2021

Long-Term Financial Forecast

2021 Long-Term Financial Forecast
Trends and Forecast Analysis

TABLE OF CONTENTS

TABLE OF CONTENTS (continued)

2021 Long Term Financial Forecast
Forecast Analysis and Trends

I: INTRODUCTION

This document is the City of Napa's Long Term Financial Forecast (LTFF). Staff regularly updates the forecast to assist in planning for a successful future for the City of Napa. The entire City organization is committed to doing all that is necessary to develop and stabilize our financial base as a strong financial foundation is essential to the provision of critical services to the community. Regardless of whether the economy is expanding, contracting, or remaining stable, financial planning is a prudent activity, and maintenance of the LTFF is essential to sound fiscal management. In general, budgetary problems will result when revenues do not keep pace with expenditures, but there is more to financial planning than trying to keep the budget in balance. The LTFF provides the strategic foundation to understanding the various trends to allow a comprehensive review of programs and services provided to the community and how these needs may change both in the near-term and long-term.

Purpose of the Long-Term Financial Forecast

The LTFF takes a forward look at the City's General Fund operating revenues and expenditures. Its purpose is to identify financial trends, shortfalls, opportunities and issues so the City can proactively address them. It does so by projecting the future fiscal results of continuing the City's current service levels and policies.

The LTFF lays the foundation for the budget, aiding both the City Manager and Council in establishing priorities and allocating resources appropriately. While the forecast has shown strong growth in prior years after the recovery from the last recession, the ongoing COVID-19 pandemic has profoundly affected the City's financial standing. This forecast projects moderate growth as we emerge from the pandemic but reveals that the City has structural budget issues that will need to be addressed with decisive Council action.

Components of this Long-Term Financial Forecast

The City's forecast is focused on emerging issues and has been documented for public review to encourage input and feedback from various stakeholders.

This forecast includes the current fiscal year (FY 2020/21) and a six-year forecast through FY 2026/27, a statement of current financial position, and a trend analysis for FY 2010/11 through FY 2019/20.

The LTFF is not able to predict the City's fiscal future, rather it serves as a tool to highlight significant trends or issues that must be addressed if the City's goals are to be achieved.

The following table displays the status of the recommended issues for study/action from the 2020 LTFF.

Description/Item	Status	Comments
Continued monitoring of hotel development projects and impacts/reliance on transient occupancy tax revenue projections	Ongoing	Baseline Transient Occupancy Tax revenues have not shown significant growth since FY17; will continue to monitor potential impacts of new development on pre-existing hotels.
Financing of the proposed Civic Center project and budgeting for ongoing debt service payments	Closed	The Civic Center project is currently on hold.
Fiscal policy changes to provide parameters for usage and replenishment of reserve balances	In process	Finance updated the General Fund Reserve policies with the FY 2019/20 and 2020/21 budget adoption. Policy updates for other fund reserves are in process.

II: FINANCIAL FORECAST

An updated financial forecast for the General Fund has been prepared to reflect economic projections of the City's future financial condition. The General Fund provides the resources to pay for most City services such as police services, street maintenance, park maintenance, recreational and other critical programs. The General Fund is also the most vulnerable to outside influences, such as State and Federal takeaways, downturns in the economy, taxpayer initiatives and other factors.

Development of the Financial Forecast

An updated financial forecast for the fiscal years 2021/22 through 2026/27 has been developed for the General Fund. The objective of the financial forecast is to provide a frame of reference for evaluating the City's financial condition as a basis for decision-making.

The forecast presented uses the present level of services and capital needs as the baseline. Inflation and historical analysis are used to predict expenditure patterns while revenues are projected by trend or by specific known events. Information regarding economic indicators and the performance of the economy, as a whole, over the forecast period was taken from the California Department of Finance, the Napa County Auditor/Controller's office, and the City's Community Development Department.

The COVID-19 pandemic, which began to impact the City of Napa in March 2020, has dramatically reduced City revenues. Multiple prolonged shutdowns have caused reductions in sales tax and transient occupancy tax, and full revenue recovery is not projected until FY 2023/24. This forecast assumes that with vaccinations, the local economy will return to FY 2018/19 activity levels in FY 2023/24, with more normal growth patterns for the remainder of the forecast. While it is currently anticipated that other revenue sources will not be impacted by the pandemic, business license tax will be monitored to see if downward adjustments are required in the future.

These continuing factors in the national, state and local economies could impact the forecast:

- COVID-19 Pandemic
- Housing Market
- Consumer Confidence
- Unemployment Rate
- Lodging/Tourism
- Local, State, and Federal Issues

COVID-19 Pandemic

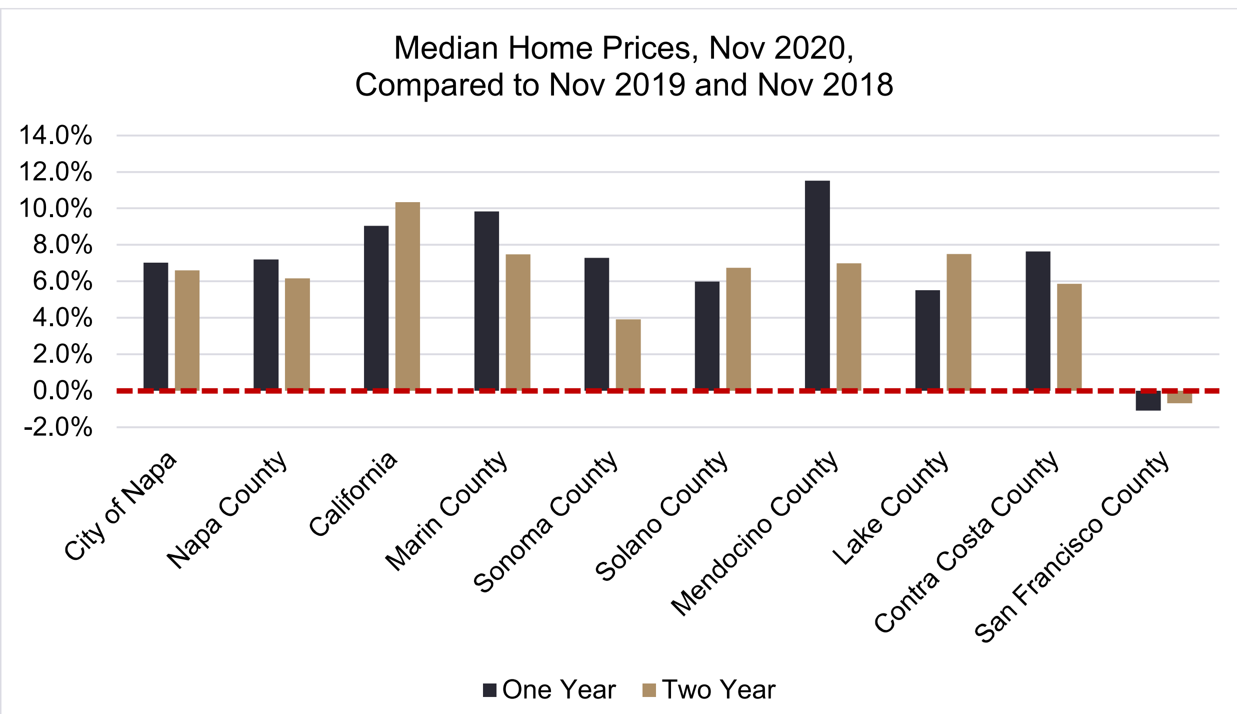
As of January 13, 2021:

- Napa County
  - Cumulative Cases: 6,880
  - Active Cases: 4,498
  - Positivity Rate: 6.0%
  - Vaccines Administered: 5,449
- State of California
  - Cumulative Cases: 2,815,933
  - Positivity Rate: 8.4%
- United States
  - Cumulative Cases: 23,009,789
  - Deaths: 383,290

The pandemic continues to rage across the country, with all indicators continuing to trend upward. While the hope is that widespread vaccination will curb the spread and allow us to return to "normal", the exact timeline is unclear.

Housing Market

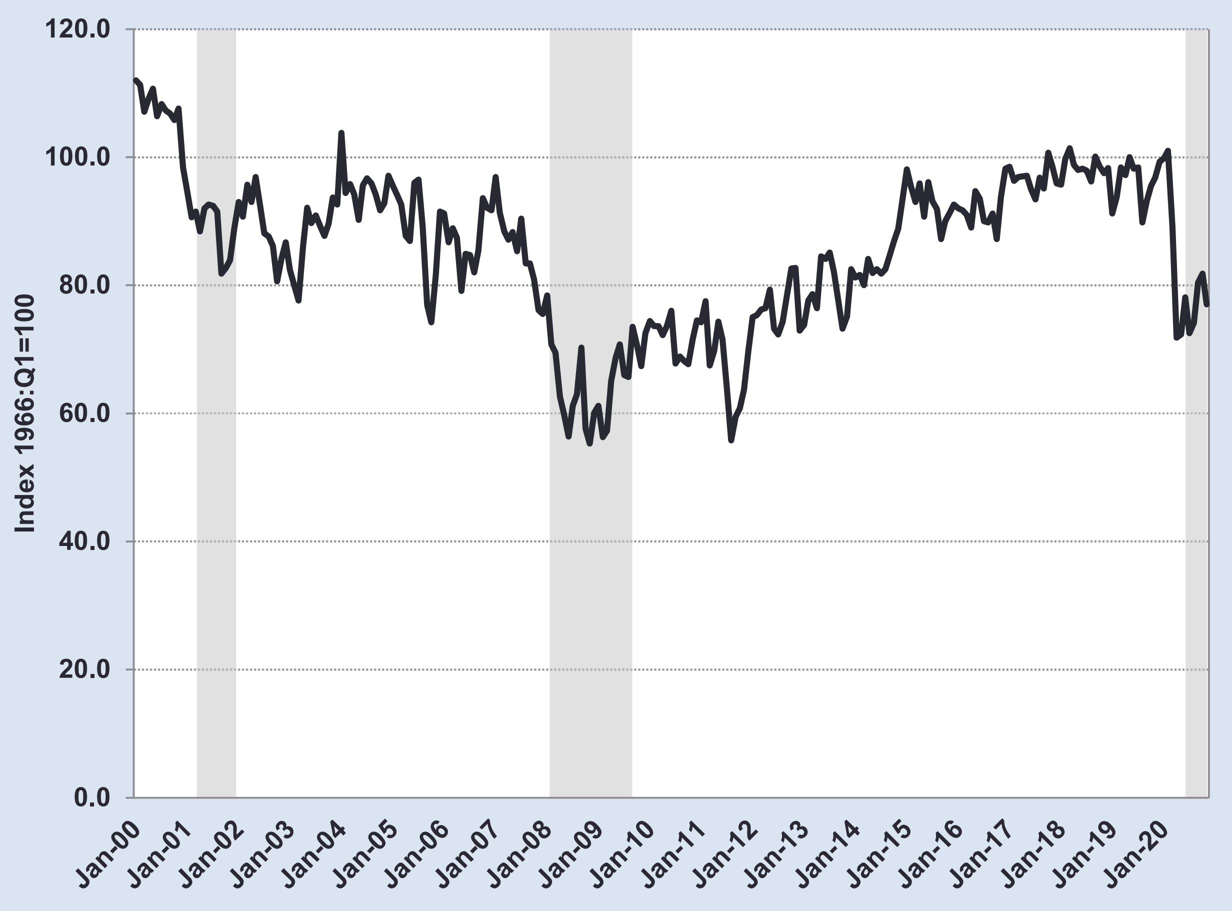
Median housing prices continue to climb for Napa, with increased growth during the pandemic due to increased demand based on lower interest rates and the greater ability to work remotely. Home prices, as well as assessed valuations, are projected to continue to increase during the forecast period.



Data Source: Zillow™ Research and EFA

Consumer Confidence

The Conference Board's *Consumer Confidence Survey*™ indicates that the Consumer Confidence Index™ has a fair amount of volatility and experienced a sharp decline with the onset of the pandemic. While confidence has since rebounded slightly, Napa has reason to be very cautious considering our reliance on elastic revenues.



Source: University of Michigan/FRED, Shaded Area = Recession

Unemployment Rate

The unemployment rate in the City of Napa was 6.4% as of November 2020. This rate is largely due to the leisure and hospitality industry, which has not recovered from the initial widespread layoffs seen in the early days of the pandemic.

The unemployment rate in the County is slightly lower at 6.0% in November 2020. In comparison, the rate for the State of California was at 7.9%.

Lodging/Tourism

Napa County hotel occupancy rates and revenue per available room continue to lag behind 2019 (pre-pandemic). Typically, TOT is the City's second largest revenue source and comprises about 23% of the total General Fund revenue for the City. These substantial decreases reduce City revenue by millions of dollars. The uncertainty in the forecast is due to the unknown timeline for occupancy rates to return to 2019 levels, not just in terms of recovery from the pandemic, but in how likely people may be to travel and stay in hotels post-pandemic.

Hotel Data, November 2020 compared to November 2019

	Occupancy %		**Revenue Per Available Room or RevPAR ($)**	
County	**2020**	**2019**	**2020**	**2019**
Napa	45.5	70.0	$118.43	$223.83
Marin	49.3	75.3	$60.47	$122.70
Sonoma	49.4	73.4	$141.96	$169.45
San Francisco	31.3	79.1	$38.32	$227.62

Source: Smith Travel Research and EFA

Local, State and Federal Issues

The current Fed target rate is just 0 – 0.25%. These low interest rates have spurred large purchases for the people in higher economic tiers, and help to buoy Napa home sales during this time. However, CalPERS has missed its 7% target return rate two fiscal years in a row, with FY 2019/20 returns reaching only 4.7%. Low CalPERS returns can lead to increased rates for the City in the future.

The City received a little under $1 million in Federal CARES dollars to the General Fund, which was spent on community initiatives, PPE, and IT equipment to allow City staff to work from home to minimize exposure and community spread. President Biden's proposed stimulus package includes $350 billion of state and local aid, but at this time it is unknown what amount could come to the City, and what restrictions would be placed upon the funding.

There are concerns that the U.S. is facing a K-shaped economic recovery, which would mean that certain economic segments recover while others stagnate. The pandemic has exacerbated economic inequality, with many higher paying "professional" jobs allowing people to work from home, and layoffs/unemployment for people with lower paying jobs. As the pandemic continues, millions of people nationwide are classified as long-term unemployed (six-months or more), and more women and BIPOC have lost employment than white men.

Revenue and Expenditure Assumptions

The Long-Term Financial Forecast includes a baseline (most likely) revenue assumption, along with optimistic and pessimistic revenue scenarios. The key assumption differences between these scenarios are as follows:

Most Likely:

Sales Tax: 3.7% average annual increase

Transient Occupancy Tax: 1.5% increase per year plus most likely new development estimate

Recession:

Assumes declining Sales Tax and Transient Occupancy Tax in FY 2020/21 and FY 2021/22, with revenues increasing in FY 2022/23 forward

The assumptions (most likely scenario) utilized in this forecast are summarized below:

- Revenue Assumptions
  - Property Tax: 4% growth/year, plus $1.2 million in Excess ERAF (50% of annual anticipated amount of $2.4 million)
  - Sales Tax: 5.8% average annual growth through FY 2023/24, 3.3% average annual growth from FY 2024/25 – FY 2025/27
  - Transient Occupancy Tax: 29.1% average annual growth through FY 2023/24, 1.5% average annual growth from FY 2024/25 – FY 2025/27 for existing hotels; plus estimated new development
  - Business License Tax: 2.3%
  - Other Revenues: 1.4% average annual growth
  - Transfers In: 3.5% growth/year
- Expenditure Assumptions
  - Salaries: 3.5% growth/year (combined COLA and step increases)
  - Frozen Positions: In FY21, 31 vacant positions were frozen by Council as of December 31, 2020. These positions accounted for approximately $4.1 million of General Fund savings. These positions are included in the forecast to show the impact of adding them back to the budget.
  - Health/Dental: 3.5% growth/year
  - CalPERS Normal Cost: 6.2% average annual growth, using rates and amounts calculated by an actuarial study
  - CalPERS UAL Payment: 7.6% average annual growth, using amounts calculated by an actuarial study
  - Semi-Discretionary Services and Supplies: 12.9% growth/year
  - Internal Services: 4.9% growth/year
  - Discretionary Services and Supplies: 0.8% growth/year
  - Fiscal Policy Transfers
    - 1% Operating Budget transfer to the CIP General Reserve
    - 2% Operating Budget transfer to the CIP Facilities Reserve
    - $100,000/year transfer to the General Plan Reserve
    - $150,000/year transfer to the Equipment Replacement Reserve

- Other Transfers
    - $900,000/year transfer to the Sidewalk Replacement Fund

Factors Not Included in the Forecast

- This forecast is based on the General Fund only. Disaster related Federal Emergency Management Agency (FEMA) and State of California Office of Emergency Services (CalOES) revenues and expenditures are not included.

- Other non-recurring revenues and expenditures have also not been included such as major non-recurring development fees and expenditures or one-time transfers to rebuild reserves.

- The forecast does not include the cost of fiscal changes that the City may want to consider, including:

    1. New positions
    2. New or enhanced programs.
    3. State impacts (e.g. offset for lost Redevelopment Agency Tax Increment).

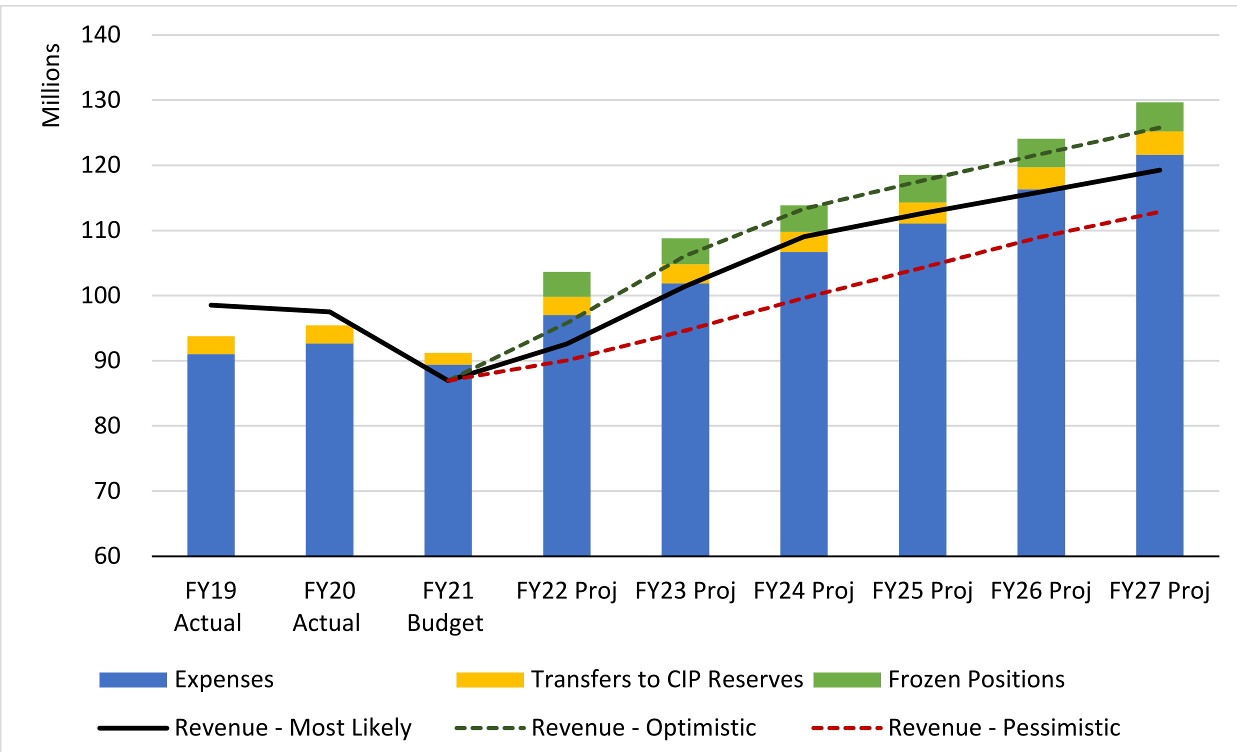
- Only sizable commercial development under construction or with a high likelihood of becoming reality has been included.

Forecast Summary and Results

Operating position refers to the City's ability to match revenues to expenditure levels, i.e. if revenues exceed expenditures, the City will have an operating surplus. If revenues fall below expenditures the result is an operating deficit. Over the forecast period, the City's revenue and expenditure projections show a negative operating position.

Most Likely (in millions)	2018/19	2019/20	2020/21	2021/22	2022/23	2023/24	2024/25	2025/26	2026/27
Revenue	98.54	97.52	86.98	92.61	101.44	109.04	112.62	115.94	119.26
Expenditures	93.77	95.45	91.20	103.65	108.79	113.86	118.51	124.08	129.68
Surplus / (Deficit)	4.77	2.08	-4.22	-11.03	-7.35	-4.82	-5.90	-8.14	-10.42

Revenues & Expenditures

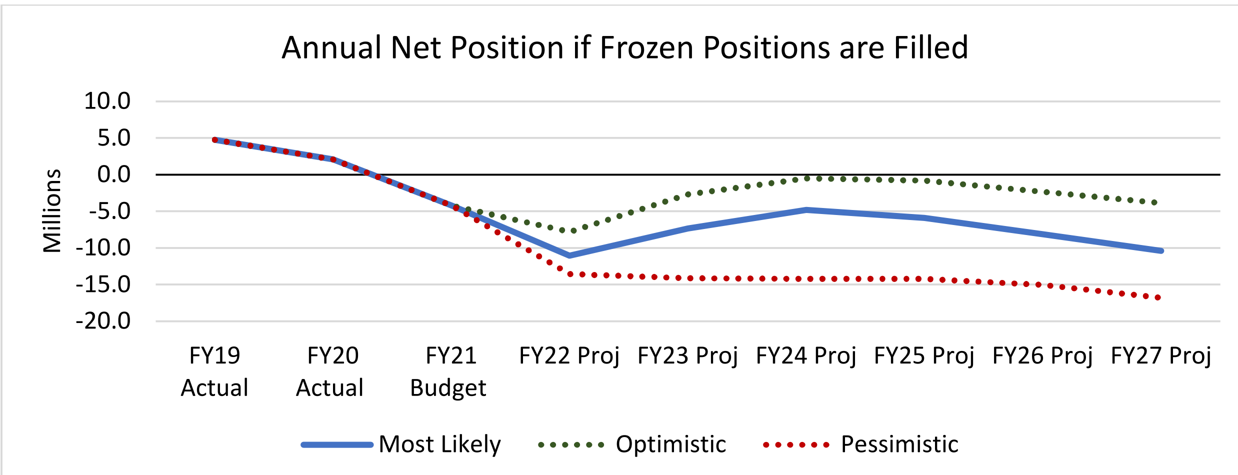


Total General Fund revenues are forecast (using the most likely scenario) to grow by an average annual increase of approximately 6.5% per year over the forecast period, from the low point of FY 2020/21. The rebound post-pandemic as well as planned hotel development projects contribute to the forecasted revenue growth.

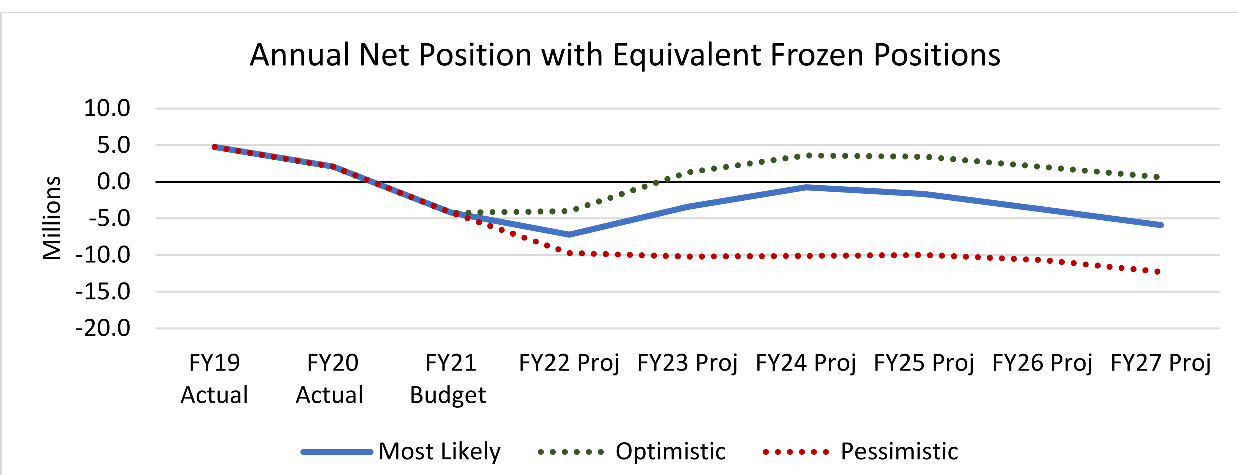
Expenditures are projected to increase at an average annual rate of 7.3% per year. This growth rate assumes that the 31 positions frozen by Council as of December 31, 2020, are unfrozen in FY 2021/22 and added back to the budget. The growth rate also assumes that expenditure budgets are allowed to increase by historical growth rates and are not controlled by budgetary decisions or fiscal policy changes. Projected expenditures include retirement contribution increases as projected by our actuarial consultants, other benefit increases, and cost of living adjustments (COLA). No new positions or programs are included in this forecast.

In most years of the forecast, expenditure growth outpaces revenue growth. That, combined with the weak revenue position in FY 2020/21, leads to deficits in each year of this forecast. These deficits would require usage of the City's General Fund reserves, which are not sufficient to cover this magnitude of deficit over the forecast period.

Based on this forecast model, the City would experience deficits each year, for each of the three revenue scenarios:



Without a means to boost revenues, the City will need to consider how to reduce costs. In the chart below, the assumption is made that the City will maintain vacant, frozen positions throughout the forecast (in an amount equivalent to the positions frozen in FY 2020/21). By reducing expenses by about $4 million per year, the annual net position moves closer to zero. The budget process for FY 2021/22 will require priority-setting and budget control decisions to reduce the deficit.



The revenue forecast is particularly volatile at this time, due to the ongoing COVID-19 pandemic. With an unknown recovery timeline, it is difficult to determine when the City will return to its typical economic activity levels. If the City recovers more rapidly or more slowly than anticipated, revenues will be strongly affected.

To better analyze the City's expenditures for this forecast, expenditures were divided into three categories: Semi-Discretionary and Non-Discretionary, Discretionary, and Frozen Positions.

Semi-Discretionary and Non-Discretionary Expenditures: 89% of total expenditures for forecast period

- Salaries and Benefits (including COLA's and Merit Increases
- CalPERS UAL payments (Non-Discretionary)
- Services and Supplies (includes utilities, software licenses, agreements with other agencies, banking fees, etc.)
- Internal Services (Fleet, Risk, IT Replacement, etc.)
- Transfers to CIP Reserves per Fiscal Policy
- Other Transfers Out per Fiscal Policy (includes General Plan reserve and Equipment Replacement reserve)

Discretionary Expenditures: 7% of total expenditures for forecast period

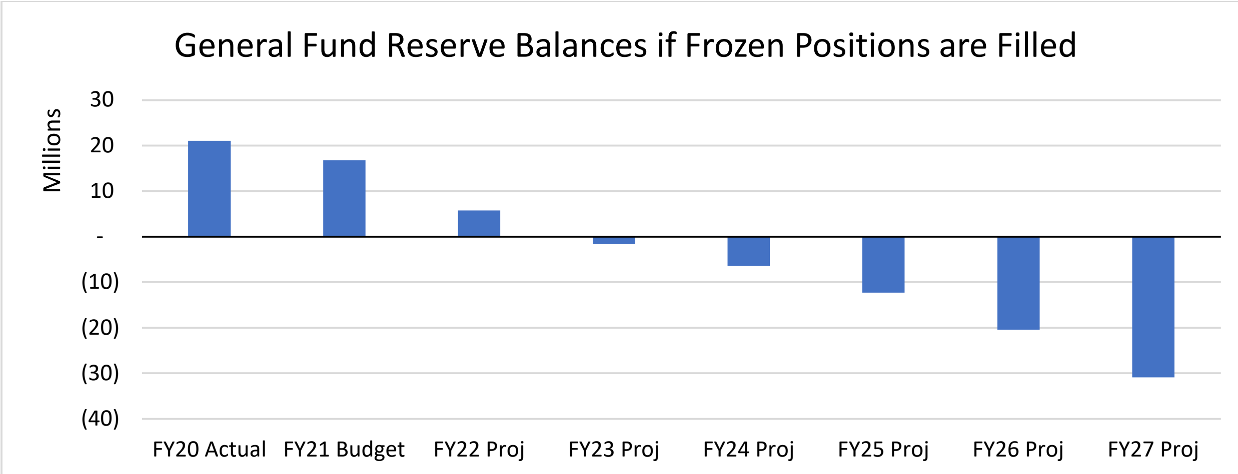
- Services and Supplies (includes professional services, travel/training, office supplies, etc.)
- Transfer to Sidewalks Program

Frozen Positions: 4% of total expenditures for forecast period

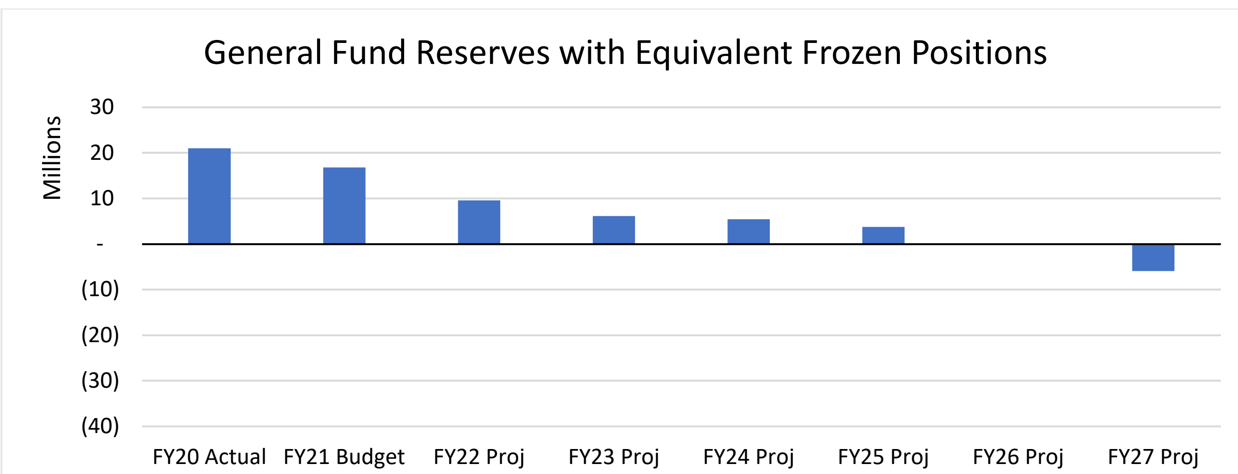
- The costs associated with adding back the positions frozen by Council in FY 2020/21, including COLA's, merit increases, and benefits. These were calculated separately from the other salary/benefit expenditures to show the impact of Council decisions on the forecast.

Increases in labor costs, CalPERS UAL payments, and semi-discretionary services are the primary drivers of expenditure growth. The forecast includes an estimated COLA for all bargaining groups equivalent to average CPI growth over the past ten years in the Bay Area. Bargaining groups have received cost of living adjustments for the past several years, so estimated COLA's were included to show the impact of continuing current practices. Semi-discretionary services include City utility payments and agreements with other agencies; annual costs are rising rapidly, and the City has little control over the cost increases.

Reserve Fund Balances



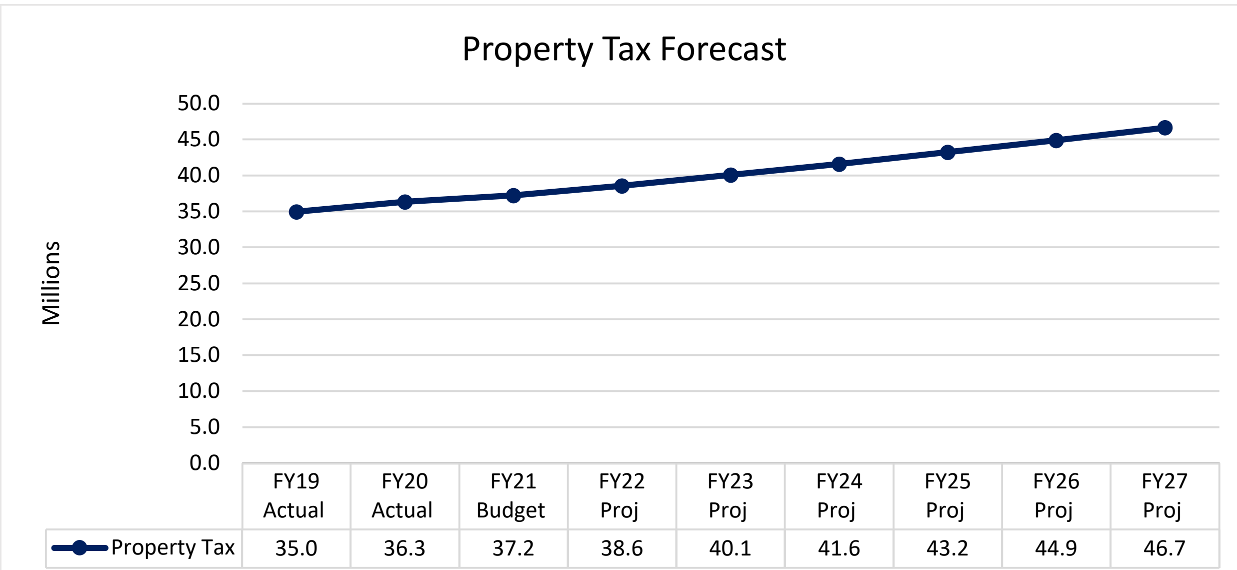
Current fiscal policy sets the levels of the Operating, Contingency, and Emergency Reserves at 5%, 1% and 14% of the budgeted operating expenditure appropriations for each year, respectively. As of December 31, 2020, 31 full-time positions were frozen by City Council, accounting for about $3.7 million of savings to the General Fund. The chart above shows the impact to General Fund reserves if those positions were filled in FY 2021/22 – reserves would be completely drawn down in FY 2022/23. In the chart below, estimated reserve balances are shown if an equivalent level of positions remains frozen throughout the life of the forecast. The result shows that reserves will not be fully spent until 2025/26, buying the City more time to control expenditures and boost revenues.



Revenue Forecasts

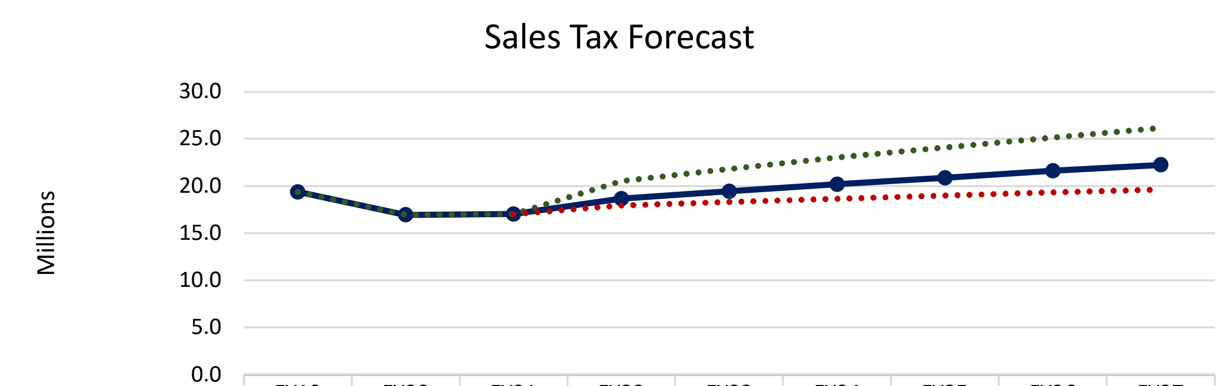
Most Likely (in millions)	FY19 Actual	FY20 Actual	FY21 Budget	FY22 Proj	FY23 Proj	FY24 Proj	FY25 Proj	FY26 Proj	FY27 Proj
Property Tax	34.97	36.35	37.23	38.56	40.06	41.61	43.23	44.91	46.66
Sales Tax	19.39	16.96	17.04	18.66	19.45	20.17	20.88	21.61	22.25
Transient Occupancy Tax	22.66	16.75	10.87	15.62	21.82	26.71	27.53	27.99	28.45
Business License Tax	3.86	3.88	3.88	3.92	3.96	4.08	4.20	4.33	4.46
Other Taxes	2.57	2.50	3.05	3.08	3.11	3.14	3.17	3.20	3.23
Licenses and Permits	2.33	2.62	2.05	2.07	2.09	2.11	2.13	2.15	2.17
Charges for Services	5.93	8.30	5.60	5.69	5.77	5.86	5.96	6.05	6.14
Other Revenue	2.90	2.23	0.95	0.97	0.99	1.01	1.03	1.05	1.07
Transfers In	3.92	7.94	6.33	4.06	4.21	4.35	4.51	4.67	4.83
Total Revenues	**98.54**	**97.52**	**86.98**	**92.61**	**101.44**	**109.04**	**112.62**	**115.94**	**119.26**

Property Tax Revenues



Property Tax continues to be the City's largest source of revenue in the General Fund and typically represents about 35% of total General Fund revenues. The County Assessor has indicated property taxes are expected to show steady gains, likely averaging 4% per year over the next ten years. Property Tax is not adjusted in our optimistic/pessimistic scenarios.

Sales Tax Revenues



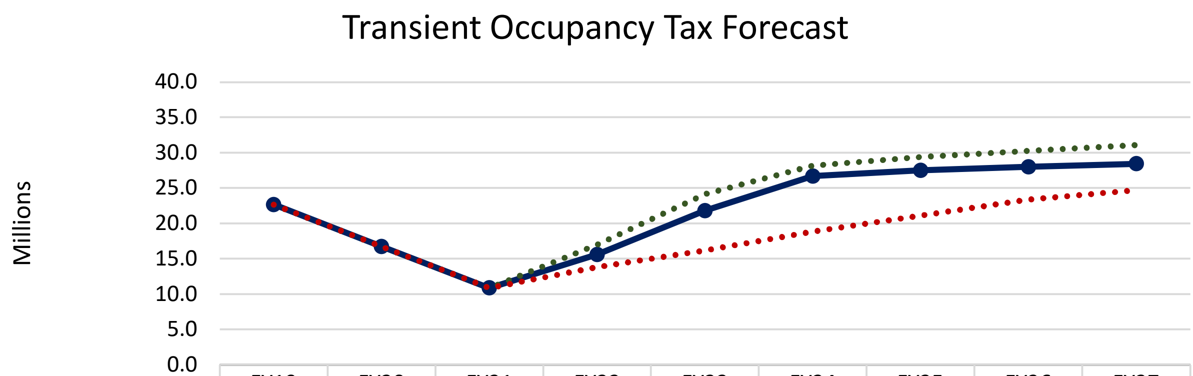
	FY19 Actual	FY20 Actual	FY21 Budget	FY22 Proj	FY23 Proj	FY24 Proj	FY25 Proj	FY26 Proj	FY27 Proj
Most Likely	19.4	17.0	17.0	18.7	19.4	20.2	20.9	21.6	22.3
Optimistic	19.4	17.0	17.0	20.5	21.8	23.0	24.1	25.2	26.2
Pessimistic	19.4	17.0	17.0	17.9	18.3	18.7	19.0	19.3	19.6

Sales tax is one of the City's most economically sensitive revenue sources and as such has been adversely affected by the pandemic. The City's sales tax consultant, HdL Companies, forecasts that sales tax revenue will rebound in FY 2021/22. While the City has experienced declines in its sales tax revenue from Restaurants and Hotels, along with General Consumer Goods and Fuel and Service Stations, it is receiving increased revenue from the County and State Pools due to higher levels of online shopping.

The sales tax projections do not include future expansion, based on the HdL Companies model. Future development, such as the approved Costco project, could boost revenues further.

The City's current sales tax rate is 7.75%. Of this rate, the City receives 1% under the Bradley-Burns Uniform Sales and Use Tax law into the General Fund. The City also receives an allocation of the 0.5% Prop 172 sales tax from the State of California into the General Fund; these dollars support the Public Safety budget. Another 0.5% accounts for the Measure T tax, which is booked in a separate fund and used solely for transportation dollars. In California, municipalities can increase their transactions and use tax rate with voter approval up to a maximum of 10.5% for the combined state/local tax rate. The City of Napa has one of the lowest tax rates in the Bay Area, with most other municipalities ranging from 8.25% to 9.75%.

Transient Occupancy Tax Revenues



	FY19 Actual	FY20 Actual	FY21 Budget	FY22 Proj	FY23 Proj	FY24 Proj	FY25 Proj	FY26 Proj	FY27 Proj
Most Likely	22.7	16.7	10.9	15.6	21.8	26.7	27.5	28.0	28.5
Optimistic	22.7	16.7	10.9	17.0	24.2	28.2	29.4	30.3	31.1
Pessimistic	22.7	16.7	10.9	13.8	16.2	18.8	21.1	23.4	24.7

Transient occupancy tax is the other of the City's most economically sensitive revenue sources and is typically the City's second largest revenue source at 23% of General Fund revenues. The pandemic and associated multiple shutdowns have drastically reduced TOT revenues for the City. The forecast assumes that economic activity will rebound to FY 2018/19 levels in FY 2023/24. The steep climb in revenue over the next 3 fiscal years includes both the rebound as well as projected new development as shown in the Most Likely forecast scenario table below.

Transient Occupancy Tax Revenue Forecast
(in millions)

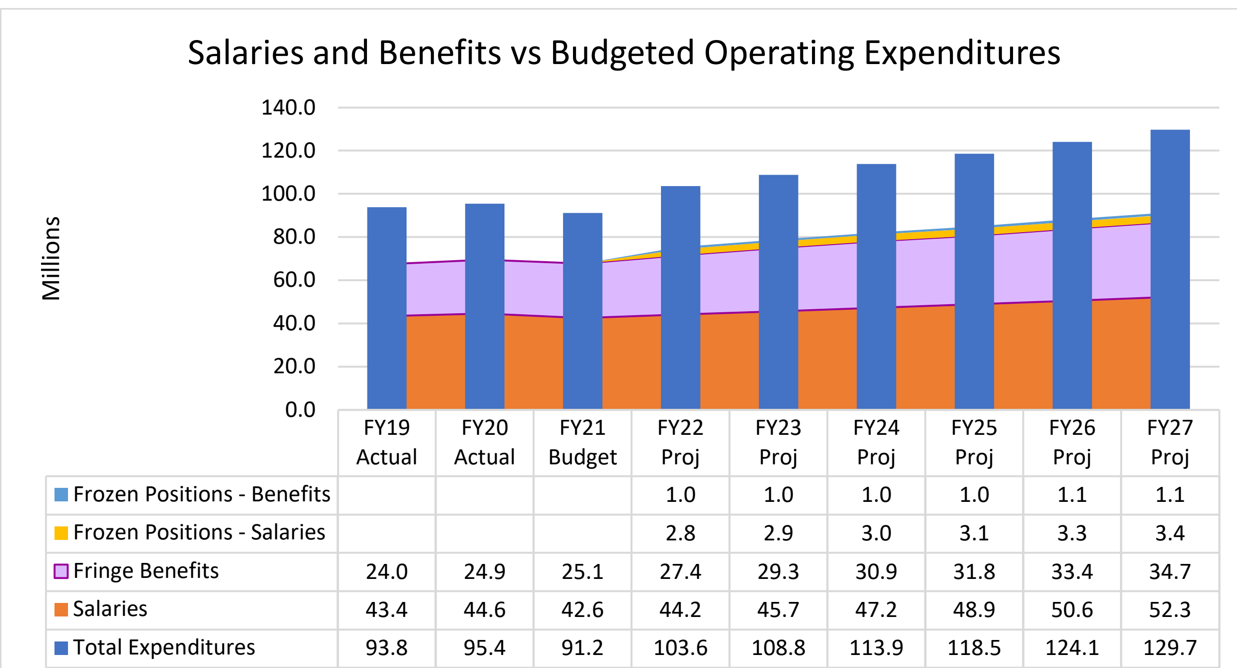
	FY19 Actual	FY20 Actual	FY21 Budget	FY22 Proj	FY23 Proj	FY24 Proj	FY25 Proj	FY26 Proj	FY27 Proj
Base TOT	19.66	14.37	9.11	11.39	15.94	19.61	19.90	20.20	20.51
New Development (Most Likely)	3.00	2.38	1.76	4.23	5.87	7.10	7.62	7.79	7.95
Total	22.66	16.75	10.87	15.62	21.82	26.71	27.53	27.99	28.45
Year-over-Year % Increase		-26.07%	-35.12%	43.69%	39.71%	22.43%	3.05%	1.69%	1.65%

An average annual increase of 1.5% for room rate increases has been included in the base TOT calculation for the post-recovery period of FY 2023/24 through FY 2026/27. This rate is consistent with historical increases shown for FY 2015/16 thorough FY 2018/19.

Expenditure Forecasts

Most Likely (in millions)	FY19 Actual	FY20 Actual	FY21 Budget	FY22 Proj	FY23 Proj	FY24 Proj	FY25 Proj	FY26 Proj	FY27 Proj
Semi- & Non-Discretionary									
Salaries & Benefits	63%	63%	63%	58%	57%	57%	56%	56%	55%
PERS UAL	9%	10%	11%	11%	12%	12%	12%	12%	12%
Services & Supplies	6%	7%	7%	8%	9%	10%	11%	11%	12%
Internal Services	6%	7%	8%	8%	8%	8%	8%	8%	7%
Transfers to CIP Reserves	3%	3%	2%	3%	3%	3%	3%	3%	3%
Other Transfers Out	4%	1%	0%	0%	0%	0%	0%	0%	0%
Semi- & Non-Discretionary	91%	91%	91%	88%	89%	89%	89%	90%	90%
Discretionary									
Services & Supplies	8%	8%	9%	7%	7%	7%	6%	6%	6%
Other Transfers Out	1%	1%	0%	1%	1%	1%	1%	1%	1%
Discretionary	9%	9%	9%	8%	8%	7%	7%	7%	7%
Expenditures	100%	100%	100%	96%	96%	96%	96%	96%	97%
Cost Impact of Adding Back Positions Frozen in FY21				4%	4%	4%	4%	4%	3%
Total Expenditures	**100%**	**100%**	**100%**	**100%**	**100%**	**100%**	**100%**	**100%**	**100%**

Salaries and Benefits vs Budgeted Operating Expenditures



	FY19 Actual	FY20 Actual	FY21 Budget	FY22 Proj	FY23 Proj	FY24 Proj	FY25 Proj	FY26 Proj	FY27 Proj
Frozen Positions - Benefits				1.0	1.0	1.0	1.0	1.1	1.1
Frozen Positions - Salaries				2.8	2.9	3.0	3.1	3.3	3.4
Fringe Benefits	24.0	24.9	25.1	27.4	29.3	30.9	31.8	33.4	34.7
Salaries	43.4	44.6	42.6	44.2	45.7	47.2	48.9	50.6	52.3
Total Expenditures	93.8	95.4	91.2	103.6	108.8	113.9	118.5	124.1	129.7

Based on the assumptions used in the forecast model, salaries and benefits account for 72% of total expenditures, on average. These costs include the non-discretionary CalPERS UAL payments, as well as assumptions for COLA's and merit increases. No new positions are included in the forecast. The City can manage these costs through negotiations with bargaining groups and/or management of vacant positions.

III: FINDINGS

The preceding forecast, and the historical trends in the Financial Trend Analysis section to follow, indicate that the City of Napa is in a period of fiscal instability. The COVID-19 pandemic has devastated the nation, and the economic impact on the City's elastic revenue sources is profound. The forecast model is based on economic assumptions, and actual revenues could differ greatly from the projections.

Expenditure growth in the forecast is based on historical growth rates. This forecast shows that the City will need to find ways to control costs, rather than allowing them to grow as they did in prior years. With revenue shortfalls in coming years, a focus on reducing expenditures will allow the City to prolong the life of its reserves. Allowing uncontrolled expenditure growth will result in the rapid use of reserves, leaving the City at risk of insolvency.

It should be noted that this forecast focuses on the City's ability to provide for operating service delivery programs that are currently in effect using existing sources of revenue at current staffing levels. This forecast does not include new positions, funding for new programs, or other initiatives above and beyond current operations.

The following actions warrant consideration by the City Council and City staff in order to stabilize and secure the City's fiscal future.

IV: RECOMMENDED ISSUES FOR STUDY/ACTION:

- Continued monitoring of hotel development projects and impacts / reliance on transient occupancy tax revenue projections
- Fiscal policy updates to provide parameters for usage and replenishment of non-General Fund reserve balances
- Continued vacancy management to reduce costs; will need to balance need to provide City services against cost savings provided by vacancies
- Research potential ways to boost City revenues

VI: FINANCIAL TREND ANALYSIS

Utilizing the International City Management Association's (ICMA) Financial Trend Monitoring System, we have provided a comprehensive Financial Trend Report. Ratings assigned to each trend include: Favorable (F), Caution (C), Warning (W), or Unfavorable (U).

As part of the long-term financial forecast update process, the City's financial trends have been analyzed for the past ten years. Many factors are utilized in order to analyze the financial condition of the City of Napa. These factors include:

- The economic condition of the City;
- Types and amounts of revenues and whether they are sufficient and have the right mix to support the constituents of the City;
- Expenditure levels and whether these expenditures are sufficient to provide the citizens of Napa with the desired level of services in the future, especially considering the City's diversity of programs;
- Fund balances and reserve levels and whether they are sufficient to protect the City against an economic downturn and /or natural disaster.

Overview of the City's Financial Condition

The City's General Fund operating revenues increased for the seventh year in a row, showing increases in all three of the City's major revenue sources. From FY 2017/18 to FY 2018/19, Property Tax increased by 8.8%, Sales Tax by 8.1% and Transient Occupancy Tax by 12.8%. Overall, total revenue increased by $4.5 million, or 4.8%.

Over the past five years the City has incurred multiple FEMA eligible events: an earthquake (FY 2014/15), flooding (FY 2016/17), and fire (FY 2017/18). The expenditures and related FEMA reimbursements have been reflected in the Non-Recurring General Fund. Because these occurrences are sporadic and can skew trends, the costs and related expenditures are not reflected in the trends and projections, which only include the Operating General Fund.

In summary, the City is experiencing economic growth and the demand for city provided public services also continues to expand. Due to long range fiscal planning, ongoing controls over spending and an advantageous position in a strong economic niche market, the City remains in a relatively positive position compared to other cities.

Some areas of concern include:

- Community programs and services must continue to be evaluated to ensure needs are met in the most effective and efficient way possible.
- Benefit costs are on the rise due to the CalPERS discount rate decrease
- The City has substantial deferred maintenance costs that will need to be addressed.
- The City is reliant on elastic revenue sources, and these revenue sources are susceptible to negative impacts from fragile global and national economies.
- The Fed has reduced rates three times in four months, raising concerns about the national economy.
- The State Fiscal Health Index (as calculated by the Legislative Analyst's Office) currently suggests that an economic slowdown may be imminent. While the index number is high, it has declined for six straight months as of September 2019.
- Growth of the City's baseline Transient Occupancy Tax has slowed and will need to be closely monitored.

We must plan with caution and continue to maintain a positive operating position for the upcoming years, keeping in mind potential fiscal opportunities and threats.

Summary of Trends & Indicators

The FY 2008/09 through FY 2019/20 financial trend analysis combines several sources of data into a meaningful overview of the General Fund's current financial position and assists the City Administration and Council in making determinations that will lead to adoption of City fiscal policies. Reports examined as part of this analysis include those combining information from budgets and financial reports, annual State Controller's Reports, and the International City Management Association's (ICMA) Trend Monitoring System.

The following pages contain a listing of the indicators analyzed as part of this financial trend analysis and a brief summary of the rating assigned to each indicator. An expanded discussion of each indicator follows the summary. The table below is a summary of the indicators and the assigned ratings over the past five LTFFs.

Indicator	2016/17	2017/18	2018/19	2019/20	2020/21
Revenues per Capita	F	F	F	F	C
Property Tax Revenues	F	F	F	F	F
Sales Tax Revenues	F	F	F	F	W
Transient Occupancy Tax Revenues	F	F	C	C	U
Business License Tax Revenues	F	F	F	F	C
Fringe Benefits as Compared to Total Operating Expenditures	C	C	C	C	W
Salary Expenditures as Compared to Total Operating Expenditures	F	F	F	F	C
Capital Outlay as a Percentage of Operating Expenditures	F	F	F	F	F
Operating Position	F	F	F	F	U
Reserve Fund Balances	F	F	F	F	U
Liquidity Ratio	F	F	F	F	W

Favorable (F):	This trend is **positive** with respect to the City's goals, policies, and national criteria.
Caution (C):	This rating is used when there are factors influencing the indicator that may not be apparent in existing trend but could result in a **change** of status from a **positive** to a **negative** direction in the future.
Warning (W):	This rating indicates that a trend has **changed** from a positive direction and is going in a direction that may have an **adverse** effect on the City's financial condition. The City also uses this rating to indicate that, although a trend may appear to be favorable, it is not yet in conformance with adopted fiscal policies.
Unfavorable (U):	This trend is **negative**, and there is an immediate need for the City to take corrective action.

Indicator Number	Description	Finding	Comments
General Fund Revenue Trends			
1	Revenues Per Capita	C	Revenues have dropped significantly due to the pandemic and will likely take years to return to pre-pandemic levels.
2	Property Tax Revenues	F	Property values continue to increase, and the median sales price of housing remains high.
3	Sales Tax Revenues	W	Sales Tax revenues have been negatively impacted by the pandemic.
4	Transient Occupancy Tax Revenues	U	Multiple shutdowns due to the pandemic have greatly reduced the City's TOT revenue. Additionally, prior to the pandemic the City observed slow baseline revenue growth in this category. Planned new development will hopefully bolster this revenue source once visitors return to Napa.
5	Business License Tax Revenues	C	Business license tax revenues are based on gross receipts of individual businesses. Revenues from FY 2019/20 did not increase from FY 2018/19 and may decrease in the future if local businesses close.
F: Favorable C: Caution W: Warning U: Unfavorable			

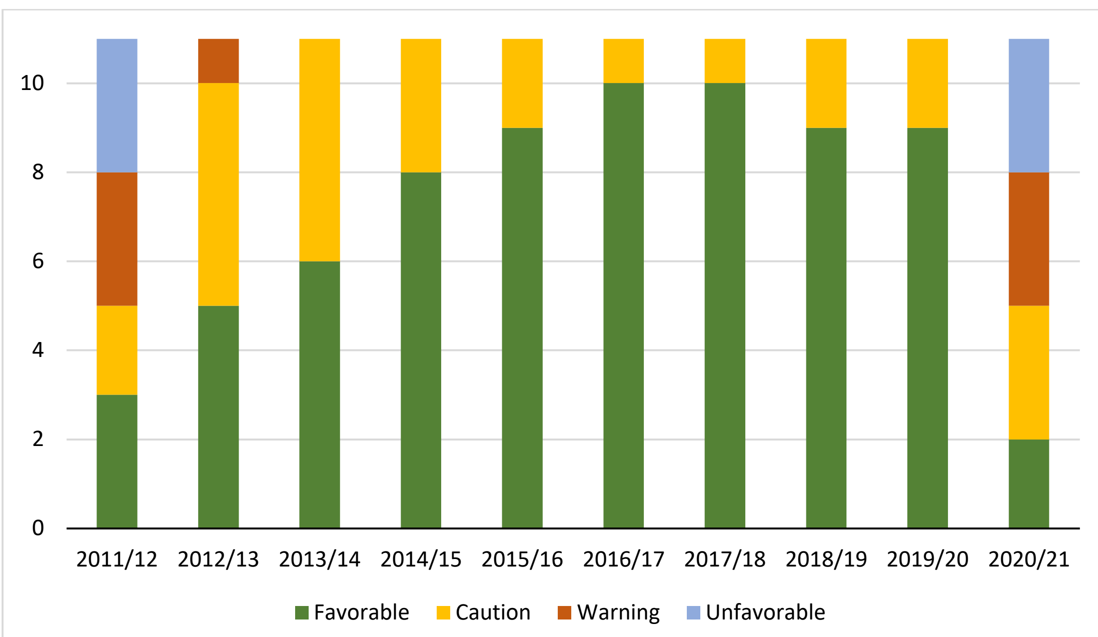
General Fund Expenditure Trends			
6	Fringe Benefits vs Total Operating Expenditures	W	Fringe benefit costs as compared to the city's total operating expenditures have stabilized through increased cost sharing and employee incentives to control the increased cost of benefits. However, the City's CalPERS Unfunded Accrued Liability payments are rising dramatically over the next ten fiscal years and will put pressure on City finances.
7	Salary Expenditures vs Total Operating Expenditures	C	Salary expenditures as compared to operating expenditures have remained relatively stable over the past five years. With the current need to reduce expenditures, this trend will likely change in the future.
8	Capital Outlay as a Percentage of Operating Expenditures	F	Fiscal policy was created in FY 2015/16 to create an Equipment Replacement Reserve. Regular contributions to this reserve will provide a stable source of funds for capital outlay.
General Fund Operating Position Trends			
9	Operating Position	U	The City's General Fund had a small operating deficit in FY 2019/20, with a larger deficit budgeted in FY 2020/21. Depending on the rate of recovery of the economy, the City will likely need to draw on reserves for multiple years.
10	Reserve Fund Balances	U	The upcoming need to draw on reserves to support the General Fund will reduce the reserves, and the forecast does not include the future payback of those funds.
11	Liquidity Ratio	W	The City's liquidity has been bolstered by the cash kept in its General Fund reserves. The planned usage of those reserves will reduce liquidity and could cause cash flow issues.
F: Favorable C: Caution W: Warning U: Unfavorable			

Revenue Trends			Operating Position		
1.	Revenues per Capita	C	9.	Operating Position	U
2.	Property Tax	F	10.	Reserve Fund Balances	U
3.	Sales Tax	W	11.	Liquidity	W
4.	Transient Occupancy Tax	U			
5.	Business License Tax	C			

Expenditure Trends		
6.	Fringe Benefits	W
7.	Salary Expenditure	C
8.	Capital Outlay	F

Rating Changes

The COVID-19 pandemic has created financial stress for the City, and most of the indicator ratings have been reduced. The loss of TOT revenue, future operating deficits and the resultant drawdowns of reserves all warrant “Unfavorable” ratings. The “Warning” rating includes concerns regarding reduced sales tax revenue, increasing CalPERS payments, and reduced liquidity. Finally, “Caution” ratings for reduced overall City revenue as compared to population, potential loss of local businesses, and the lack of budget flexibility caused by the City’s labor costs.



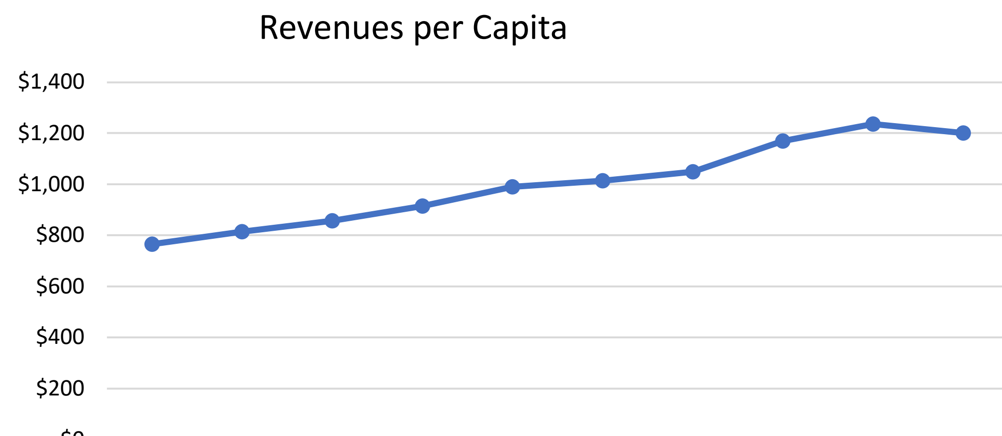
General Fund Revenue Trend Indicators

General Fund revenues finance the majority of the daily operations of the City. As a result, changes in revenue levels and composition of these revenues will have a significant impact on the City's ability to provide services to the citizens of Napa. The dollar amount received is important, but the type of revenue received also plays an important role in the financial stability of the City. Revenues should be balanced between those that change as the economy shifts (elastic) and those that flow independently of economic activity (inelastic). General Fund revenues should also come from diverse sources within the community and be sufficiently flexible to finance expenditures as the needs of the City change.

The following section evaluates five indicators used to determine the financial condition of the City's revenue base. A detailed revenue analysis is provided for the following indicators:

- Revenues per Capita
- Property Tax Revenues
- Sales Tax Revenues
- Transient Occupancy Tax Revenues
- Business License Tax Revenues

Indicator 1: Revenues Per Capita



	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16	2016/17	2017/18	2018/19	2019/20
Revenues per Capita	765	814	857	914	990	1,013	1,049	1,170	1,236	1,200

2021 Finding: **Caution**
2020 Finding: **Favorable**

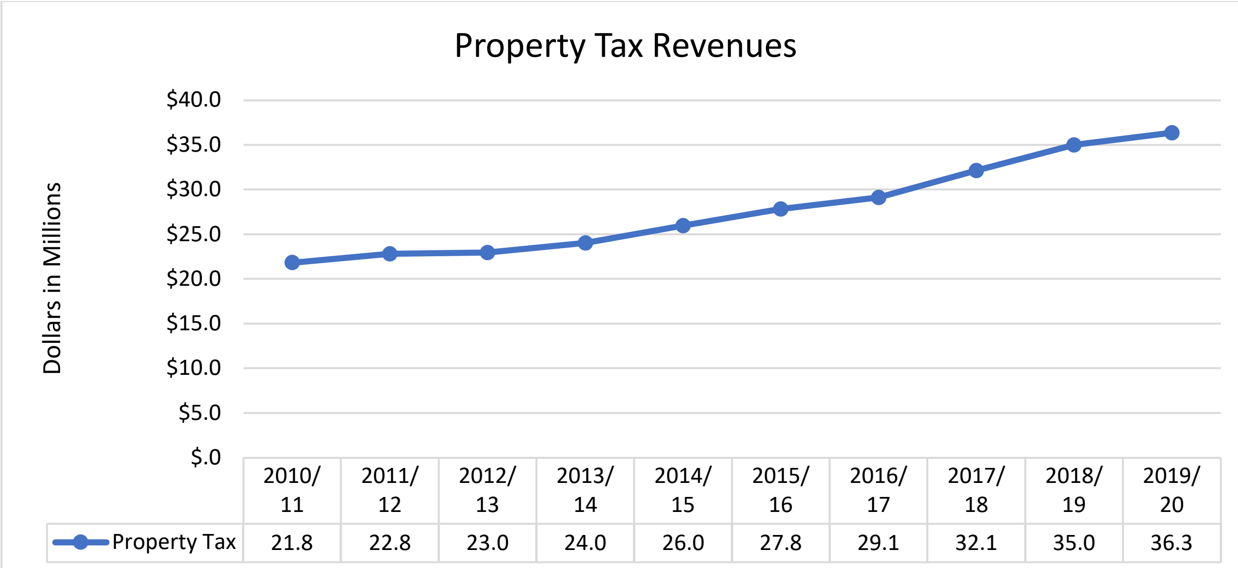
Description
Revenues per capita are a measure of the City's ability to maintain service levels.

Comments and Analysis
Prior to FY 2019/20, revenues per capita steadily increased as the City emerged from the recession. These increases were largely driven by tourism and increased transient occupancy tax and sales tax collections, as well as escalating property values and retail and hotel development within the City. The impact of the COVID-19 pandemic for the last quarter of the fiscal year caused this indicator to decrease even as population growth declined. General Fund revenue will be lower in FY 2020/21 and will likely not fully recover until FY 2023/24.

Population growth has been slow over this period, averaging 0.26% per year over the past ten years (about 1,800 new residents in total).

The 2020 rating of Favorable has been downgraded to Caution in 2020 for this indicator due to forecasted revenue declines.

Indicator 2: Property Tax Revenues



	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16	2016/17	2017/18	2018/19	2019/20
Property Tax	21.8	22.8	23.0	24.0	26.0	27.8	29.1	32.1	35.0	36.3

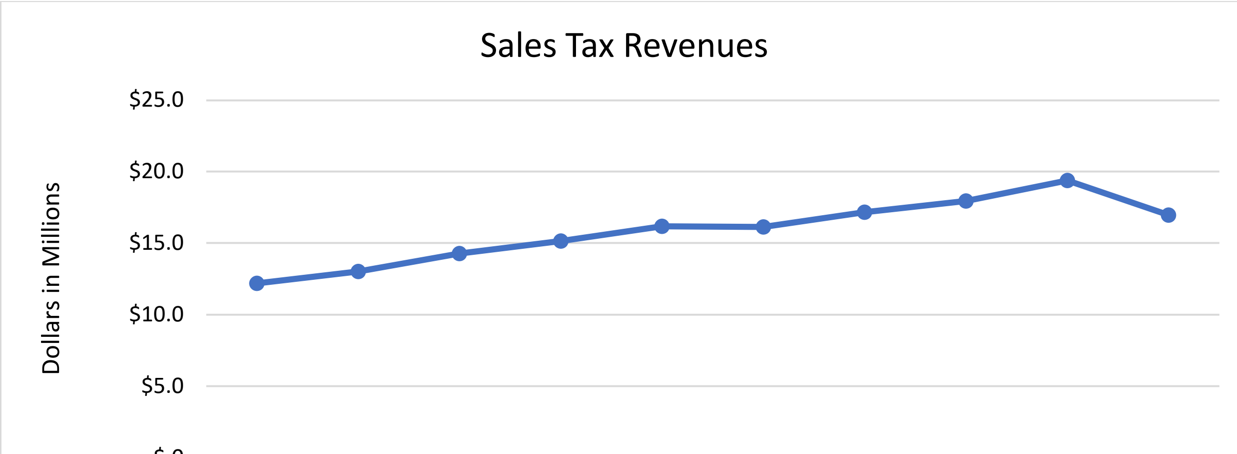
2021 Finding: **Favorable**
2020 Finding: **Favorable**

Description
Property tax revenues are evaluated over time to measure the City's economic health. Property taxes are the City's largest source of revenue and are relatively inelastic in that they should remain constant as the economy changes. By State law (Proposition 13), the County levies property taxes at one percent of full market value at the time of purchase. Assessed values can be increased by no more than two percent per year. The City also has the authority to impose an excess property tax levy to pay debt service on voter-approved debt. Currently, no such debt exists.

Comments and Analysis
Property taxes have grown steadily over the past several years, and local property values show no signs of declining. Home prices are consistently higher than they were prior to the last recession.
FY 2019/20 reflected an increase of 2.5% ($0.87 million) in property tax growth, along with an additional $0.5 million of excess ERAF posted to the General Fund. In the forecast, it is assumed that 50% of the projected annual $2.4 million of excess ERAF will be posted to the General Fund ($1.2 million/year). The increase in property tax is due to increasing property values and a still active resale market. Furthermore, steady growth is projected for FY 2020/21 and forward, though at a lower rate than observed in the past few fiscal years.

The 2020 rating of Favorable remains in 2021 due to ten years of positive growth, along with projections of continued growth throughout the life of the forecast.

Indicator 3: Sales Tax Revenues



	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16	2016/17	2017/18	2018/19	2019/20
Sales Tax	12.2	13.0	14.3	15.1	16.2	16.1	17.2	17.9	19.4	17.0

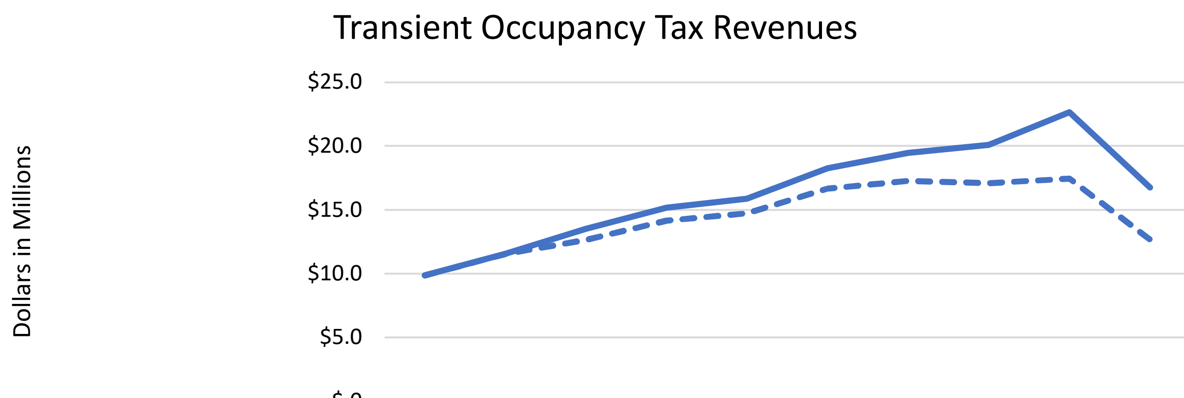
2021 Finding: **Warning**
2020 Finding: **Favorable**

Description
Sales tax revenue is a strong indicator of the city's economic health. Sales taxes are the City's third largest source of revenue (20%) and are elastic in nature, varying with changes in the economy. The California Department of Tax and Fee Administration levies the sales tax on most retail sales with principal exemptions applying to sales of food for home consumption and prescription drugs. The overall Napa County sales tax rate is 7.75%, of which the City receives the 1.0% local portion. The city also receives a portion of the 0.5% earmarked for public safety as mandated by the State (Proposition 172), as well as a portion of the 0.5% for County Measure T (recorded in a separate fund for qualified transportation projects).

Comments and Analysis
Napa's sales tax revenue is heavily dependent on the tourism industry and therefore tends to follow economic cycles. In FY 2019/20, sales tax receipts were strong through February, and steeply declined March-June due to the COVID-19 pandemic. Restaurants and food products have been strong drivers of the City's sales tax revenue, and those categories will take time to recover. Currently, it is expected that sales tax revenues will recover to pre-pandemic levels in FY 2023/24.

The 2020 rating of Favorable is downgraded to Warning for this indicator due to the negative impact from the pandemic, and the concern that some local businesses may not survive the prolonged economic slowdown.

Indicator 4: Transient Occupancy Tax Revenues



	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16	2016/17	2017/18	2018/19	2019/20
Baseline TOT	9.9	11.6	12.7	14.2	14.7	16.7	17.3	17.1	17.4	12.7
TOT with New Development	9.9	11.6	13.5	15.2	15.9	18.3	19.5	20.1	22.7	16.7

2021 Finding: **Unfavorable**
2020 Finding: **Caution**

Description

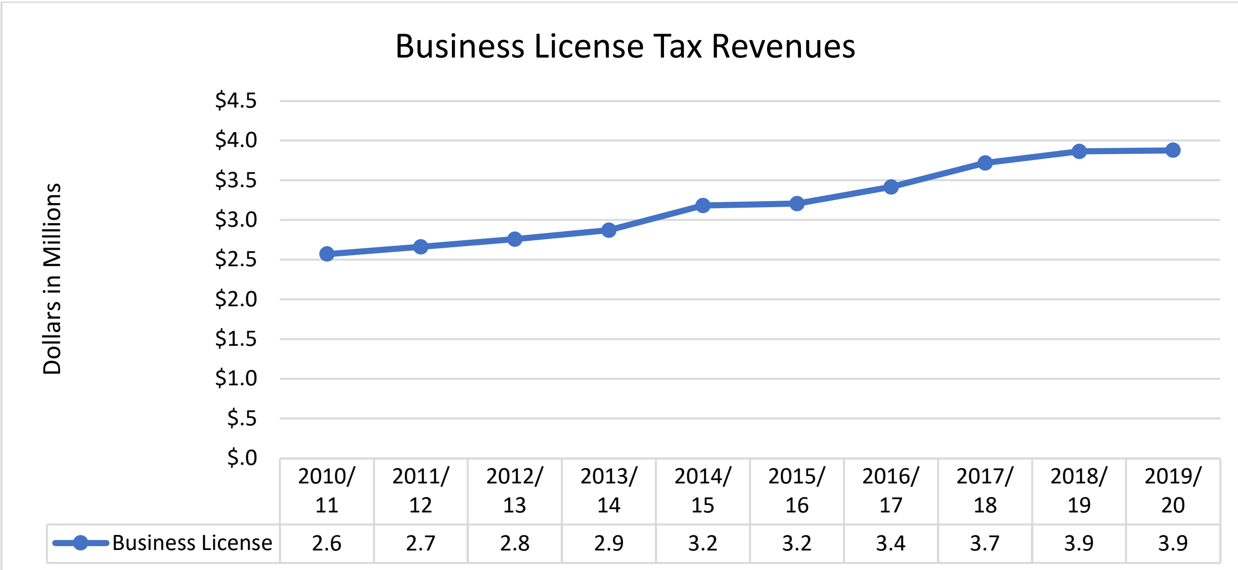
Transient occupancy tax revenue (TOT) is a strong indicator of the city's economic health. This revenue source is the City's second largest source of revenue (23.0%) and is elastic in nature, varying with changes in the economy. The City of Napa levies the tax on rooms at hotels, motels, bed and breakfasts and vacation rentals within the City. The tax rate is 13%, of which 1% goes to an Affordable Housing Fund. An additional 2% assessment rate is collected on behalf of the Tourism Improvement District, bringing the total rate paid to 15%.

Comments and Analysis

Napa's TOT revenue is heavily dependent on the tourism industry and therefore tends to follow economic cycles. The City experienced a significant rise in tourism beginning in FY 2010/11, along with increasing room rates, which are indicated by the strong upward trend in overall TOT receipts through FY 2018/19. However, prior to the pandemic, the actual baseline growth rate slowed in recent years, with most of the City's TOT growth coming from new development. The pandemic has led to steep declines in TOT revenue, with hotels shut down for periods of time and most people remaining home rather than traveling.

The 2020 rating of Caution is downgraded to Unfavorable due to the negative impact from the pandemic as well as the continued low revenue growth in established hotels that was observed prior to the pandemic.

Indicator 5: Business License Tax Revenues



2021 Finding: **Caution**
2020 Finding: **Favorable**

Description
Business license tax revenue accounts for 3.9% of the City's revenues and is a good indicator of the City's economic health. This tax is generally based on gross receipts of individual business within the City. Much like sales tax revenues, business license tax revenues are relatively elastic as they vary directly with changes in the economy.

Comments and Analysis
Business license tax receipts have steadily increased over the past nine years. Revenues flattened in FY 2019/20 and are budgeted to remain at the same level in FY 2020/21. This revenue source will be closely monitored to determine how it is affected by the pandemic, and the strength of our local business economy.

The 2020 rating of Favorable is downgraded to Caution, as we wait to see the extent of the impact of the pandemic on local businesses.

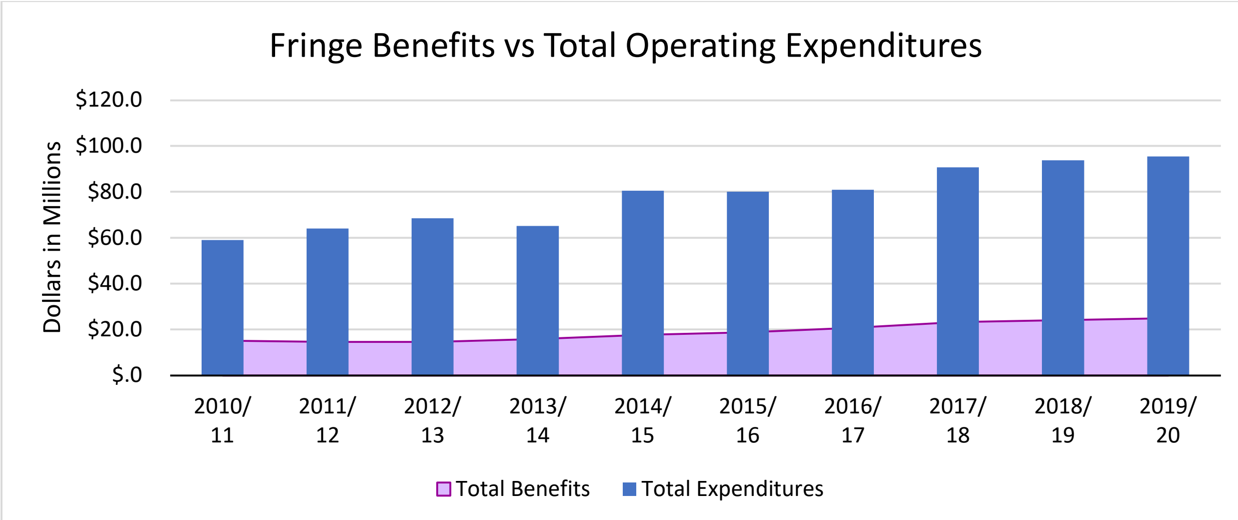
General Fund Expenditure Trend Indicators

General Fund expenditures are largely indicative of the level and types of services the City provides. Changes in the total dollar amount of expenditures can indicate a shift in the level of services delivered, either because demand has changed or because the cost of maintaining existing services has increased or decreased. Therefore, the analyses that follow show not only the change in total dollars, but changes in the types of expenditures for the past fiscal year.

A full expenditure analysis is provided for the following:

- Fringe Benefits vs Operating Expenditures
- Salaries vs Operating Expenditures
- Capital Outlay as a Percentage of Operating Expenditures

Indicator 6: Fringe Benefits vs Total Operating Expenditures



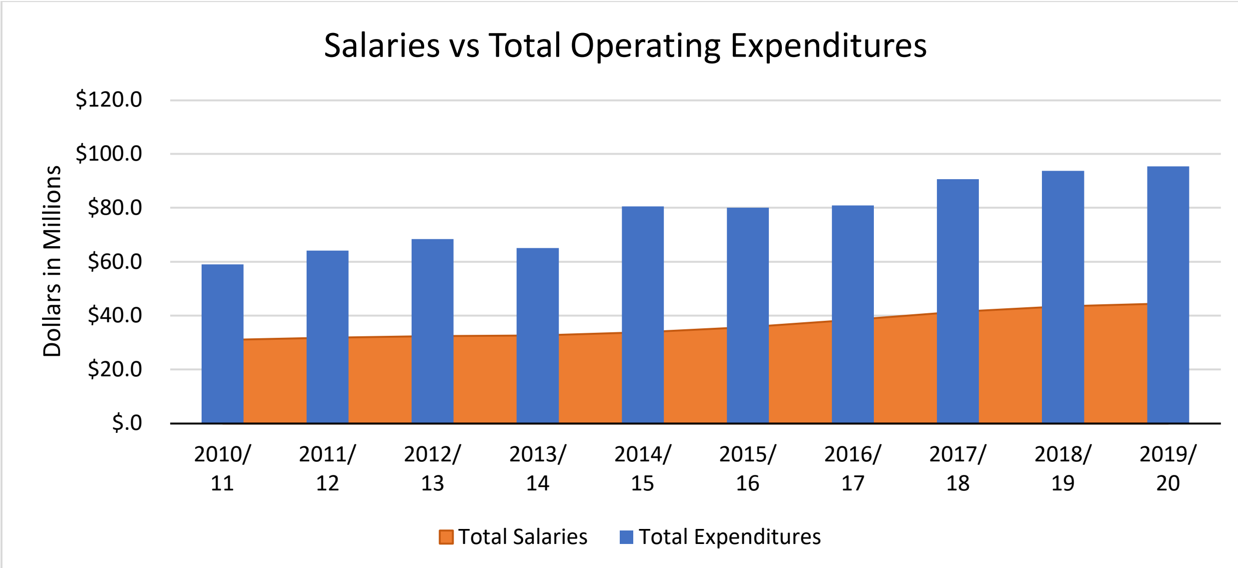
2021 Finding: Warning
2020 Finding: Caution

Description
Fringe benefits include, but are not limited to, the City's share of payroll taxes, pension plan costs, medical, life and disability insurance, and workers' compensation funding.

Comments and Analysis
Fringe benefit costs have ranged from 21-26% of the City's total operating expenditures over the past ten years. For FY 2016/17 through FY 2019/20, the percentage has held steady at 26%, with fringe benefit costs increasing at the same rate as other budgeted City expenditures. CalPERS last adjusted its discount rate in 2016, and will likely adjust it again in the future, which would greatly increase the City's costs. Even with current rates, the City's CalPERS Unfunded Accrued Liability annual payment is growing rapidly over the next ten years. Looking forward, the City will need to reduce expenditures where possible to cope with declining revenues, which will cause the amount of fringe benefits as compared to total operating expenditures to increase.

The 2020 rating of Caution for this indicator is downgraded to Warning. Although the City has demonstrated the ability to manage some impact of increasing benefit costs through increased cost sharing and employee incentives to control the increased cost of benefits, the volatility of fringe benefits (specifically pension plan and workers compensation) and the significance of fringe benefits as a whole (approximately 26% of the City's operating costs), require strong and constant management of this indicator.

Indicator 7: Salaries vs Total Operating Expenditures



2021 Finding: Caution
2020 Finding: Favorable

Description

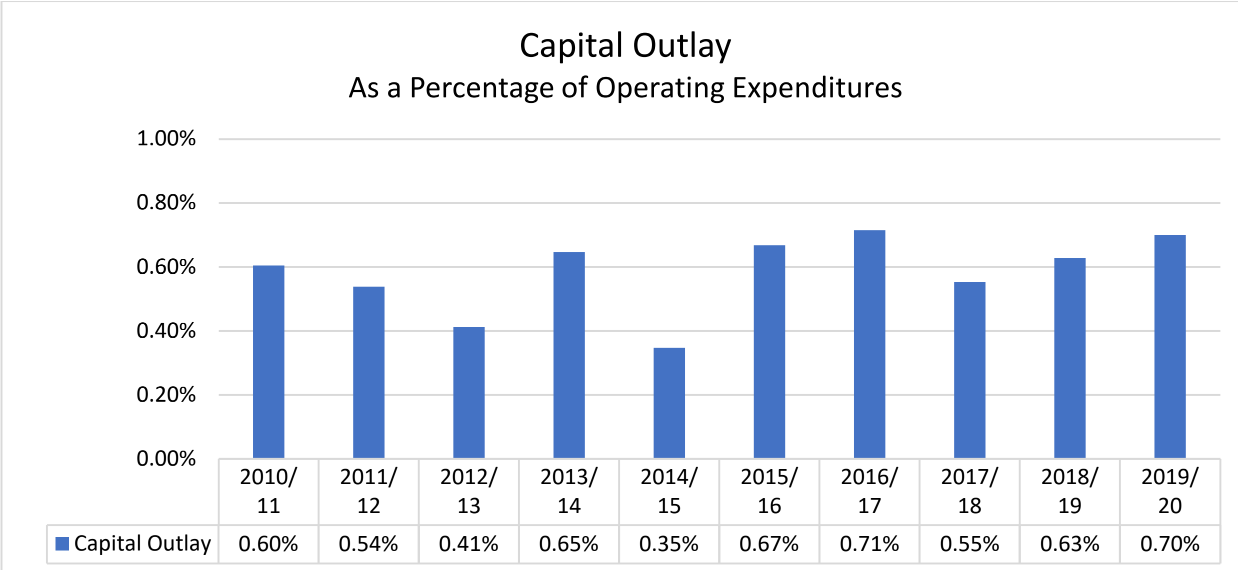
These expenditures include salary and wages paid to regular, part-time, and temporary staff and represent 42-50% of General Fund disbursements over the last ten years. Any changes in salary expenditures will have a material impact on the City's finances.

Comments and Analysis

Salary expenditures as compared to operating expenditures have remained relatively stable over the past ten years and has remained at or below 50% for the past ten years. Continued monitoring of this indicator is warranted since these expenditures represent the largest category of General Fund operating costs, and directly drive many of the benefit amounts, including pension costs. Looking forward, the City will need to reduce expenditures where possible to cope with declining revenues, which will cause the amount of salaries as compared to total operating expenditures to increase. In FY 2020/21, the City froze 32 positions, leaving them unbudgeted and vacant for cost savings. It is likely that this practice will need to continue in future years as the City recovers from the pandemic.

The 2020 rating of Favorable is downgraded to Caution, as this will need to be closely monitored as the City works to control costs. As cost of living adjustments for employees are negotiated, salary costs are expected to continue to increase, which will also drive benefit costs up. The City will need to continue to monitor and manage salaries and thoroughly analyze new position requests and requests to fill vacancies.

Indicator 8: Capital Outlay as a Percentage of Operating Expenditures



2021 Finding: **Favorable**
2020 Finding: **Favorable**

Description

This category includes General Fund expenditures to replace radios, equipment, computers and other IT components and any purchases of capitalizable assets. This category does not include capital project expenditures for the construction of improvements or buildings, or for infrastructure such as streets or storm drains. Additionally, this category does not include replacement vehicles as the City has a Vehicle Replacement Policy that provides a mechanism for that funding. The ratio of capital outlay to total operating expenditures is an indicator as to whether worn or obsolete equipment is being replaced. A decline in this ratio over a period of years may indicate that capital outlay needs are being deferred and that inefficient or obsolete equipment is being utilized.

Comments and Analysis

While spending has fluctuated over the past 10 years, on average the annual amount spent is equivalent to 0.58% of total operating expenditures. Additionally, an Equipment Replacement Reserve was created in FY 2015/16, and has a current balance of $0.49 million. An analysis of current equipment will be conducted to determine how much should be set aside annually to ensure that all City equipment is replaced as needed. This commitment to funding equipment replacement is the main driver of the Favorable finding.

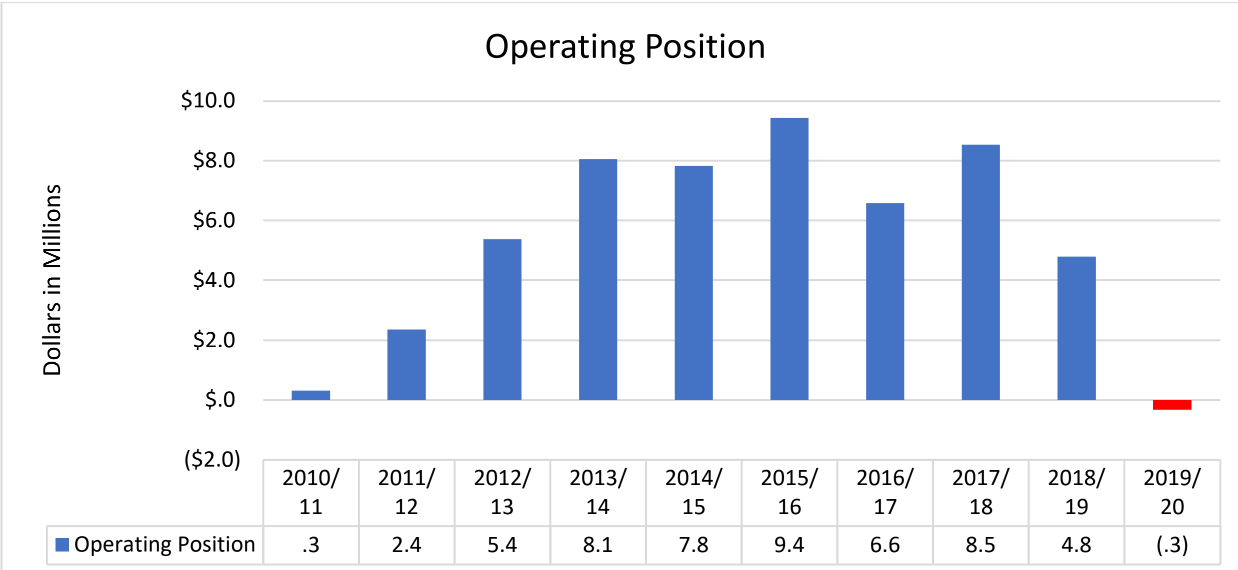
General Fund Operating Position Trend Indicators

Operating position is defined as the City's ability to balance current revenues against current expenditures, maintain adequate reserve levels, and cover short-term liabilities with short-term assets.

A complete analysis is provided in this section, and the following indicators are examined in detail:

- Operating Position
- Balance of Reserve Funds
- Liquidity Ratio

Indicator 9: Operating Position



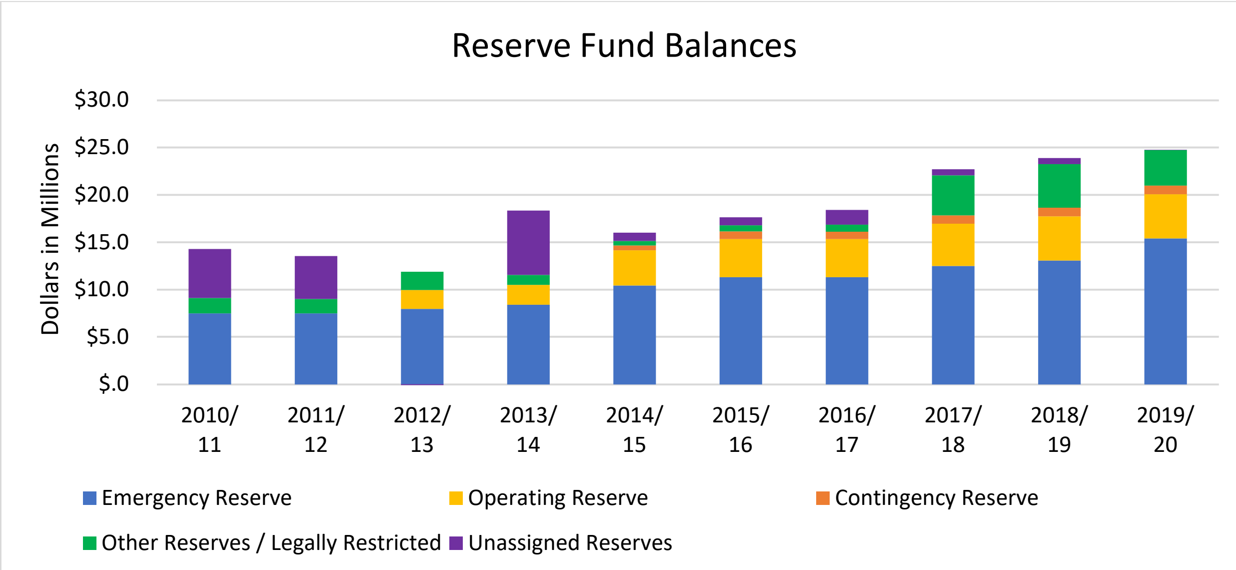
2021 Finding: Unfavorable
2020 Finding: Favorable

Description
This indicator measures the City's ability to balance operating revenues, excluding fund balances from the prior year, against operating expenditures. When operating revenues exceed operating expenditures an operating surplus is achieved. A deficit occurs when the reverse happens, and the City is forced to utilize available fund balances from prior years or General Fund reserves.

Comments and Analysis
As shown in the graph above, the City has experienced operating surpluses as it emerged from the last recession and through FY 2018/19. In FY 2019/20, the pandemic arriving in the last quarter of the fiscal year caused large declines in revenue. The small operating deficit shown above was mostly offset by a one-time transfer of $4.6 million from the City's Capital Improvement Program reserves into the General Fund. Multi-million dollar operating deficits are anticipated in future years as the City works to

The 2019 rating of Favorable remains in 2020 due to the City's ability to sustain a positive operating position for the past nine years.

Indicator 10: Balance of Reserve Funds



2021 Finding: **Unfavorable**
2020 Finding: **Favorable**

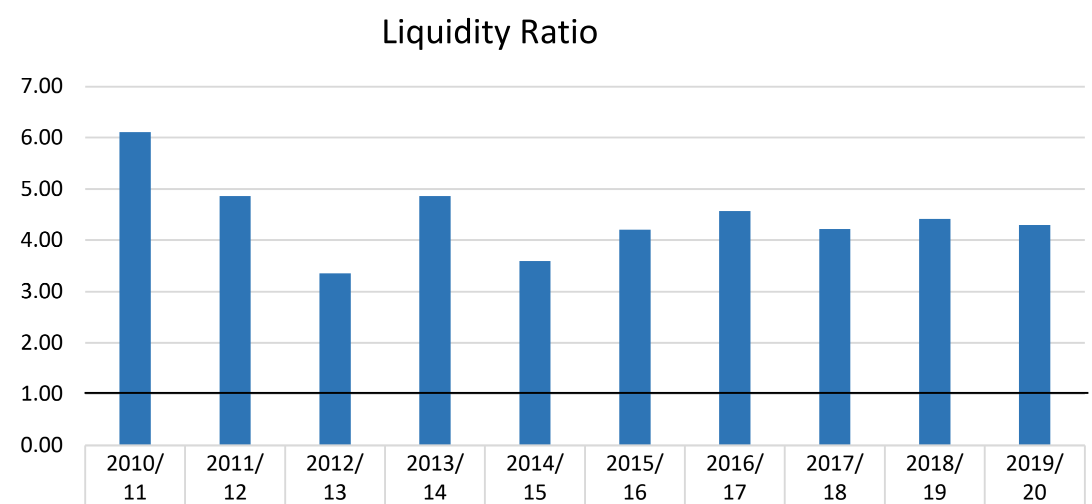
Description
The City has three main reserves available for use in the event of a financial emergency, short-term revenue fluctuations or an economic downturn. The Emergency Reserve, Operating Reserve and Contingency Reserve are funded with the use of fiscal year-end surplus dollars. The City attempts to operate each year at a surplus to ensure the maintenance of adequate fund balance and reserve levels.

Comments and Analysis
The City has a fiscal policy designating an amount of annual operating expenditures as an emergency reserve and has achieved full compliance since the policy was first implemented in FY 2007/08 at 12% of operating expenditures and then increased in FY 2014/15 to 14%. Undesignated Fund Balance was used to meet budget shortfalls during the recession. The Operating Reserve is to be maintained at 5% of operating expenditures. The Contingency Reserve has a funding goal of 1% of operating expenditures. All reserves are currently fully funded per fiscal policy.

The FY 2020/21 Budget assumes the use of $3.6 million from the Emergency Reserve, and that amount could be higher as the City is currently in its second shutdown and will likely not receive its budgeted TOT revenue. Looking forward, reserves could be needed to offset continued deficits.

Given the current and future needs to spend down reserves, without a plan to re-fund the reserves, this indicator is downgraded from Favorable to Unfavorable.

Indicator 11: Liquidity Ratio



	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16	2016/17	2017/18	2018/19	2019/20
Liquidity Ratio	6.11	4.86	3.36	4.86	3.59	4.21	4.57	4.22	4.42	4.30

2021 Finding: **Warning**
2020 Finding: **Favorable**

Description
Liquidity measures the City's ability to meet short-term obligations. Liquidity is measured by comparing current assets to current liabilities. Current assets include cash, short-term investments, accounts receivable, and other assets that can be rapidly converted to cash. Current liabilities include accounts payable, accrued wages, accrued expenses, and deposits, all obligations that can be immediately demanded for payment. A liquidity ratio of less than 1:1 can indicate insolvency and is cause for alarm. A ratio above that is considered favorable.

Comments and Analysis
The City has been able to maintain a liquidity ratio well above 1:1 for the past ten years. The ratio stood at 4.30 at the end of FY 2019/20, meaning the City's General Fund has enough current assets to cover its current liabilities more than four times over. The City's liquidity has been buoyed by the cash in its General Fund reserves. As reserves are spent, the liquidity ratio will decrease. Due to the planned usage of reserves in FY 2020/21 and the likely continued usage of reserves in future years, this indicator has been downgraded from Favorable to Warning. Cash flow and liquidity will need to be closely monitored to ensure the City is able to stay solvent.