



FY 2025 – FY 2034 LONG RANGE FINANCIAL FORECAST

City Council Item #12

JANUARY 22, 2024

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OVERVIEW

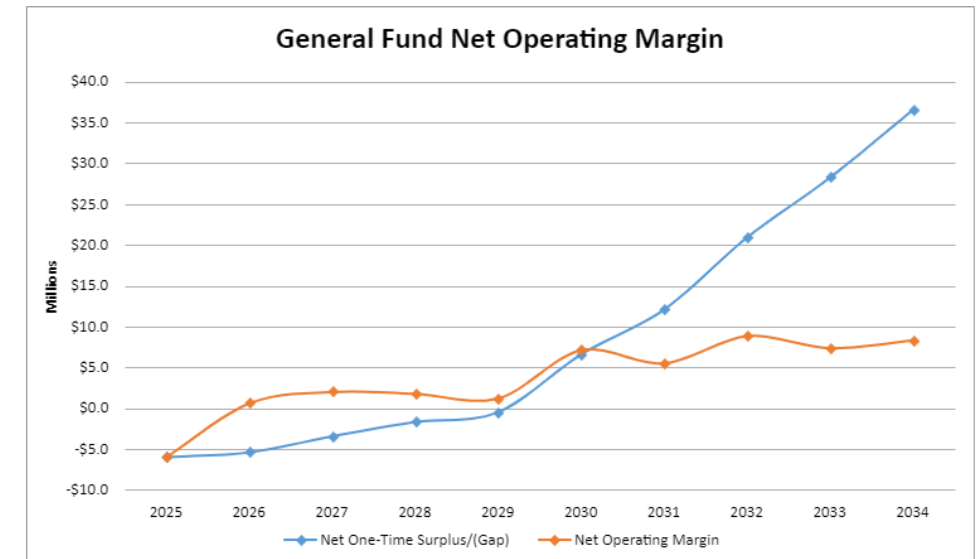
- Economy continues to demonstrate resiliency to formal recession
 - Forecast reflects stagnation offset by inflation
- LRFF consistent with FY 24 Adopted Budget, reflects near-term deficits
 - FY 2025 shortfalls resolved with Uncertainty Reserve
 - Consistent with FY 2024 Adopted Budget two-year strategy
 - Measure K (Business Tax) included for approved projects
 - Measure L (Equity Transfer) phased to 18% by FY 2027
- Expense projections based on current approved service levels
 - Assumes 20% BSR to mitigate uncertainty (typical target = 18.5%)
 - Cost of labor, inflation, and vacancies are key factors
- Estimated surplus in FY 2024 (\$3.4M) from Major Tax Revenue; to be reviewed at Mid-Year

FISCAL YEAR 2025 - 2034 BASE CASE FORECAST

| | Actual 2023 | Adopted 2024 | Projected 2024 | 2025 | 2026 | 2027 | 2028 | 2029 | 2030 | 2031 | 2032 | 2033 | 2034 |
|---|----------------|-----------------|-------------------|-----------|-----------|-----------|-----------|-----------|-----------|-----------|-----------|-----------|-----------|
| Total Revenue | \$254,799 | \$261,141 | \$264,281 | 275,889 | \$289,060 | \$301,025 | \$312,564 | \$325,208 | \$339,684 | \$353,085 | \$365,820 | \$379,944 | \$394,026 |
| BSR Contribution (One-Time) | - | \$3,440 | \$3,440 | - | - | - | - | - | - | - | - | - | - |
| Reappropriated Funds (One-Time) | - | \$15,000 | \$15,000 | - | - | - | - | - | - | - | - | - | - |
| Total Source of Funds | \$254,799 | \$279,581 | \$282,722 | \$275,889 | \$289,060 | \$301,025 | \$312,564 | \$325,208 | \$339,684 | \$353,085 | \$365,820 | \$379,944 | \$394,026 |
| <i>Year over Year increase (revenue only)</i> | | | | 5.6% | 4.8% | 4.1% | 3.8% | 4.0% | 4.5% | 3.9% | 3.6% | 3.9% | 3.7% |
| Total Expenditures | \$243,695 | \$279,581 | \$279,282 | \$281,887 | \$294,473 | \$304,465 | \$314,253 | \$325,708 | \$333,099 | \$341,030 | \$344,933 | \$351,721 | \$357,516 |
| Total Use of Funds | \$243,695 | \$279,581 | \$279,282 | \$281,887 | \$294,473 | \$304,465 | \$314,253 | \$325,708 | \$333,099 | \$341,030 | \$344,933 | \$351,721 | \$357,516 |
| <i>Year over Year increase</i> | | | | 0.8% | 4.5% | 3.4% | 3.2% | 3.6% | 2.3% | 2.4% | 1.1% | 2.0% | 1.6% |
| Net One-Time Surplus/(Gap) | \$11,104 | (\$0) | \$3,440 | (\$5,998) | (\$5,414) | (\$3,440) | (\$1,689) | (\$500) | \$6,585 | \$12,055 | \$20,887 | \$28,223 | \$36,511 |
| Cumulative Net Operating Margin (One-Time) | | | | | | | | | | | | | \$87,220 |
| Net Operating Margin | | | | (\$5,998) | \$585 | \$1,974 | \$1,751 | \$1,189 | \$7,085 | \$5,470 | \$8,832 | \$7,336 | \$8,288 |
| Forecasted One-Time Gap after Use of Uncertainty Reserve | | | | (\$0) | | | | | | | | | |
| Cumulative Net Operating Margin | | | | | | | | | | | | | \$36,511 |

Assumes that the annual shortfalls are solved with ongoing solutions and annual surpluses are spent for ongoing expenditures

- Revenues catch up to Expenses in FY 2030
- Mild economic stagnation through end of FY 2025
- Uncertainty Reserve offsets FY 2025 shortfall, consistent with 2-yr balancing strategy in prior year





ASSUMPTIONS NOT INCLUDED IN FORECAST

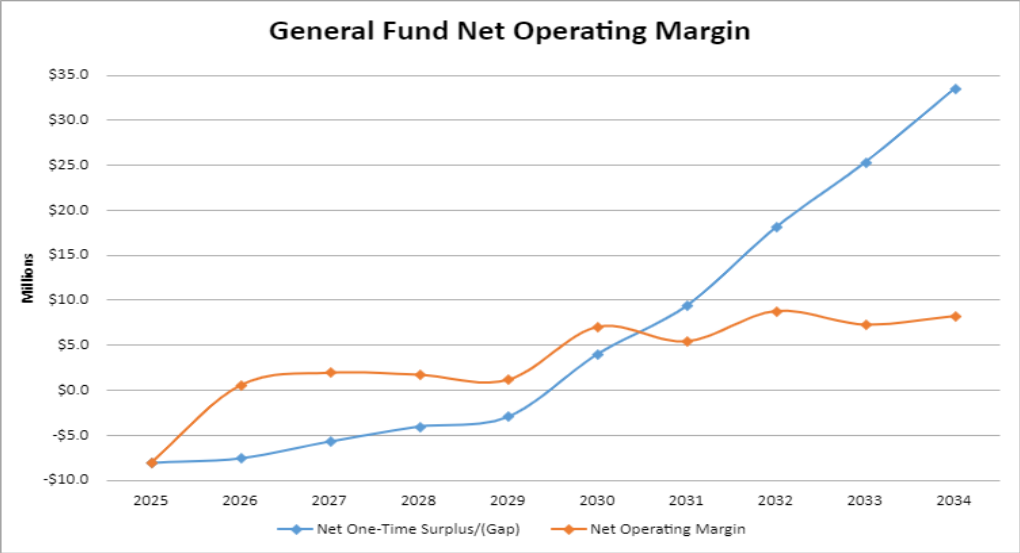
- Labor Negotiations (contracts expire in Jan/Jun 2025); LRFF includes an estimated reserve for changes in vacancy rates, labor and benefit variability, and inflation
- Capital Improvements: Parks Master Plan, Railroad Grade Separation, Vehicle Fleet Electrification
- Cubberley Community Center Redevelopment
- Limited Term Programs:
 - Psychiatric Emergency Response Team (PERT)
 - PA Link
 - Downtown Streets Team
 - Project Homekey

ALT SCENARIO A: ECONOMICALLY SENSITIVE REVENUE IN FY25

| | Actual 2023 | Adopted 2024 | Projected 2024 | 2025 | 2026 | 2027 | 2028 | 2029 | 2030 | 2031 | 2032 | 2033 | 2034 |
|---|----------------|-----------------|-------------------|-----------|-----------|-----------|-----------|-----------|-----------|-----------|-----------|-----------|-----------|
| Total Revenue | \$254,799 | \$261,141 | \$264,281 | 273,760 | 286,825 | 298,692 | 310,138 | 322,682 | 337,041 | 350,335 | 362,971 | 376,979 | 390,943 |
| BSR Contribution (One-Time) | - | \$3,440 | \$3,440 | - | - | - | - | - | - | - | - | - | - |
| Reappropriated Funds (One-Time) | - | \$15,000 | \$15,000 | - | - | - | - | - | - | - | - | - | - |
| Total Source of Funds | \$254,799 | \$279,581 | \$282,722 | \$273,760 | \$286,825 | \$298,692 | \$310,138 | \$322,682 | \$337,041 | \$350,335 | \$362,971 | \$376,979 | \$390,943 |
| Year over Year increase (revenue only) | | | | 4.8% | 4.8% | 4.1% | 3.8% | 4.0% | 4.4% | 3.9% | 3.6% | 3.9% | 3.7% |
| Total Expenditures | 243,695 | 279,581 | 279,282 | 281,887 | 294,471 | 304,463 | 314,251 | 325,705 | 333,097 | 341,028 | 344,930 | 351,718 | 357,513 |
| Total Use of Funds | \$243,695 | \$279,581 | \$279,282 | \$281,887 | \$294,471 | \$304,463 | \$314,251 | \$325,705 | \$333,097 | \$341,028 | \$344,930 | \$351,718 | \$357,513 |
| Year over Year increase | | | | 0.8% | 4.5% | 3.4% | 3.2% | 3.6% | 2.3% | 2.4% | 1.1% | 2.0% | 1.6% |
| Net One-Time Surplus/(Gap) | \$11,104 | (\$0) | \$3,440 | (8,128) | (\$7,646) | (\$5,771) | (\$4,112) | (\$3,023) | \$3,944 | \$9,307 | \$18,041 | \$25,261 | \$33,431 |
| Cumulative Net Operating Margin (One-Time) | | | | | | | | | | | | | \$61,304 |
| Net Operating Margin | | | | (\$8,128) | \$481 | \$1,876 | \$1,658 | \$1,089 | \$6,968 | \$5,363 | \$8,733 | \$7,221 | \$8,169 |
| Cumulative Net Operating Margin | | | | | | | | | | | | | \$33,431 |

Models the impact of a 1% loss in revenue from major taxes, charges for services, and permits and licenses

Revenues decrease by \$2.1M in FY 2025 and increase projected shortfalls

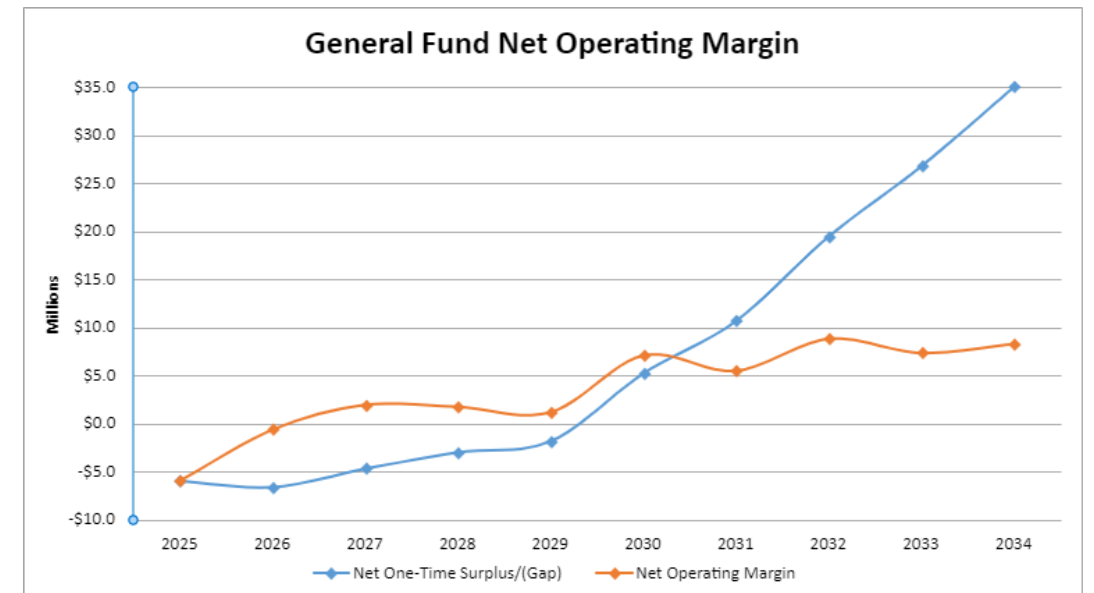


ALT SCENARIO B: COMPENSATION ADJUSTMENT IN FY26

| | Actual 2023 | Adopted 2024 | Projected 2024 | 2025 | 2026 | 2027 | 2028 | 2029 | 2030 | 2031 | 2032 | 2033 | 2034 |
|---|----------------|-----------------|-------------------|-----------|-----------|-----------|-----------|-----------|-----------|-----------|-----------|-----------|-----------|
| Total Revenue | \$254,799 | \$261,141 | \$264,281 | 275,889 | \$289,060 | \$301,025 | \$312,564 | \$325,208 | \$339,684 | \$353,085 | \$365,820 | \$379,944 | \$394,026 |
| BSR Contribution (One-Time) | - | \$3,440 | \$3,440 | - | - | - | - | - | - | - | - | - | - |
| Reappropriated Funds (One-Time) | - | \$15,000 | \$15,000 | - | - | - | - | - | - | - | - | - | - |
| Total Source of Funds | \$254,799 | \$279,581 | \$282,722 | \$275,889 | \$289,060 | \$301,025 | \$312,564 | \$325,208 | \$339,684 | \$353,085 | \$365,820 | \$379,944 | \$394,026 |
| <i>Year over Year increase (revenue only)</i> | | | | 5.6% | 4.8% | 4.1% | 3.8% | 4.0% | 4.5% | 3.9% | 3.6% | 3.9% | 3.7% |
| Total Expenditures | 243,695 | 279,581 | 279,282 | 281,887 | 295,719 | 305,761 | 315,587 | 327,082 | 334,501 | 342,460 | 346,392 | 353,208 | 359,033 |
| Total Use of Funds | \$243,695 | \$279,581 | \$279,282 | \$281,887 | \$295,719 | \$305,761 | \$315,587 | \$327,082 | \$334,501 | \$342,460 | \$346,392 | \$353,208 | \$359,033 |
| <i>Year over Year increase</i> | | | | 0.8% | 4.9% | 3.4% | 3.2% | 3.6% | 2.3% | 2.4% | 1.1% | 2.0% | 1.6% |
| Net One-Time Surplus/(Gap) | \$11,104 | (\$0) | \$3,440 | (5,998) | (\$6,659) | (\$4,735) | (\$3,023) | (\$1,874) | \$5,183 | \$10,625 | \$19,429 | \$26,736 | \$34,993 |
| Cumulative Net Operating Margin (One-Time) | | | | | | | | | | | | | \$74,676 |
| Net Operating Margin | | | | (\$5,998) | (\$661) | \$1,924 | \$1,712 | \$1,149 | \$7,057 | \$5,442 | \$8,804 | \$7,307 | \$8,258 |
| Cumulative Net Operating Margin | | | | | | | | | | | | | \$34,993 |

Models the impact of a 1% compensation adjustment once negotiated agreements sunset

Expenses increase by \$1.2M in FY 2026 and increase projected shortfalls



FY 2025 BUDGET DEVELOPMENT GUIDELINES

- Develop a structurally balanced budget to maintain fiscal sustainability
- Examine appropriate use of surpluses
- Review resource allocation for City Council's identified priorities
- Focus on business process redesign and explore alternative service delivery models
- Explore expansion of existing revenue sources or the addition of new revenue sources
- Continue to prioritize proactively funding long term liabilities

Council Referral: Consider pegging the Human Services Resource Allocation Process (HSRAP) budget allocations to a benchmark, such as percentage of General Fund budgeted expenditures.

Finance Committee recommends continuation of this item in February 2024

- HSRAP funding averaged 0.26% of the General Fund budget from FY 2001 – FY 2024
- Total human services funding averaged 0.83%
- \$0.8M needed annually to increase total human services funding to 1% of the General Fund budget in FY 2025 – FY 2027 of the LRFF base case
- Human services funding never approved to be tied to the General Fund budget
- Prior to FY 2016 HSRAP included Avenidas & Palo Alto Community Childcare (PACCC), after FY 2016 these programs were funded through direct allocation separate from HSRAP

- Variability in LRFF Assumptions and Actual Results
 - Economic Advisory Report issued by Office of City Auditor (OCA) ([CMR 13915](#))
 - Actual results within 9% of original estimates
 - Long-term financial planning models and inputs align with the OCA’s considerations and best practices
- Historical Vacancy Analysis – General Fund
 - Up to \$1.7M savings in prior years, above budget assumptions for a 3% vacancy factor
 - Prior year actuals remained within 1.5% of budgeted levels
 - LRFF adjusts the vacancy factor to 5%, increasing potential savings by \$2M

| | 2019 | 2020* | 2021* | 2022 | 2023 |
|---|----------|----------|----------|----------|----------|
| Total Savings/(Loss) <i>actual salary and benefit costs vs. adjusted budget</i> | \$1.3M | \$1.3M | (\$1.7M) | \$1.6M | \$1.7M |
| Annual Vacancy Rate | 12% | 12% | 15% | 12% | 13% |
| Total Adjusted Budget <i>net of vacancy factor</i> | \$123.3M | \$134.7M | \$124.1M | \$134.3M | \$148.4M |
| Variance to Budget | 1.1% | 1.0% | (1.4%) | 1.2% | 1.2% |

*FY20 and FY21 are anomaly years due to the pandemic

INFO REQUESTED BY FINANCE COMMITTEE (ATTACHMENT C)

- Grants and Funding from Other Agencies

| | 2019 | 2020 | 2021 | 2022 | 2023 |
|--------------|---------|--------|---------|--------|---------|
| General Fund | \$0.8M | \$0.8M | \$1.1M | \$8.8M | \$12.1M |
| Capital Fund | \$12.4M | \$4.3M | \$12.6M | \$4.0M | \$17.0M |

- The General Fund is supported by diverse external funding sources, with the most significant contributions coming from federal, state, and county funding, transportation initiatives, library partnerships, and emergency response.
- External revenues supporting capital improvement projects fall into three broad categories: local/regional grants (including Measure B), state grants, and federal grants, with local/regional grants comprising the largest source in three of the five years.

CONCLUSION AND NEXT STEPS

- Revenue trends indicate near term economic stagnation followed by return to growth
- 2025-2034 LRFF consistent with FY 2024 Adopted Budget two-year strategy
 - Focus on investing only in key areas of priority or urgent needs
 - Alternative scenarios increase projected shortfalls
 - Uncertainty Reserve and one-time surpluses are critical to manage the near-term fiscal stability and investments in priority initiatives
- FY 2024 Mid-Year will include recommendations for addition of key resources and appropriation of funds as directed by Council
 - Review of objectives deferred as outlined in FY 2024 Adopted Budget

Next Steps Annual Budget Process

- *Feb 2024:* FY 2024 Mid-Year Budget
- *May 2024:* FY 2025 Proposed Budget
- *June 2024:* FY 2025 Budget Adoption

RECOMMENDED ACTION

The Finance Committee and Staff recommend that the City Council:

Accept the Fiscal Year 2025 – 2034 Long Range Financial Forecast Base Case and the FY 2025 Budget Development Guidelines (Attachment B)

Direct staff to use this forecast as a starting point for the FY 2025 budget process



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