FINANCIAL FORECAST

Introduction

The Five-Year Financial Forecast provides a long-term macro-view of City general fund revenues and expenditures to assist in evaluating the impact of policy choices on the long-term fiscal health of the City. The Five-Year Forecast is useful in identifying trends and potential issues that may arise in the future that require fiscal planning affecting the current budget. Multi-year fiscal planning is critical to ensuring long-term stability for the organization. The fact that there are restrictions imposed by the State that limit local governments in their discretion to raise revenues adds weight to the importance of longer term financial forecasting.

This forecast is a snapshot in time starting with the assumption that there is no significant change in the 'base budget" of the agency over the forecast period. The base budget is roughly the existing level of service and its resources projected through each future year with some adjustments about likely changes, such as inflation and known mandates, in the cost and revenue for that base budget over the forecast period. By understanding the factors impacting the forecast policy makers can change the long-term outcome by taking certain budgetary actions in the present. As such, the five-year budget model serves as an important fiscal strategic planning tool.

The City of Davis has historically experienced and addressed a recurring situation where general fund expenses have exceeded revenues. With past efforts to reduce expenses though human resource reductions, cost reductions and the resulting service level reductions, the gap of less revenues than expenses has been mitigated. Peering into the future from the point of the conclusion of FY 14/15, it is apparent from the forecast that this trend of revenues meeting or exceeding expenditures may remain as long as increases to general fund expenditures are kept within allowable limits and keeping with the General Fund reserve of 15%.

Five-Year General Fund Forecast

The City has been addressing its financial challenges for several years. Over the past eight years, 112 positions (24% of the City workforce) funded in whole or in part by the general fund have been cut. Furthermore, employees are paying more of their benefit costs, the City uses more contract services in areas where costs savings can be realized and new voter approved sales tax revenue enhancements have been implemented. FY 15/16 projections show for the first time in the past eight years these efforts have been sufficient to offset the general fund's structural imbalance.

The budget forecast begins with the FY 14/15 Budget estimate that includes the removal of expenditures carried over to FY 15/16. This shows an ending fund balance at the end of FY 14/15 of $10.2 million or a 21.21% reserve. This is artificially high due to the removal of carryovers. Carrying this beginning balance into next year, where the carryovers are shown as expenditures, would project the FY 15/16 adopted budget ending with a $7.8 million dollar fund balance reserve of 15.42%.

FY 15/16 is the first time in many years the forecast has projected General Fund revenues in excess of expenditures after accounting for $3.13 million in carry overs from the prior fiscal year. This is the result of many years of expenditure reductions, as well as a ½ cent sales tax increase approved by a majority of Davis voters in June 2014. The 5 Year Forecast projection indicates improved fund balance by the end of the five year forecast period. This scenario is likely to change with the completion of employee contracts updates, yet manageable with prudent negotiations.

The conclusion drawn from this is that the City needs to continue on the path of examining ways to contain costs; ensure that its revenue collections for user fees and efforts to obtain grant funding are robust; consider other revenue sources, including taxes or fees, that may preserve and or improve service levels and address long-term needs; seek partnerships with government and private agencies that will reduce costs; and, through targeted economic development efforts in line with community values, increase and broaden the tax base of the General Fund.

After FY 20/21 the ½ cent sales tax sunsets. The table below shows the effect of the loss of that revenue in the absence of any other revenue sources or expenditure reductions. At that time the City's budget surplus becomes a budget deficit with the General Fund reserve going negative in FY 23/24.

FY 15-16 Adopted Budget
General Fund Projection - $'s in millions

	2014/15 Estimate	2015/16 Adopted	2016/17 Forecast	2017/18 Forecast	2018/19 Forecast	2019/20 Forecast	2020/21 Forecast	2021/22 Forecast	2022/23 Forecast	2023/24 Forecast	2024/25 Forecast
Beginning Fund Balance	$ 6.0	$ 10.2	$ 7.8	$ 7.9	$ 8.4	$ 9.5	$ 10.9	$ 12.8	$ 9.4	$ 4.4	$ (0.2)
Revenues	$ 52.2	$ 52.4	$ 50.2	$ 51.6	$ 52.8	$ 54.2	$ 55.5	$ 51.0	$ 50.2	$ 51.5	$ 52.9
Expenditures	$ (48.0)	$ (54.8)	$ (50.1)	$ (51.1)	$ (51.7)	$ (52.8)	$ (53.6)	$ (54.4)	$ (55.2)	$ (56.1)	$ (57.0)
Ending Fund Balance	$ 10.2	$ 7.8	$ 7.9	$ 8.4	$ 9.5	$ 10.9	$ 12.8	$ 9.4	$ 4.4	$ (0.2)	$ (4.3)
General Fund Reserve %	21.21%	15.42%	16.46%	16.92%	18.74%	20.88%	23.99%	19.19%	9.14%	-0.34%	-8.53%

<u>Additional Information and Assumptions Related to the Forecast</u>

The following summarizes the results of the City's General Fund forecast for FY 15/16.

o General Fund revenues are projected to grow at an average annual rate of 2.5% per year, resulting in ongoing revenue growth of $6.21 million for the period FY 15/16 through FY 20/21. This is net of $3.09 million dollars in one-time revenue in FY 15/16 and carryover revenue from FY 14/15.

o General Fund expenditures are projected to experience annual increases from FY 15/16 through FY 20/21 averaging 2.1% per year, resulting in total General Fund expenditures growth of $5.07 million over the forecast period. Again this is net of $3.17 million dollars in one-time expenditures in FY 15/16 and $3.13 million in expenditures carried over from FY 14/15.

o The operating projections shown over the five-year planning horizon remain sensitive to assumptions related to major city revenues and expenditure categories. Among the main areas of concern are property and sales tax revenues. While the City has seen a fairly robust improvement to these revenues for the past several years, it is not certain that it will continue to grow at these levels. In addition, expenditures for personnel services are sensitive to employee negotiations, as well as CalPERS pension and medical costs. For all these reasons, we continue to be cautiously optimistic and diligent to maximize revenues and contain costs.

Five-Year Forecast Assumptions

Many factors which drive the forecast are beyond the control of the City, such as inflation, federal and state spending cuts, state-wide initiatives, short-term economic cycles, and emergencies. These assumptions impact revenue and expenditure projections and variations can cause wide swings in the budget.

Inflation

Inflation is an important factor in any economic forecast because of its influence on both city revenues and expenditures. Inflation-sensitive revenue, such as sales and business license taxes, make up approximately 30 percent of the General Fund budget. Salary and benefit costs can also be influenced by annual cost-of-living increases.

The City of Davis uses the April-to-April All Urban Consumer Price Index for the San Francisco Bay Area as its inflation index. This index has increased an average of 2.5% over the last five years. Forward-looking indicators of overall economic strength or weakness are important to consider. Other factors can also be used in areas where specific increases are known, i.e. water rates and insurances.

CONSUMER PRICE INDEX
Change from previous year

YEAR	
2011	2.8
2012	2.1
2013	2.4
2014	2.8
2015	2.5
Average	2.5%

Population

Based on data from the State Department of Finance, population is projected to be 66,757 for FY 2015/16 which is flat over the prior year. Population impacts some state revenues (allocated on a per-capita basis) as well as drives demands for a variety of city services. The population figure reported for the City of Davis excludes persons housed on the University of California at Davis campus as it lies outside of City limits.

General Fund Revenues

The amount of money available to fund services and programs through the General Fund is determined by the dollars generated by the City's economic base and the City's revenue structure (i.e., the fees and rates applied such as business licenses). The General Fund provides the only discretionary revenue available to the Council and citizens to directly support local priorities. The General Fund provides most of the funding if not all for services such as police and fire protection, parks, recreation, community development, as well as most of the administrative and support functions of City government.

There are seven primary sources that the City uses throughout the year as key indicators of the health of overall General Fund revenue: real property tax, sales tax, business license fees, motor vehicle in-lieu taxes, transient occupancy (hotel) tax, Municipal Service Tax and fee revenues. In FY 15/16, these indicator revenues are expected to comprise an estimated 82% of the total General Fund revenue.

General Fund Major Revenue Sources

The City's ability to maintain General Fund revenue consistent with inflation and other increasing pressures has been severely limited by various voter initiatives over the last 20 years. This trend began in 1979 with Proposition 13, and continued with the State-wide Proposition 218. The effects these voter initiatives have had on the City's General Fund have been further compounded by the State's shift of local property tax revenues away from cities to school districts (ERAF) and the State General Fund.

The projection of revenues into the future is based on past performance and analysis of actual current private and public sector activity. This includes such private sector activities as housing trends, employment, property turnover and business growth; and public sector developments such as policy shifts at the local, state and federal levels.

Revenue projections are inherently dependent on a number of assumptions, which vary by revenue source. The assumptions used to project the General Fund Revenues in the Five-Year Strategic Plan are as follows:

- *Real Property Tax* – The State Constitution sets the base property tax rate at 1% of assessed value. The City receives approximately 18% of the property tax generated in Davis, with the majority of the revenue going to the State. Property tax receipts are projected to see a 3% increase for FY 15/16, and grow at 3.5% throughout the forecast.

- *Sales Tax* – Sales tax revenues are derived from the tax imposed on sales of goods and services transacted within the City. An increase in the local sales tax rate was renewed by voters in June of 2010 and was set to expire in June 2016. The City placed Measure "O" on the June 2014 ballot, which passed voter approval, adding an additional 0.5% to the local tax rate and extending the current rate through December 31, 2020. This increased the current local sales tax rate from 8% to 8.50%. Sales Tax revenues are projected to be increase at 3.0% throughout the forecast.

- *Business License Tax* – This revenue source is derived from a tax imposed on gross receipts of businesses licensed to operate in the City. The tax rate varies depending on the business enterprise. The revenue projections assume 1% growth in throughout the forecast.

- *Motor Vehicle In-Lieu* – This revenue source represents the City's allocated share of state-wide vehicle registrations, apportioned throughout the County on a per capita basis. Historically, this revenue source has provided a stable funding source to the General Fund, in excess of $5 million in FY 14/15.

The FY 2004/05 State Budget changed how VLF revenues are distributed, and lessened the reliance of this revenue source on the part of cities. In that year, roughly 90% of cities' VLF revenues were exchanged for an equal amount of Property Tax revenues from the state. In subsequent years, the amount of the property tax "in-lieu" payments increased in proportion to growth in each jurisdiction's assessed value.

- *Municipal Service Tax* – This revenue source was adopted by local voters in 1986. The tax is paid by residential property owners based primarily on a per dwelling unit basis, and to commercial property owners primarily on a per square foot of building basis. The tax is expected to generate $2.8 million in FY 15/16. An annual increase of 3% is built into the Five-Year Forecast.

Fee Revenues – Several City programs are funded through fees charged to participants and users of city services. These range from fees for recreation programs to fees for building permits. In general, fees are reviewed and updated on a regular basis to reflect increasing costs. For this five-year projection, fee revenues are assumed to increase 2% per year.

Expenditure Baseline

The expenditure baseline for the Five-Year Forecast is the FY 14/15 Estimate, and the FY 15/16 Adopted budgets. The forecast projects expenditures as a result of anticipated changes highlighted in this section.

Current service/staffing levels - The baseline Five-Year forecast assumed current staffing levels and updated employee service and operational costs. Since the FY 15/16 baseline budget was constructed continued citywide reorganizations and restructuring have reduced the full-time equivalent staff by two (2) positions from the FY 14/15 level.

Personnel Costs

The City's current contracts with a majority of its employee bargaining units included provisions for cost sharing with employees which resulted in wage and benefit savings over time. For example, the City is no longer paying the employee share of CalPERS benefits for all bargaining units except for the Davis Professional Firefighter's Association which opted to take a pay cut in lieu of covering that share. The City also negotiated cost sharing of medical insurance increases; reduced the available cash in-lieu payments; and, restructured the retiree medical benefit. All of these measures reduce the City's long-term costs.

Due to the expiration of most employee contracts in FY 15/16 and negotiations just in the beginning stages, there have been no wage increases projected in the budget or throughout the Five-Year Forecast. Other benefits which will continue unless negotiated differently have been included in the model, i.e. Medical, PERS Pension, Retiree Medical, Workers Compensation, Unemployment and Life insurance. In total the forecast reflects total General Fund compensation (salaries and benefits) increases of 2.8% for FY 2015/16, and averaging increases of 2.2% per year over the remainder of the five-year forecast. This percentage takes into account the cost increases for CalPERS retirement benefit and the full funding of the City's current Other Post Employment Benefits (OPEB-Retiree Medical) requirement.

125 Plan Benefits

Costs related to Health, Dental, and Life insurance are assumed to grow at an annual rate of 4% throughout the forecast. With the implementation of the most recent MOU's, the City shares the cost of increases in Medical insurance with the employee and the amount of cash that employee can take in lieu of benefits is decreasing in January 2016 to a maximum of $500 per month.

Other Post-employment Benefits (OPEB)

GASB 45 requires public agencies to evaluate and report in its annual financial statements the fully-funding cost of any post-employment benefits (i.e. retiree healthcare). While GASB 45 does not require full-funding of post-employment benefits, it effectively highlights the difference between the actual cost of these benefits and the funds typically allocated on an annual basis for pay-as-you-go funding plans. These include retiree Medical, Disability, Workers' Compensation and Unemployment.

The last actuarial valuation estimated the City's unfunded liability at $60 million which equates to $6.48 million annual contribution in FY 15/16 for full funding. The actuarial calculation assumes this will grow 3.25% annually in order to maintain the full funding requirements of the OPEB obligation and this value has been used in the five-year forecast.

State Retirement System

Retirement rates are set annually by the California Public Employees' Retirement System (CalPERS). The rates established for FY 15/16 reflect an increase from current rates. CalPERS has changed some of its actuarial assumptions which will result in rate increases. The City hired an outside consultant to do its own evaluation of future costs to the City for CalPERS and these are slightly higher. The City uses the values received from CalPERS for FY 15/16 and the actuarial values in the out years.

The following table summarizes the employer contribution rates used in the Adopted FY 15/16 Budget and Five-Year Forecast:

	FY15/16	FY16/17	FY17/18	FY18/19	FY19/20	FY20/21
Public Safety	32.98%	35.55%	38.05%	40.60%	43.10%	43.25%
Civilian (Misc.)	26.63%	28.30%	29.60%	30.90%	32.20%	32.20%

Note: The PERS rates used are based on actuarial forecasts prepared by Bartel Associates Inc. These actuarial calculations include assumptions for newly adopted PERS Market value smoothing method change using 25 year (fixed) amortization period paid over 30 years, as well as anticipated changes to mortality assumptions and anticipated investment returns from 7.5 to 7.25%.

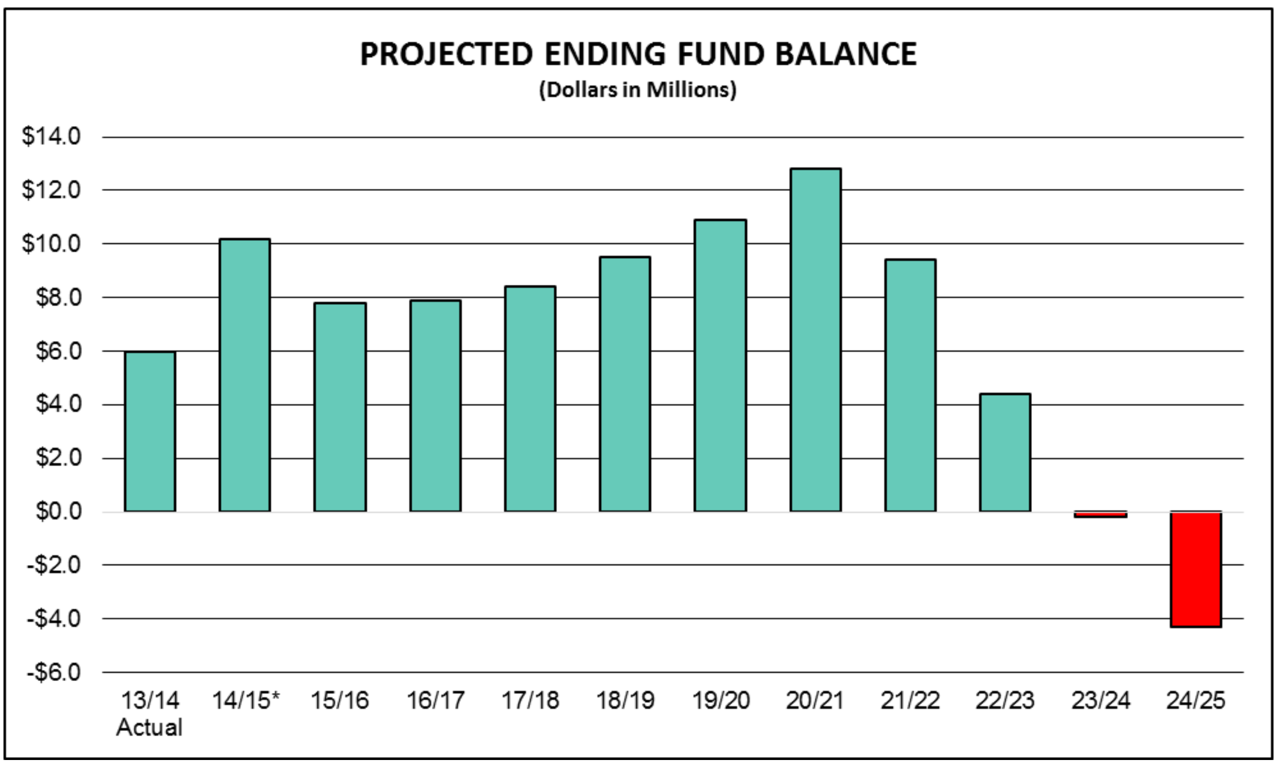
On an all-funds basis, the City's cost for retirement benefits in FY 15/16 is $7.7 million, which is an increase of $697,000 over FY 14/15 budget. The General Fund represents approximately 60% of citywide personnel costs which implies that the General Fund cost for retirement contributions would increase by just over $418,000 for FY 15/16.

Beginning in FY 04/05, the City's Police and Fire retirement plans were combined into a single Public Safety plan so as to avoid being mandated to participate in a statewide safety plan (required for all agencies with fewer than 100 members). The City was able to avoid potentially higher costs for public safety retirement because the rates for Police and Fire have typically been well-below state averages for similar plans. On June 30, 2014, the City's pool of participating safety employees fell below the required 100 members and has been placed into the statewide safety plan.

Other Major Forecast Expenditure Assumptions

City service costs for water and sewer have been included in the forecast model with anticipated increases to rates over the next five years consistent with Council approved rate structures. These costs are projected to increase nearly $1.0 million over this time. This cost is partially offset by $581,937 in annual lease revenue. The City is also setting aside money to improve and upgrade the current irrigation infrastructure in an effort to conserve water use in the City parks. The FY 15/16 Budget includes $500,000 towards this effort as well as $150,000 carried over from the prior year. These amounts are reflecting year end projections and may change on the basis of FY 14/15 final year end actual results.

City roads and bike paths are in need of rehabilitation. The City is dedicating $3.4 million all funds ($3.0 million in General Fund) in FY 15/16 earmarked for the annual street and bike path paving program, which is aimed at improving the pavement throughout the City in an effort to ensure that the City's transportation infrastructure is maintained to an acceptable level. This effort frontloads the infrastructure maintenance project until a long-term funding source can be identified.



*FY 14/15 Fund Balance is artificially high due to expenditure carried over into FY 15/16