular City Council meeting. This budget document is prepared following the affirmation and directions given by the City Council.

3. RECOMMENDED ACTION

The following action items are recommended to adopt the Fiscal Year 2026-2027 Budget, effective July 1, 2026:

1. Adopt Resolution No. 11702. A Resolution of the City Council of the City of Orange adopting said City's Budget for the Fiscal Year 2026-27 and authorizing transfer of funds within and between appropriations, transfer of funds between funds, and additional appropriations.
 - a. Total revenues of \$292.4 million and total expenditures of \$315.7 million, including transfers.
 - b. General Fund revenues totaling \$170.7 million and expenditures totaling \$169.6 million;
 - c. Staffing for Fiscal Year 2026-2027 at 708.7 budgeted FTEs; and
 - d. Five-Year Capital Improvement Program.
2. Adopt Resolution No. 11699. A Resolution of the City Council of the City of Orange adopting the appropriations limit for the Fiscal Year 2026-2027.
3. Adopt Resolution No. 11700. A Resolution of the City Council of the City of Orange amending Resolution No. 11668 between the City of Orange and the Orange Municipal Employees' Association.

4. FISCAL IMPACT

The Fiscal Year 2026-2027 Annual Operating and Capital Improvement Budget includes total revenues of \$292.4 million and total expenditures of \$315.7 million for all funds, including transfers. Available fund balance will be used to cover the difference between revenue and expenditure in Special Revenue Funds and Capital Improvement Project Funds. This does not necessarily reflect an ongoing structural imbalance, but rather timing and funding strategy for these funds.

The total General Fund revenues are \$170.7 million, and expenditures are \$169.6 million, including

transfers.

5. STRATEGIC PLAN GOALS

Goal 2: Enhance Economic Development and Achieve Fiscal Sustainability.

6. DISCUSSION AND BACKGROUND

Background:

The City's budget is a financial plan based on anticipated revenues and expenditures in a fiscal year starting July 1st through June 30th. Each year, the City's budget is prepared, prioritizing public safety and infrastructure projects, City Council Goals, and providing the highest possible level of service to the community. The Fiscal Year 2026-2027 (FY27) budget development has been presented and reviewed over the course of three City Council budget study sessions, taking place in March, April, and May 2026.

As noted in the budget study sessions, FY27 continues to present significant financial challenges for the General Fund, as the City faces an ongoing structural imbalance between recurring revenues and expenditures. Development of the FY27 Budget began with a zero-based budgeting approach, requiring departments to justify expenditures from the ground up rather than relying on prior-year spending as the baseline. Over the last couple of months, staff continued to refine the FY27 budget to incorporate the City Council directions, reprioritize operational needs, and incorporated changes from the third quarter financial information.

The FY27 Preliminary Budget was affirmed by the City Council on May 26th for all funds, with total revenues of approximately \$292.9 million and total expenditures of \$317.3 million, including transfers. In response to the City Council's feedback related to the inclusion of a vacancy rate in the budget, the following adjustments have been made to the proposed adopted budget:

- Reduced the General Fund salaries budget by \$1.2 million;
- Reduced the transfer in from Capital Projects Fund (CIP) by \$500,000; and
- Increased the Catastrophic Reserve to 20% from 18%.

Details of these adjustments are noted in the discussion of the staff report.

The FY27 Adopted Budget document reflects \$292.4 million in revenue, a decrease of \$500,000, and expenditures of \$315.7 million, a decrease of \$1.7 million, in all funds when compared to the FY27 Preliminary Budget. Available fund balance will be used to cover the difference between revenue and expenditure in Special Revenue Funds and Capital Improvement Project Funds. This does not necessarily reflect an ongoing structural imbalance, but rather timing and funding strategy for these funds. The total full-time equivalent (FTE) is 708.7 FTEs, with approximately 600 FTEs being funded by the General Fund. The total General Fund revenues are \$170.7 million, a decrease of \$500,000, and expenditures of \$169.6 million, a decrease of \$1.2 million, from the FY27 Preliminary Budget.

Discussion:

Fiscal Year 2025-26 (FY26) General Fund Year-End Estimates

There are no changes to the FY26 Year-end Estimates as presented last month. The FY26 General Fund revenues are estimated at \$157.4 million. Revenue estimates are based on FY26 trends in property transfer tax, fees for services, fines, plan check fees, construction inspection fees, building

permit revenues, and miscellaneous revenues.

FY26 General Fund expenditures are estimated at \$161.1 million. Expenditures estimates are based on ongoing operating expenses incurred throughout FY26, including several costs recognized later in the fiscal year, such as the City's \$1.5 million North SPA payment and one-time paid-parking implementation costs.

Considering these estimates, the General Fund is projected to end FY26 with an operating deficit of \$3.7 million. After maintaining the 18% Catastrophic Reserve, the estimated undesignated fund balance is \$1.9 million. These estimates are based on year-to-date actual results and do not include year-end accounting entries. A comprehensive review of FY26 financial results will be presented following completion of the annual financial audit.

Table 1: FY26 Year-End Estimated Fund Balance

	FY26 YE Estimate
Operating Revenues	\$157,868,578
Total Revenues	157,868,578
Operating Expenditures	144,093,480
Debt Service	17,519,111
Total Expenditures	161,612,591
Operating Surplus/Deficit	-3,744,013
Transfers-In	4,485,252
Transfers-Out	1,455,252
Net Surplus/Deficit	-714,013
Estimated Beginning Fund Balance - 7/1/2025	28,553,772
Estimated Ending Fund Balance - 6/30/2026	27,839,759
Catastrophic Reserve	25,936,826
Undesignated Ending Fund Balance - 6/30/2026	\$1,902,932

Fiscal Year 2026-27 (FY27) General Fund Revenue

The FY27 General Fund operating revenues, including transfers, is projected to be almost \$170.7 million, a decrease of \$500,000 from the preliminary budget. This is due to the decrease in transfers from the CIP Fund.

Provided below is a summary of the assumptions used for the FY27 General Fund revenues as presented at the preliminary budget meeting.

- Property Tax:** The City's largest source of General Fund revenues is proposed to be \$61.7 million in FY27, an increase of approximately \$1.9 million (3.1%) over the FY26 year-end estimates. The increase reflects revised year-end revenue estimates and signs of a strengthening housing market driven by slightly lower interest rates and rising rental costs, which have contributed to increased home sales activity. While Proposition 13 generally limits annual assessed value increases to 2% on existing properties, additional growth occurs when properties change ownership and are reassessed at current market value. The housing market

is expected to remain stable in FY27, supporting continued modest growth in property tax revenues.

FY25 Actuals: \$57,658,841
 FY26 Year-end Estimate: \$59,822,181
 FY27 Budget: \$61,700,600
 Increase/Decrease to YE: +\$1,878,419 or +3.1%

- **Sales Tax:** The FY27 revenue is projected at approximately \$51.6 million, reflecting a \$258,000 (0.5%) increase over the FY26 year-end estimates. According to statewide reports from the City's sales tax consultant, while inflation has moderated and interest rates have declined, statewide economic indicators suggest consumers still remain cautious. As a result, taxable sales growth is expected to remain modest in all other categories, with consumer spending largely focused on essential goods and value-oriented purchases. Although fuel prices have continued to trend upward due to external and foreign market factors, the FY27 projections assume moderate additional growth in sales tax revenues due to thresholds within the City's current sales tax agreements and the potential volatility of this sector.

FY25 Actuals: \$49,342,726
 FY26 Year-end Estimate: \$51,335,804
 FY27 Budget: \$51,594,300
 Increase/Decrease to YE: +\$258,496 or +0.5%

- **Fines and Forfeitures:** Fine and forfeitures revenue is projected at approximately \$2.9 million in FY27, an increase of about \$471,000 (19.4%) over the year-end estimates. This reflects anticipated revenues of approximately \$1.0 million from the City's paid parking program in Old Towne, as well as \$300,000 from increased collections associated with Transient Occupancy Tax and Business License audit activities.

FY25 Actuals: \$2,636,075
 FY26 Year-end Estimate: \$2,426,324
 FY27 Budget: \$2,897,600
 Increase/Decrease to YE: +\$471,276 or +19.4%

- **Fees for Service:** The city is projecting just under a total of almost \$8.0 million in FY27, an increase of just over \$300,000 (4.0%), compared to the year-end estimates. These fees are intended to offset the City's operating costs of providing services and have been revised following the user fee study to more appropriately align charges with the cost of service delivery. This estimate considers the updated fees adopted at the January 13th Council meeting, the April 28th Council meeting.

FY25 Actuals: \$6,602,124
 FY26 Year-end Estimate: \$7,647,596
 FY27 Budget: \$7,953,100
 Increase/Decrease to YE: +\$305,504 or +4.0%

- **Internal Service Charges:** Internal Service Charges are projected to be approximately \$4.8 million, an decrease of \$5.2 million (-52.1%) from the FY26 year-end estimates. The decrease in Internal Service Charges reflects a revised methodology that excludes Internal Service Charges charged to and from the General Fund; as a result, both expenditure and revenue

projections are lower compared to the FY26 Year-End Estimate. This does not reflect any reduction in services but rather an accounting change.

FY25 Actuals: \$15,474,265
 FY26 Year-end Estimate: \$10,077,495
 FY27 Budget: \$4,830,500
 Increase/Decrease to YE: -\$5,246,995 or -52.1%

- **Miscellaneous/Other Revenue:** Miscellaneous/other revenue is projected at almost \$4.2 million in FY27, an increase of approximately \$183,000 (4.6%) compared to year-end estimates. This category includes one-time reimbursements, donations, and other miscellaneous revenues, including approximately \$1.0 million in Cal OES reimbursements for fire deployments and \$150,000 to offset credit card fee surcharges.

FY25 Actuals: \$1,620,906
 FY26 Year-end Estimate: \$3,995,136
 FY27 Budget: \$4,177,800
 Increase/Decrease to YE: +\$182,664 or +4.6%

- **Revenue from Other Agencies:** FY27 revenue in this category is projected at approximately \$1.5 million, almost \$312,000 (-17.2%) decrease from the FY26 year-end estimates. This category is primarily comprised of revenue received from other government agencies, as well as one-time grants from state funded programs. As is typical, revenue in this category may fluctuate throughout the year as additional grant programs are awarded and recognized.

FY25 Actuals: \$2,501,399
 FY26 Year-end Estimate: \$1,816,924
 FY27 Budget: \$1,505,100
 Increase/Decrease to YE: -\$311,824 or -17.2%

- **Transfers In:** Transfers into the General Fund are projected to total \$15 million in FY27, a decrease of \$500,000 from the FY27 Preliminary Budget, and an increase of over \$10.5 million (234.4%) over the FY26 year-end estimates. This amount primarily reflects one-time transfers of available fund balances from the Emergency Medical Transport Fund (\$3.5 million), Equipment Replacement Fund (\$3 million), and Capital Improvement Program Fund (\$8.5 million) to temporarily offset the projected General Fund operating deficit. These transfers are non-recurring in nature and provide temporary budget relief rather than a long-term structural solution.

FY25 Actuals: \$3,250,000
 FY26 Year-end Estimate: \$4,485,252
 FY27 Budget: \$15,000,000
 Increase/Decrease to YE: +\$10,514,748 or +234.4%

Provided in Table 2 is a summary of the major General Fund revenues by source type, comparing the changes from the FY26 year-end estimates and FY27 Adopted Budget:

Table 2: General Fund Revenues

Revenue Category	FY25 Actual	FY26 YE Estimate	FY27 Adopted	Variance to FY25 Actual	Variance to FY26 Estimate
Property Tax	\$57,658,841	\$59,822,181	\$61,700,600	7.0%	3.1%
Sales Tax	49,342,726	51,335,804	51,594,300	4.6%	0.5%
Internal Service Charges	15,474,265	10,077,495	4,830,500	-68.8%	-52.1%
Fees for Services	6,602,124	7,647,596	7,953,100	20.5%	4.0%
Licenses and Permits	6,667,071	7,645,141	7,835,100	17.5%	2.5%
TOT	6,150,976	6,100,192	6,198,100	0.8%	1.6%
Miscellaneous Revenue	1,620,906	3,995,136	4,177,800	157.7%	4.6%
Use of Property	3,730,340	3,922,905	3,929,100	5.3%	0.2%
Franchises	2,753,299	3,078,880	3,057,300	11.0%	-0.7%
Fines and Forfeitures	2,636,075	2,426,324	2,897,600	9.9%	19.4%
Revenue from other Agencies	2,501,399	1,816,924	1,505,100	-39.8%	-17.2%
Total Operating Revenues	155,138,022	157,868,578	155,678,600	0.3%	-1.4%
Transfers-In	3,250,000	4,485,252	15,000,000	361.5%	234.4%
TOTAL REVENUES	\$158,388,022	\$162,353,830	\$170,678,600	7.8%	5.1%

In summary, FY27 General Fund operating revenues, excluding transfers, are projected at approximately \$155.7 million. Revenue projections were developed using FY26 year-end estimates and current trends across the City's major revenue categories, including property tax, sales tax, fees for services, licenses and permits, transient occupancy tax, and other local revenues. While several revenue categories are projected to increase in FY27, total operating revenues are projected to remain relatively consistent with FY25 actual revenues and slightly below FY26 estimated revenues. Including transfers-in of \$15.0 million, total FY27 General Fund revenues are projected at approximately \$170.7 million.

FY27 General Fund Expenditures

The General Fund operating expenditures, including debt service, for FY27 is almost \$160.1 million, a decrease of \$1.2 million from the preliminary budget and a decrease of almost \$1.6 million (-1%) from the FY26 year-end estimates. The operating expenditure reflects the continued focus on

maintaining service levels while holding costs steady.

Based on City Council direction, the FY27 budget was created through a zero-based budget process. All departments provided documentation and descriptions of all non-personnel expenditure requests. Budget meetings were held between the departments and City Manager and Director of Finance to discuss the requests and necessity of the expenditure.

Provided below are the budget assumptions impacting the FY27 Operating Budget for the General Fund expenditures as presented at the preliminary budget meeting, except for salaries & benefits:

- **Salaries & Benefits:** The FY27 Preliminary Budget for salaries and benefits is \$108.6 million, an increase of just over \$4.6 million (4.5%) above the FY26 year-end estimates. The increase reflects the revised staffing assumptions as well as the transfer of five firefighter positions previously charged to the EMT Fund (Fund 225) back to the General Fund. As presented during the FY27 Budget Study Session, the FY27 salaries and benefits budget includes annual step increases and a proposed 3% salary adjustment for all City employees, fully funds projected overtime costs based on recent historical trends, and incorporates approved position changes, including the elimination of 43.55 FTEs, maintaining 12 frozen positions, and adding 18.75 FTEs in FY27. Although the budget includes significant position reductions, salaries and benefits continue to increase year-over-year primarily due to negotiated compensation adjustments and the City's transition to fully funding projected overtime costs rather than relying on vacancy savings.

The City Council expressed concern regarding the absence of vacancy savings in the FY27 budget. In response, staff conducted a review of unspent salary budgets over the last four fiscal years.

Based on this analysis, staff identified four departments, Community Development, Library, Police, and Public Works, that have consistently carried unspent salary budgets of 3% or more. As a result, staff applied a 3% vacancy savings reduction to the salary budgets of these departments, resulting in a reduction of approximately \$1.2 million. The vacancy savings does not reduce authorized positions or FTEs. It is a budgeting assumption based on the expectation that some positions will remain vacant for a portion of the year due to normal turnover, retirements, promotions, recruitment timelines, and onboarding periods.

FY25 Actuals:	\$104,364,884
FY26 Year-end Estimate:	\$103,947,889
FY27 Budget:	\$108,599,700
Increase/Decrease to YE:	+\$4,651,811 or +4.5%

- **Professional/Other Services:** The proposed FY27 budget for contractual services is approximately \$7.5 million. This reflects a net decrease of over \$2.6 million (-25.9%) compared to the year-end estimates. This expenditure category includes \$125,000 to support enhancements within the City's Economic Development Division, \$250,000 for year-round aquatics services, \$498,000 for the Old Towne paid parking program, and \$100,000 for on-call building inspection services.

FY25 Actuals:	\$6,141,942
FY26 Year-end Estimate:	\$10,083,247
FY27 Budget:	\$7,473,200

Increase/Decrease to YE: -\$2,610,047 or -25.9%

- **Materials and Supplies:** The proposed FY27 budget for materials and supplies is almost \$4.7 million and reflects a nominal increase of about \$28,000 (0.6%) compared to the year-end estimates.

FY25 Actuals: \$4,851,803
 FY26 Year-end Estimate: \$4,702,718
 FY27 Budget: \$4,731,000
 Increase/Decrease to YE: +\$28,282 or +0.6%

- **Miscellaneous Expenditures:** The FY27 budget for miscellaneous expenditures totals approximately \$3.9 million, representing an increase of \$676,000 (21.0%) compared to the FY26 year-end estimate. This expenditure category includes costs associated with North SPA services, election services, employee education incentives pursuant to labor agreements, mileage reimbursements, dues and memberships, training and conferences, and other miscellaneous operating expenses. The increase in FY27 is primarily attributable to anticipated election-related costs and increased General Fund contributions for North SPA services.

FY25 Actuals: \$961,597
 FY26 Year-end Estimate: \$3,217,645
 FY27 Budget: \$3,894,200
 Increase/Decrease to YE: +\$676,655 or +21.0%

- **Internal Service Costs/Allocations:** Internal service costs are projected to total approximately \$3.7 million, a decrease of approximately \$5.1 million (-57.9%) from year-end estimates. Figures have been refined using the Cost Allocation Plan model and FY26 Year End Estimates. The FY27 Budget reflects a revised methodology that excludes Internal Service Charges charged to and from the General Fund; as a result, both expenditure and revenue projections are lower compared to the FY26 Year-End Estimate

FY25 Actuals: \$14,029,588
 FY26 Year-end Estimate: \$8,866,258
 FY27 Budget: \$3,733,900
 Increase/Decrease to YE: -\$5,132,358 or -57.9%

- **Transfers to Internal Service Funds:** The FY27 Budget includes a transfer of approximately \$9.5 million to the Employee Accrued Liability Fund, this is an increase of almost \$8.1 million (556.5%). The Employee Accrued Liability Fund is estimated to close FY26 with a deficit of approximately \$5.6 million. The transfer is necessary to support the projected accrued leave payouts and unfunded liability during the year.

FY25 Actuals: \$487,680
 FY26 Year-end Estimate: \$1,455,252
 FY27 Preliminary Budget: \$9,554,500
 Increase/Decrease to YE: +\$8,099,248 or +556.5%

Table 3: General Fund Expenditures

Expenditure Category	FY25 Actual	FY26 YE Estimate	FY27 Adopted	Variance to FY25 Actual	Variance to FY26 Estimate
Salaries and Benefits	\$104,364,884	\$103,947,889	\$108,599,700	4.1%	4.5%
Repair/Maintenance	6,865,145	9,594,564	10,037,200	46.2%	4.6%
Professional/Other Services	6,141,942	10,083,247	7,473,200	21.7%	-25.9%
Internal Service Charges	14,029,588	8,866,258	3,733,900	-73.4%	-57.9%
Materials and Supplies	4,851,803	4,702,718	4,731,000	-2.5%	0.6%
Utility Charges	3,321,196	3,534,948	3,605,500	8.6%	2.0%
Capital Outlay	1,006,636	146,212	74,500	-92.6%	-49.0%
Miscellaneous	961,597	3,217,645	3,894,200	305.0%	21.0%
Debt Services	17,377,333	17,519,111	17,908,400	3.1%	2.2%
Total Operating Expenditures	158,920,124	161,612,591	160,057,600	0.7%	-1.0%
Transfers Out	487,680	1,455,252	9,554,500	1859.2%	556.6%
TOTAL EXPENDITURES	\$159,407,804	\$163,067,843	\$169,612,100	6.4%	4.0%

In summary, FY27 General Fund expenditures, including transfers, are projected at approximately \$169.6 million, which is consistent with the FY27 Preliminary Budget presented at the last month, with the exception of incorporating a vacancy rate adjustment within the Salaries and Benefits category. Expenditure projections reflect anticipated personnel costs, operational and maintenance needs, debt service obligations, and planned transfers.

Total FY27 General Fund expenditures represent an increase of approximately \$6.5 million, or 4.0%, compared to FY26 estimated expenditures. The majority of this increase is attributable to the planned transfer for employee accrued liabilities.

FY27 General Fund - Fund Balance

Based on the FY26 Year-End Estimates, the FY27 beginning fund balance is projected to be approximately \$27.8 million, of which approximately \$1.9 million is undesignated fund balance. The FY27 Adopted Budget projects an operating deficit of \$4.4 million, reflecting the difference between total revenues of \$155.7 million and total expenditures of \$160.1 million. However, the General Fund also includes a planned \$15.0 million transfer-in and a \$9.6 million transfer-out, resulting in a projected net surplus of approximately \$1.1 million and an estimated ending fund balance of \$28.9 million.

The Fiscal Management Policies adopted by the City Council on August 12, 2025, recommend maintaining a catastrophic reserve equal to 20% of General Fund operating expenditures. While the FY27 Preliminary Budget recommended reducing the reserve to 18% due to projected fiscal challenges, subsequent vacancy rate adjustments within the Salaries and Benefits expenditure category improved the General Fund's projected financial position. As a result, the FY27 Adopted Budget includes a catastrophic reserve at the full 20% policy target, resulting in a reserve balance of approximately \$28.4 million.

After accounting for the catastrophic reserve, the General Fund is projected to end FY27 with an undesignated ending fund balance of approximately \$476,000. Although the FY27 budget is balanced through transfers and other available resources, the General Fund continues to face a structural operating imbalance, as operating expenditures exceed operating revenues by approximately \$4.4 million.

The table below summarizes the FY27 Adopted General Fund budget, estimated ending fund balance, catastrophic reserve, and undesignated ending fund balance.

Table 4: General Fund Balance

	FY26 YE Estimate	FY27 Adopted	Variance to FY26 Estimate
Operating Revenues	\$157,868,578	\$155,678,600	-1.4%
Total Revenues	157,868,578	155,678,600	-1.4%
Operating Expenditures	144,093,480	142,149,200	-1.3%
Debt Service	17,519,111	17,908,400	2.2%
Total Expenditures	161,612,591	160,057,600	-1.0%
Operating Surplus/Deficit	-3,744,013	-4,379,000	17.0%
Transfers-In	4,485,252	15,000,000	234.4%
Transfers-Out	1,455,252	9,554,500	556.6%
Projected Net Surplus/Deficit	-714,013	1,066,500	-249.4%
Estimated Beginning Fund Balance - 7/1	28,553,772	27,839,759	-2.5%
Estimated Ending Fund Balance - 6/30	27,839,759	28,906,259	3.8%
Catastrophic Reserve	25,936,826	28,429,840	9.6%
Undesignated Ending Fund Balance - 6/30	\$1,902,932	\$476,419	-75.0%

FY27 Budget for Other Funds

Special Revenue Funds (200 - 400 Series):

There are no changes to the Special Revenue Funds. The FY27 Budget for Special Revenue Funds are used to account for revenues that are legally restricted or committed to expenditures for specific purposes. These funds support a variety of City programs and services that are financed through

dedicated revenue sources such as grants, state and federal funding, development-related fees, public safety revenues, and other restricted resources. Unlike the General Fund, Special Revenue Funds may only be used for their designated purposes and are subject to specific legal, regulatory, or policy requirements governing their use. The City's Special Revenue Funds support programs including transportation improvements, public safety initiatives, community development activities, housing programs, and other operational and capital needs. As external funding sources and economic conditions fluctuate, the City continues to closely monitor revenues and expenditures within these funds to ensure ongoing compliance, maintain service levels, and support long-term program sustainability.

Table 5: Fund Balance - Special Revenue Funds

	EMT Program (225)	Measure M2 (263)	Other Transportation Funds (270-274)	Citywide TSIP (287)
Revenues	\$5,353,600	\$4,335,500	\$7,474,000	\$304,000
Transfers-In	-	-	-	-
Total Revenues	5,353,600	4,335,500	7,474,000	304,000
Expenditures	5,575,900	4,205,600	7,801,300	1,695,900
Transfers-Out	3,500,000	-	-	-
Total Expenditures	9,075,900	4,205,600	7,801,300	1,695,900
Projected Surplus/Deficit	-3,722,300	129,900	-327,300	-1,391,900
Estimated Beginning Fund Balance - 7/1/26	4,176,378	6,919,471	6,764,540	3,662,662
Projected Ending Fund Balance - 6/30/27	\$454,078	\$7,049,371	\$6,437,240	\$2,270,762

Capital Improvement Funds (500 Series):

The only change to the Capital Improvement Funds from the Preliminary Budget is the reduction in transfers to the General Fund. The FY27 Capital Improvement Program totals just over \$33.2 million, across 17 different funding sources. In addition, the FY27 Adopted Budget includes an \$8.5 million transfer-out from the Capital Improvement Program Fund to the General Fund, which is \$500,000 lower than the FY27 Preliminary Budget. Following City Council feedback regarding the inclusion of vacancy savings assumptions in the General Fund budget, staff incorporated a vacancy factor within select department salary budgets, reducing the projected General Fund operating deficit. As a result, less one-time funding was needed from the CIP Fund, allowing the City to preserve an additional \$500,000 in capital resources for future infrastructure and capital improvement projects. The

following table reflects fund balances for the major capital funds.

Table 6: Fund Balance - Capital Improvement Funds

	Capital Project Fund (500)	Park Funds (510-12)	Fire Facilities Fund (560)	Police Facilities Fund (570)	Library Facilities Fund (580)
Revenues	\$3,585,000	\$383,100	\$22,800	\$21,500	\$17,800
Transfers-In	-	-	-	-	-
Total Revenues	3,585,000	383,100	22,800	21,500	17,800
Expenditures	5,140,400	2,870,000	600,000	615,000	326,900
Transfers-Out	8,500,000	-	-	-	-
Total Expenditures	13,640,500	2,870,000	600,000	615,000	326,900
Projected Surplus/Deficit	-10,055,500	-2,486,900	-577,200	-593,500	-309,100
Estimated Beginning Fund Balance - 7/1/26	12,013,635	8,462,380	703,983	724,052	468,497
Projected Ending Fund Balance - 6/30/27	\$1,958,135	\$5,975,480	\$126,783	\$130,552	\$159,397

Internal Service Funds (700 Series):

There are no changes to Internal Service Funds for FY27 Budget. Internal Service Funds are used to account for the financing of goods and services provided by one department or agency to other departments or agencies on a cost reimbursement basis. Allocations to the City's Internal Service Funds (ISFs), from the General Fund and other operating funds, including Enterprise Funds and eligible Special Revenue Funds, support operating costs related to accrued liability, workers compensation, and general liability insurance.

Historically, these ISFs were intentionally underfunded to minimize impacts to the General Fund, with the expectation that any year-end surpluses would be used to supplement shortfalls through transfers. However, as the City has continued to face budgetary constraints, fewer surplus funds have been available, resulting in continued underfunding of these ISFs and the deferral of necessary capital replacements and other long-term obligations.

It should also be noted that the ISFs for the City's Information Technology and Fleet divisions were consolidated into the General Fund in FY25. As a result, the associated operational costs associated with those services continue to be reflected comprehensively within the General Fund.

Table 8: Fund Balance - Internal Service Funds

	Equipment Replacement (720)	Worker's Comp (730)	General Liability (731)	Accrued Liability (760)	IT Capital (790)
Revenues	\$244,200	\$6,239,400	\$4,887,600	\$3,613,000	\$446,800
Transfers-In	-	-	-	9,554,500	-
Total Revenues	244,200	6,239,400	4,887,600	13,167,500	446,800
Expenditures	2,795,000	5,344,700	6,144,400	10,618,200	1,116,000
Transfers-Out	-	-	-	-	3,000,000
Total Expenditures	2,795,000	5,344,700	6,144,400	10,618,200	4,116,000
Projected Surplus/Deficit	-2,550,800	894,700	-1,256,800	2,549,300	\$3,669,200
Estimated Beginning Fund Balance - 7/1/26	3,052,486	-12,755,459	-12,302	-5,606,386	7,181,367
Projected Ending Fund Balance - 6/30/27	\$501,686	-\$11,860,759	-\$1,269,102	-\$3,057,086	\$3,512,167

Enterprise Funds (600 Series):

There are no changes to the FY 27 Enterprise Funds Budget. Enterprise Funds are used to account for services provided to the public on a fee-for-service basis, where the costs of operations, capital improvements, and debt obligations are primarily recovered through user charges. The City's Water and Sewer Enterprise Funds support the operation, maintenance, and long-term sustainability of critical utility infrastructure, including water production, distribution, and wastewater collection systems.

In FY27, the City is proposing approximately \$6.5 million in water infrastructure improvements to support system reliability, increase groundwater production capacity, and replace aging infrastructure throughout the water system. Additionally, approximately \$3.5 million is proposed for sewer system improvements to continue the replacement and rehabilitation of aging sewer pipelines and related infrastructure throughout the City. These investments are intended to address aging infrastructure, reduce ongoing maintenance demands, improve operational efficiency, and ensure the City can continue to meet service and regulatory requirements while maintaining reliable utility services for residents and businesses.

The table below provides a high-level overview of the City's Enterprise funds, reflecting projected revenues, expenditures for operating and capital expenses, and fund balances.

Table 7: Fund Balance - Enterprise Funds

	Water (600)	Sewer (601)
Revenues	\$45,584,600	\$9,486,700
Transfers-In	-	-
Total Revenues	45,584,600	9,486,700
Proposed Expenditures	49,920,000	9,248,600
Proposed Transfers-Out	-	-
Total Expenditures	49,920,000	9,248,600
Projected Surplus/Deficit	-4,335,400	238,100
Estimated Beginning Fund Balance - 7/1/26	6,057,236	4,917,562
Projected Ending Fund Balance - 6/30/27	\$1,721,836	\$5,155,662

Appropriations Limit (Gann Limit)

Article XIII B of the California Constitution requires local governments to annually calculate an appropriations limit, commonly referred to as the Gann Limit. The appropriations limit establishes a constitutional cap on the amount of tax proceeds that may be appropriated each fiscal year and is adjusted annually based on the population growth factor and changes in California per capita personal income.

The City calculates its annual appropriations limit using the adjustment factors published by the California Department of Finance. Consistent with State guidance, the City utilizes the greater of the annual population change for the City of Orange or Orange County as the population factor. This factor is multiplied by the California per capita personal income factor to determine the annual adjustment to the City's appropriations limit.

During preparation of the FY27 appropriations limit calculation, staff identified an error in the population growth factor used in the FY21 and FY22 appropriations limit calculations, which resulted in the City's appropriations limits being understated. The prior-year appropriations limits were corrected and used as the basis for calculating the FY27 appropriations limit. The correction did not result in the City exceeding its appropriations limit in any prior fiscal year and has no impact on previously adopted budgets or financial statements.

Based on the adjustment factors published by the California Department of Finance, the City's FY27 appropriations limit is calculated at approximately \$268.0 million. Appropriations subject to limitation, which are primarily financed by proceeds of taxes, are estimated at approximately \$132.6 million, representing 49.4% of the City's appropriations limit. Accordingly, the City remains well below its constitutional spending limitation for FY27, with available appropriations capacity of approximately

\$135.4 million.

Financial Model

The Financial Management Policy requires a long-range financial forecast to accompany budget adoption. The forecast serves as a planning tool to support long-term financial policies, operational decision-making, and fiscal sustainability strategies. It also helps evaluate the effectiveness of current policies and financial strategies while identifying when adjustments may be necessary to address future fiscal challenges. Staff prepared two five-year financial forecasts (FY27 Models) using the FY27 Budget as the baseline. Model 1, a baseline model, were developed using a combination of historical trend analysis, recent actual performance, current economic conditions, inflationary trends, and available market indicators. Historical growth trends over multiple time periods were evaluated to balance recent performance with long-term economic cycles.

To better evaluate long-term pension-related risks and forecast sensitivity, staff developed a second forecasting scenario using modified CalPERS assumptions, Model 2.

FY27 Model 1

Revenue Assumptions

Sales Tax:

While the City's historical five-year average sales tax growth is approximately 0.7%, the forecast assumes gradual growth beginning at 0.7% in FY28 and increasing incrementally to 2.5% by FY32. This approach balances historical performance with long-term inflationary expectations, anticipated economic stabilization, and projected taxable sales activity. The assumption is intended to reflect normalized long-term economic conditions rather than recent post-pandemic volatility.

Property Tax:

Property tax has historically been one of the City's more stable major revenue sources, with historical growth averaging between 4.1% and 5.3% over the past 10 years. The model assumes annual growth of 4.9%, consistent with the City's 10-year historical average.

Transient Occupancy Tax (TOT):

Unlike property tax, TOT revenues are more sensitive to market conditions, tourism activity, and economic fluctuations. Historical growth ranges from approximately 3.7% based on the five-year average to 12.3% using the 10-year average. Given the economic sensitivity of this revenue source, the model utilizes the more conservative five-year average growth assumption of 3.7%.

Fees and Fines:

These revenues have historically demonstrated moderate stability, with growth trends ranging from 3.7% to 6.4%. Considering recent Council-approved fee adjustments and the implementation of new fines, the model assumes annual growth of 4%.

Other Revenues:

This category includes investment earnings, donations, leases, rents, and miscellaneous revenues, which can fluctuate significantly from year to year. Due to the volatility of these revenues, the model assumes a conservative 2% annual increase based on recent historical trends.

Internal Service Revenues:

This category reflects cost allocation charges to Special Revenue and Enterprise Funds. The City's recently updated cost allocation study prepared by Matrix Consulting Group recommends annual CPI-based adjustments and a comprehensive update every five years. Consistent with that recommendation, the model assumes annual growth of 3%.

Actual results may vary depending on broader economic conditions, consumer spending patterns, inflationary trends, and regional economic performance.

Expenditure Assumptions**Salaries and Benefits:**

Historical growth averages for salaries and benefits are approximately 3.1% over 10 years and 3.3% over 15 years, which are generally consistent with the current March 2026 CPI-U of 3.3%. More recent three- and five-year averages are significantly lower at approximately 0.7%, reflecting the City's efforts to control personnel costs during periods of structural fiscal imbalance. The model assumes annual growth of 3% to align with long-term inflationary expectations and anticipated labor cost pressures.

Vacancy savings: As mentioned in the FY27 budget assumptions, The FY27 Model has been updated to include a vacancy savings for four departments, Community Development, Library, Police, and Public Works. These departments have consistently carried an average unspent salary budgets of 3% or more over the last four fiscal years. As a result, staff applied a 3% vacancy savings reduction to the salary budgets of these departments, resulting in a reduction of approximately \$1.2 million. The vacancy savings does not reduce authorized positions or FTEs. It is a budgeting assumption based on the expectation that some positions will remain vacant for a portion of the year due to normal turnover, retirements, promotions, recruitment timelines, and onboarding periods.

Operating Non-Personnel Expenses:

This category includes contracted services, maintenance, supplies, utilities, and other operating costs. Historical growth has fluctuated significantly due to inflationary pressures and operational needs. Although historical growth rates exceeded inflation in certain years due to one-time operational needs and elevated inflationary pressures, the model assumes a normalized annual increase of 3%, consistent with anticipated CPI trends and ongoing expenditure management efforts.

Internal Service Costs:

Similar to Internal Service Revenues, these costs are based on the City's updated cost allocation study prepared by Matrix Consulting Group. The model assumes annual CPI-based increases of 3%.

Leave Payouts:

Under various Memoranda of Understanding (MOUs), the City is obligated to provide annual payouts for certain accrued leave balances. Annual leave payout obligations are estimated at approximately \$6 million. The existing cost allocation model recovers approximately \$3 million annually, requiring an estimated additional General Fund contribution of approximately \$3 million, which is included in the forecast.

Unfunded Accrued Liability (UAL):

The UAL represents the City's annual required contribution to CalPERS for unfunded pension obligations. One modeled scenario assumes FY26 investment returns of approximately 12%, resulting in projected UAL payments decreasing to approximately \$5.2 million in FY28 and no projected payments in subsequent years. While this scenario is mathematically possible under current modeling assumptions, it presents a significant forecasting risk and may not be sustainable over the long term.

Workers' Compensation:

The Workers' Compensation Fund is projected to end FY27 with an estimated fund balance of approximately \$12 million. Staff recommends an ongoing annual contribution of \$1 million to support long-term fund stability and offset projected operating deficits.

General Liability:

The General Liability Fund is projected to end FY27 with a negative fund balance of approximately \$1.3 million and is currently experiencing annual operating deficits of approximately \$1.3 million. To stabilize the fund and support ongoing operational needs, the model includes an annual contribution of \$1.5 million.

Capital Projects Fund:

The City is required to maintain an annual Maintenance of Effort (MOE) contribution of approximately \$4.3 million to remain eligible for Measure M2 grant funding. The model includes an annual contribution of \$2 million toward meeting this long-term funding requirement.

Based on these assumptions, Model 1 projects an operating deficit of approximately \$16.5 million in FY28, improving to approximately \$6.9 million by FY32. As a result, the General Fund balance is projected to decline to approximately \$12.4 million in FY28 and be fully depleted by FY30.

While the model incorporates a balanced approach using historical trends, current economic conditions, and inflationary assumptions, it is important to recognize that the assumption of substantially reduced UAL payments beyond FY28 represents a significant forecasting risk. Changes in CalPERS actuarial assumptions, investment performance, or discount rate policies could result in higher future pension costs and further impact the City's long-term financial outlook.

FY27 Model 2

Model 2 reflects a sensitivity scenario in which CalPERS exercises its Funding Risk Mitigation Policy, similar to the 2021 reduction in the discount rate following strong investment performance. All other revenue and expenditure assumptions remained consistent with Model 1.

CalPERS currently maintains a Funding Risk Mitigation Policy that allows for future reductions to the discount rate when investment returns materially exceed assumptions over multiple years. Given recent strong investment performance, there is a reasonable possibility that CalPERS could reduce the discount rate in future valuation cycles. Although strong investment performance may improve funded status, a lower discount rate also increases the present value of future pension obligations, which can increase annual employer contribution requirements.

To evaluate this potential risk, staff prepared a second scenario reducing the CalPERS discount rate assumption from 6.8% to 6.6%. Under this scenario, projected UAL payments nearly doubled to just over \$10 million in FY28 and added an additional estimated payment of approximately \$6.6 million in

FY29.

Under this alternative scenario, the projected operating deficit increases to approximately \$21.3 million in FY28 before improving to approximately \$6.9 million by FY32, consistent with Model 1. The General Fund balance is projected to decline to approximately \$7.6 million in FY28 and be fully depleted by FY29.

Long-range financial forecasting is inherently sensitive to changes in economic conditions, inflation, labor negotiations, CalPERS actuarial assumptions, investment performance, and future policy decisions. Actual results will vary and should be reevaluated annually as part of the budget development process.

Conclusion

Both forecasting scenarios demonstrate the ongoing structural fiscal challenges facing the City. The forecasts demonstrate that, absent structural changes, expenditure growth is projected to continue outpacing recurring revenue growth over the long term. While economic conditions, investment performance, and inflationary trends may improve certain financial indicators over time, the City continues to face long-term expenditure pressures, particularly related to pension obligations, liability costs, and operational sustainability. As a result, the City will likely need to evaluate a combination of ongoing expenditure reductions, operational and organizational efficiencies, long-term financial planning strategies, and potential revenue enhancements to achieve long-term fiscal sustainability.

Unfunded Requests and Future Considerations

Due to limited ongoing revenues, several priority needs were not included in the FY27 Preliminary Budget and remain subject to future Council consideration if additional recurring resources become available, with priority given to those that support public safety, regulatory compliance, and core service delivery. The following items are identified:

Operating Budget

- Restore negative fund balance in the ISFs.
- Restore public safety positions.
- Address deferred maintenance.
- Expansion of Fire Prevention staffing model to address increased inspection, plan review, and compliance workload.
- Restore community programs and events.
- Implementation of a body-worn camera program for the Code Enforcement Division to enhance transparency, accountability, and staff safety.
- Restoration of the Historic Preservation Planner position to support planning, development review, and preservation efforts.
- Additional administrative support within the City Manager's Office, City Clerk's Office, and Finance Department to address increasing operational demands and workload.

Deferred Capital Projects

- Facilities Condition Assessment
- City Hall Roof Replacement
- Fire Station 7 - Roof Replacement

- Fire Station 8 - Exterior Paint and Roof Replacement
- Main Library Gutter Replacement
- Community Services Building Roof Replacement
- City Hall Landscape Renovation
- City Hall - Elastomeric Coating Renewal

Conclusion

The FY27 Operating and Capital Budget reflects the significant fiscal challenges facing the City while prioritizing public safety and maintaining a standard level of service for the residents and businesses of Orange. The budget includes substantial balancing measures, operational adjustments, and the strategic use of available resources to address ongoing structural budget pressures and support core City operations. However, limited financial resources continue to constrain the City's ability to address deferred maintenance, restore service reductions, and meet increasing operational demands and community expectations. While the FY27 Budget provides a responsible financial plan for the coming year, long-term fiscal sustainability will require continued evaluation of expenditures, service levels, organizational efficiencies, and revenue strategies. Tonight, staff is seeking the City Council's adoption of the FY27 Operating and Capital Budget for all funds.

7. ATTACHMENTS

- Attachment 1 Resolution No. 11702
- Attachment 2 Resolution No. 11699
- Attachment 3 Resolution No. 11700
- Attachment 4 Schedule of Changes in Fund Balance
- Attachment 5 Schedule of Revenues and Expenditures
- Attachment 6 Recommended Staffing Changes
- Attachment 7 Schedule of Positions by Department
- Attachment 8 FY27 Budget Reductions and Balancing Measures
- Attachment 9 Five-Year Capital Improvement Plan
- Attachment 10 Fund Description
- Attachment 11 FY27 Financial Model