2022

Alston Park. Photo by Linda Button

Long-Term Financial Forecast

2022 Long-Term Financial Forecast
Trends and Forecast Analysis

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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. 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 2021/22) and a five-year forecast through FY 2026/27, a statement of current financial position, and a trend analysis for FY 2011/12 through FY 2020/21.

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 2021 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.
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.
Continued vacancy management to reduce costs; will need to balance need to provide City services against cost savings provided by vacancies	Ongoing	In the FY 2021/22 budget, the staffing plan included frozen positions, as well as positions budged for ½ the year and the Human Resources Department created a tiered hiring plan. Departments will continue to review staffing and vacancies as the FY 2022/23 budget is developed.
Research potential ways to boost City revenues	Ongoing	City Council adopted a 3-year update of the Master Fee Schedule in October 2021, increasing the City's user fees. Finance continues to research other ways to boost revenues in order to keep pace with rising expenditures.

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 2022/23 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 over the forecast period was taken from the California Department of Finance, the Napa County Auditor/Controller's office, the City's Community Development Department, and the City's economic consultant, Economic Forensics and Analytics.

The COVID-19 pandemic, which began to impact the City of Napa in March 2020, has dramatically reduced City revenues. Multiple prolonged shutdowns caused reductions in sales tax and transient occupancy tax, and while revenue is recovering, expenses have continued to climb. The City's business license tax revenue and charges for services revenue were also adversely impacted by the pandemic. Recovery to pre-pandemic levels is anticipated in ~~FY 2022/23~~the current fiscal year, but if expenditures grow at their historical rates, they will outpace revenues in every year of the forecast.

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

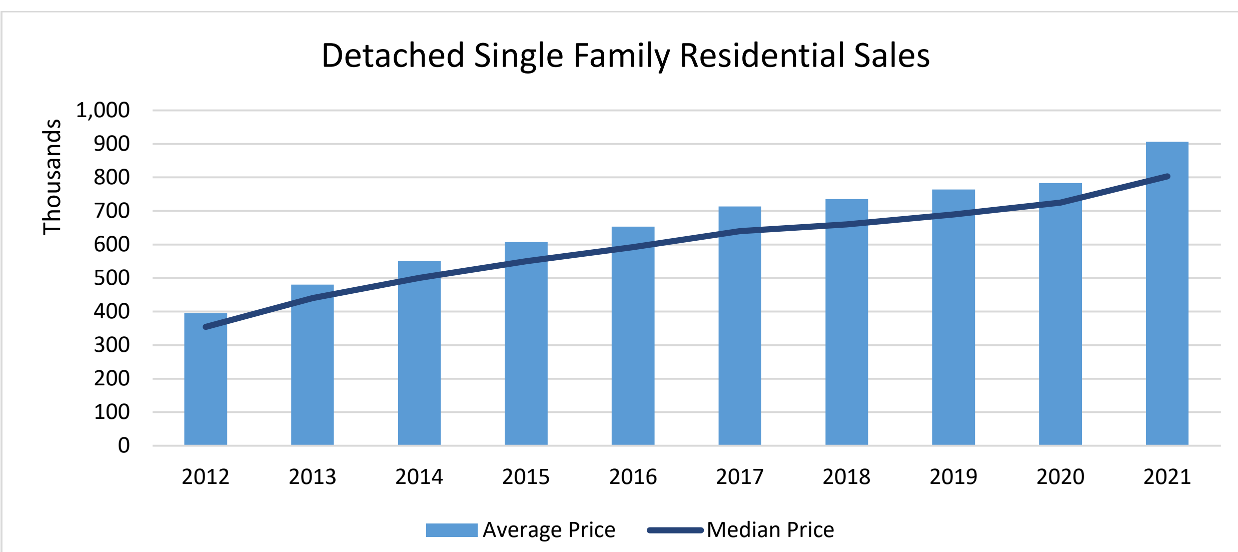
As of January 10, 2022:

- Napa County
  - Cumulative Cases: 16,034
  - Deaths: 109
  - Full Vaccination Rate: 78% of eligible Napa County Residents
- State of California
  - Cumulative Cases: 6,083,283
  - Deaths: 77,260
  - Full Vaccination Rate: 72% of people 5+
- United States
  - Cumulative Cases: 60,164,525
  - Deaths: 836,603
  - Full Vaccination Rate: 62.6%

The pandemic continues across the country, with all indicators beginning to trend upward again with the Omicron variant surge. While the hope was that widespread vaccination would curb the spread and allow us to return to "normal", lack of vaccine mandates and the politicization of the vaccine has left America vulnerable to mutations of the virus. California reinstated an indoor mask mandate on December 15, but currently there are no indicators that we will see a repeat of the business closures experienced in spring 2020 and winter 2020/21.

Housing Market

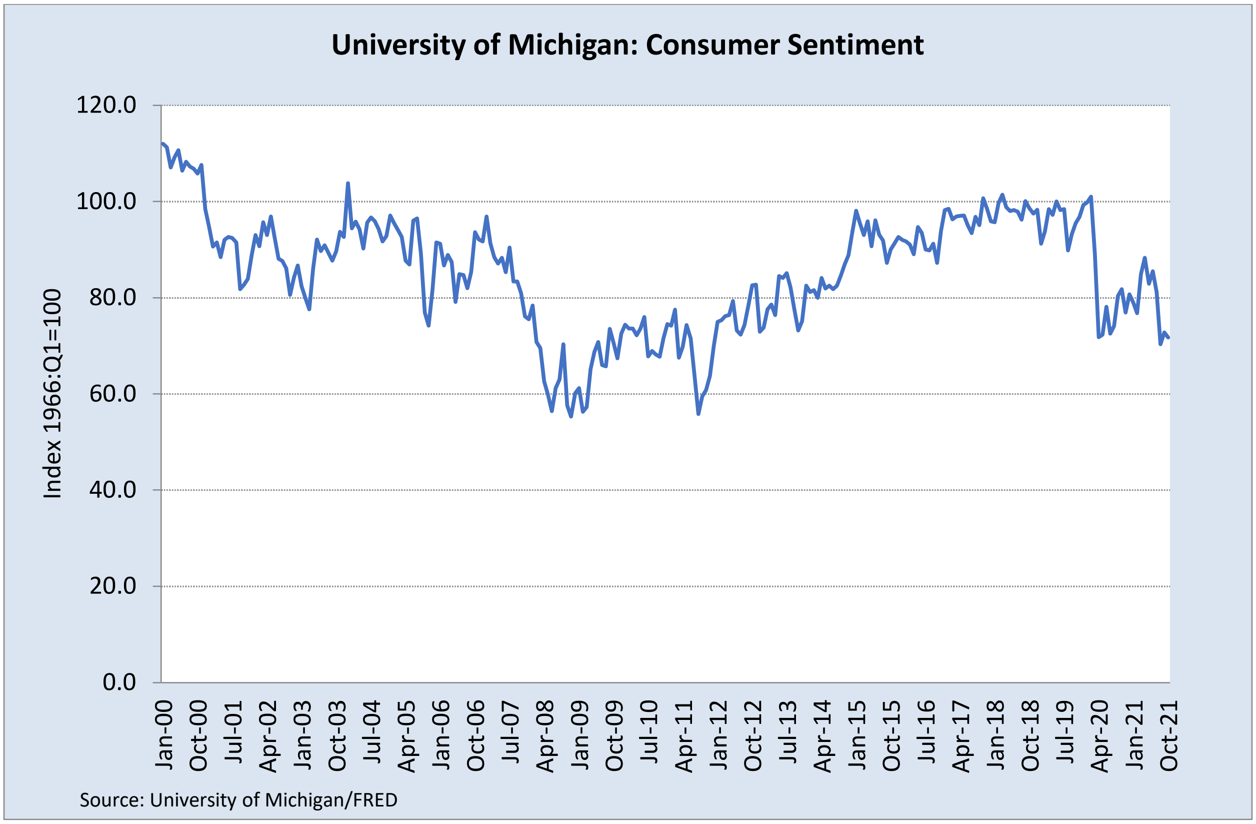
Median housing prices continue to climb for Napa, with increased growth during the pandemic due to increased demand based on lower interest rates and the greater ability to work remotely. Home prices, as well as assessed valuations, are projected to continue to increase during the forecast period.



Data Source: HdL Coren & Cone

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 grew during the first half of calendar 2021, the onset of the Delta variant has caused the index to drop again. Napa has reason to be very cautious considering our reliance on elastic revenues, as well as the continued emergence of new strains of the coronavirus.



Unemployment Rate

Unemployment rates across California continue to decline. The preliminary unemployment rates for November 2021 put the City of Napa at 4.5%, the County at 4.2%, and the State at 6.9%.

However, these declining rates can obscure the fact that the labor force for the City has also declined. In February 2020, the City had a labor force of 41,400, with 40,000 employed. As of November 2021, the City's labor force has decreased to 39,200, with just 37,400 employed.

Lodging/Tourism

Napa County hotel occupancy rates have shown strong growth, rebounding to near 2019 (pre-pandemic) levels. Typically, TOT is the City's second largest revenue source and comprises about 23% of the total General Fund revenue for the City. The substantial decreases felt from March 2020 through FY 2020/21 reduced City revenue by millions of dollars. If current trends hold, the City could reach pre-pandemic revenue levels in FY 2022/23. However, if the Omicron surge leads to a return of lockdowns and business closures, it could take much longer for revenues to return. Additionally, a return to pre-pandemic levels of TOT revenue means that multiple years of typical revenue growth has been lost due to the pandemic.

Occupancy Rate Evolution: October 2019, October 2020, and October 2021, Percent of Available Rooms Occupied, County Level			
County	**Oct 2019**	**Oct 2020**	**Oct 2021**
Napa County	74.0	52.9	71.9
Marin County	80.1	58.5	69.5
San Francisco	84.0	35.7	52.0
Sonoma County	75.8	67.3	68.3

Source: Smith Travel Research and EFA

Local, State and Federal Issues

The Federal Reserve Board has continued to hold the benchmark funds rate to 0-0.25 percent, originally set in March 2020. At their meeting in December the Fed did not increase rates but indicated that rates will likely increase in 2022, with three rate increases currently projected due to recent surging inflation. December inflation was the strongest in almost forty years, but economists predict that this will be the peak, with inflation softening by mid-2022. The Fed had opted to purchase at least $120 billion in bonds each month to further progress towards their employment and price stability goals but are planning to begin tapering their monthly asset purchases, potentially stopping by March 2022. While last year the Fed was willing to allow inflation to exceed 2% in the hopes that robust growth could drive unemployment rates down, there is now concern about rising inflation and the impact on the economy. The hope is that increasing interest rates in 2022 will help to slow inflation back to the targeted rate of 2%. High inflation has not been included as a factor in this forecast, but if the predicted softening does not occur in 2022 it may need to be included in next year's forecast.

The Fed's low interest rates have spurred large purchases for people in higher economic tiers and helped to buoy Napa home sales during this time.

The City received a $7.37 million payment from the American Rescue Plan Act in May 2021, which remains unspent. A second payment is anticipated in May 2022. The City is currently putting together a plan for these funds, which must be expended or obligated by FY 2023/24. There are concerns that using these funds for revenue replacement could cause the City to over-extend its ongoing expenditure obligations, so one-time projects are also being examined.

Revenue and Expenditure Assumptions

The Long-Term Financial Forecast includes a baseline (most likely) revenue assumption, along with optimistic and pessimistic revenue scenarios. The pessimistic scenario is not a recession model, but rather shows a slower recovery trajectory. The key assumption differences between these scenarios are as follows:

Most Likely:

Property Tax: 4.0% annual growth, includes VLF in all years
Sales Tax: 3.0% annual growth
Transient Occupancy Tax: 1.5% increase per year plus most likely new development estimate
Business License Taxes: 3.0% annual growth
Charges for Services (non-Dispatch): 2.0% annual growth

Optimistic:

Property Tax: 4.0% annual growth, includes VLF in all years (no change from Most Likely scenario)
Sales Tax: 4.0% annual growth building off an increased baseline
Transient Occupancy Tax: 2.5% increase per year building off an increased baseline, plus optimistic new development estimate
Business License Taxes: 4.0% annual growth
Charges for Services (non-Dispatch): 3.0% annual growth building off an increased baseline

Pessimistic:

Property Tax: 4.0% annual growth, no VLF in FY 2023/24 or FY 2024/25
Sales Tax: 2.0% annual growth building off a reduced baseline
Transient Occupancy Tax: 0.5% increase per year building off a reduced baseline, plus pessimistic new development estimate
Business License Taxes: 2.0% annual growth
Charges for Services (non-Dispatch): 1.0% annual growth building off a reduced baseline

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

- Revenue Assumptions
  - Property Tax: 4% growth/year, plus $1.2 million annually in Excess ERAF
  - Sales Tax: 3% growth/year building off HdL's FY 2022/23 forecast
  - Transient Occupancy Tax: 1.5% average annual growth based on FY 2021/22 projections; plus estimated new development
  - Business License Tax: 3% growth/year
  - Other Revenues: 1.8% average annual growth
  - Transfers In: 3.63% growth/year
- Expenditure Assumptions
  - Salaries: 3.63% growth/year (combined COLA and merit increases)
  - Health/Dental: 3.23% growth/year (6-year average historical growth rate)

- CalPERS Normal Cost: annual percentages pulled from CalPERS Pension Outlook calculator based on updated Asset Liability Management Assumptions. Miscellaneous Plan average annual rate of 10.85%, Safety Plan average annual rate of 19.8%.
- CalPERS UAL Payment: 4.4% average annual growth, pulled from CalPERS Pension Outlook calculator based on updated Asset Liability Management Assumptions.
- Semi-Discretionary Services and Supplies: 10.57% growth/year (6-year average historical growth rate)
- Internal Services: 8.6% average growth/year
- Discretionary Services and Supplies: 1.99% growth/year (6-year average historical growth rate)
- Fiscal Policy Transfers
    - 1% Operating Budget transfer to the CIP General Reserve
    - 2% Operating Budget transfer to the CIP Facilities Reserve
    - Transfers to General Fund Reserves (Emergency, Operating, Contingency) to bring reserves to fiscal policy levels
        - Emergency Reserve should equal 14% of current year operating budget
        - Operating Reserve should equal 5% of current year operating budget
        - Contingency Reserve should equal 1% of current year operating budget
    - $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
- Add Back COVID-19 Cuts – this category shows the additional budget impact by reinstating the budgets that were reduced due to the COVID-19 pandemic in FY 2020/21 and FY 2021/22.
    - Frozen Positions: In FY22, 17 vacant positions were frozen by Council during budget adoption. This category shows the cost of bringing back these positions.
    - Budget Cuts Made in FY 2020/21 Not Reinstated in FY 2021/22
        - Part-Time Employees: $943,300
        - Overtime: $261,000
        - Semi-Discretionary Services and Supplies: $30,300
        - Discretionary Services and Supplies: $1,641,400
    - Additional Impacts
        - PERS UAL: bringing back General Fund positions will cause more of the annual PERS UAL payment to be allocated to the General Fund
        - Transfers to CIP Reserves: increasing the General Fund operating budget increases the amount to be transferred to the CIP Reserves

- Transfers to General Fund Reserves: increasing the General Fund operating budget increases the amount to be transferred to the General Fund Reserves

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 American Rescue Plan Act allocation for Napa of $15.12 million is not included in this forecast. The plan for these funds is in process, and these funds may or may not be used to help reduce operating deficits in future years.

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

    - New positions
    - New or enhanced programs.
    - State impacts (~~e.g.~~ e.g., offset for lost Redevelopment Agency Tax Increment).

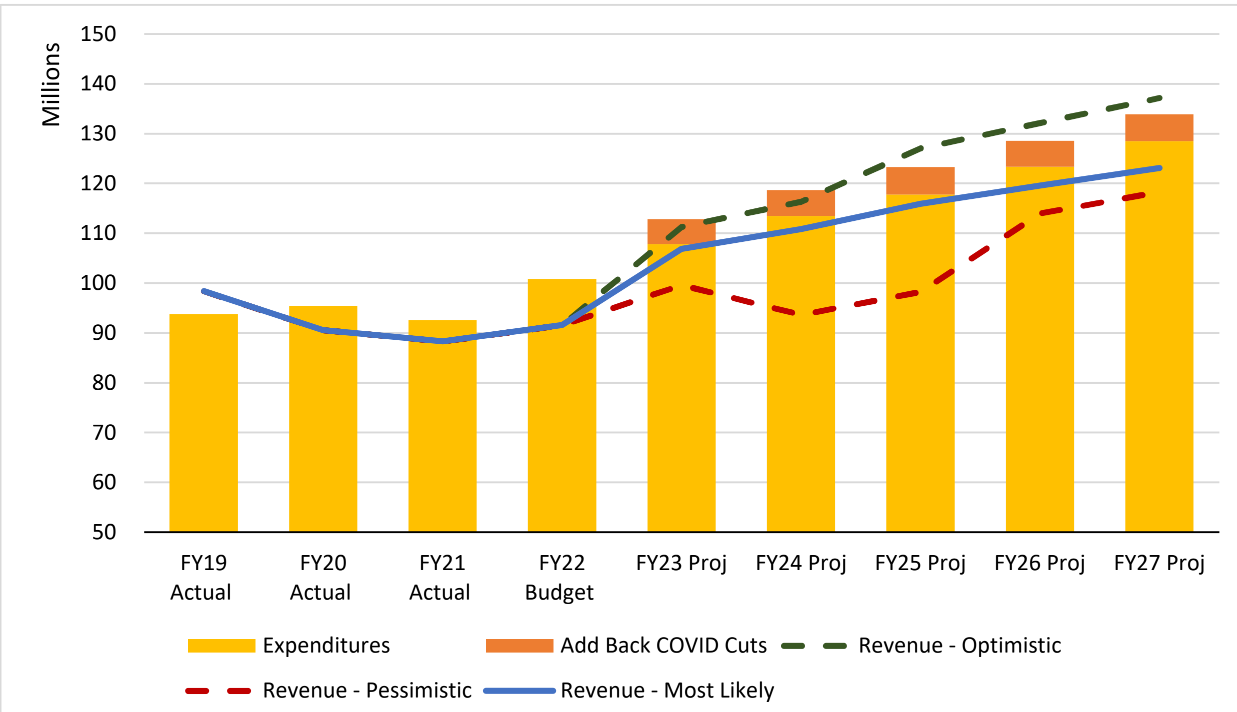
- Only sizable commercial development under construction or with a high likelihood of becoming reality has been included.

Forecast Summary and Results

Operating position refers to the City's ability to match operating revenues to expenditure levels, ~~i.e.~~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)	FY19 Actual	FY20 Actual	FY21 Actual	FY22 Budget	FY23 Proj	FY24 Proj	FY25 Proj	FY26 Proj	FY27 Proj
Revenue	98.37	90.58	88.32	91.59	106.90	110.84	115.91	119.55	123.14
Expenditures	93.77	95.45	92.58	100.84	112.84	118.67	123.27	128.59	133.88
Surplus / (Deficit)	**4.60**	**-4.87**	**-4.26**	**-9.26**	**-5.94**	**-7.83**	**-7.36**	**-9.04**	**-10.74**

Revenues & Expenditures

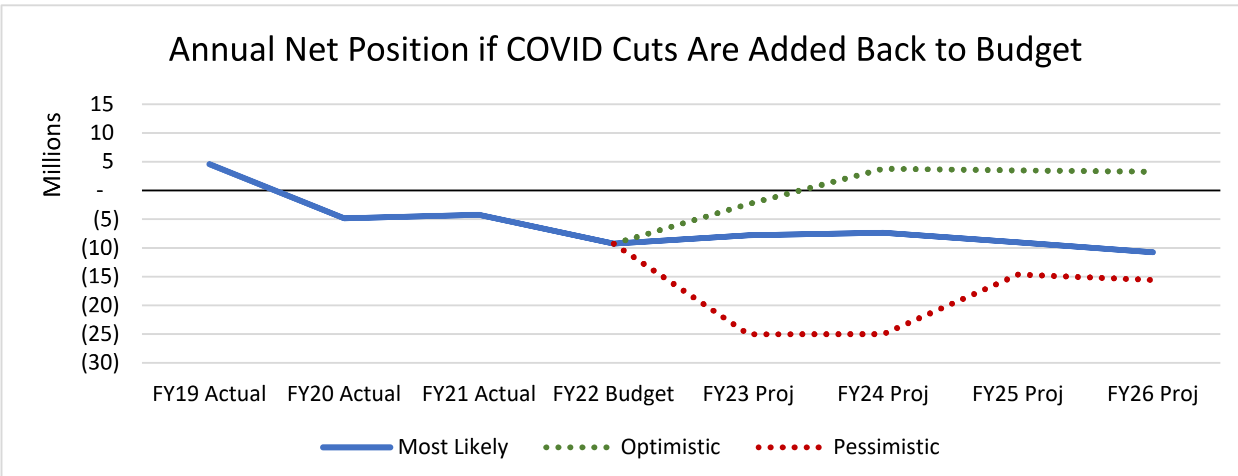


Total General Fund revenues are forecast (using the most likely scenario) to grow by an average annual increase of approximately 3.8% per year over the forecast period, from projected FY 2021/22 revenue. The rebound post-pandemic as well as planned hotel development projects contribute to the forecasted revenue growth.

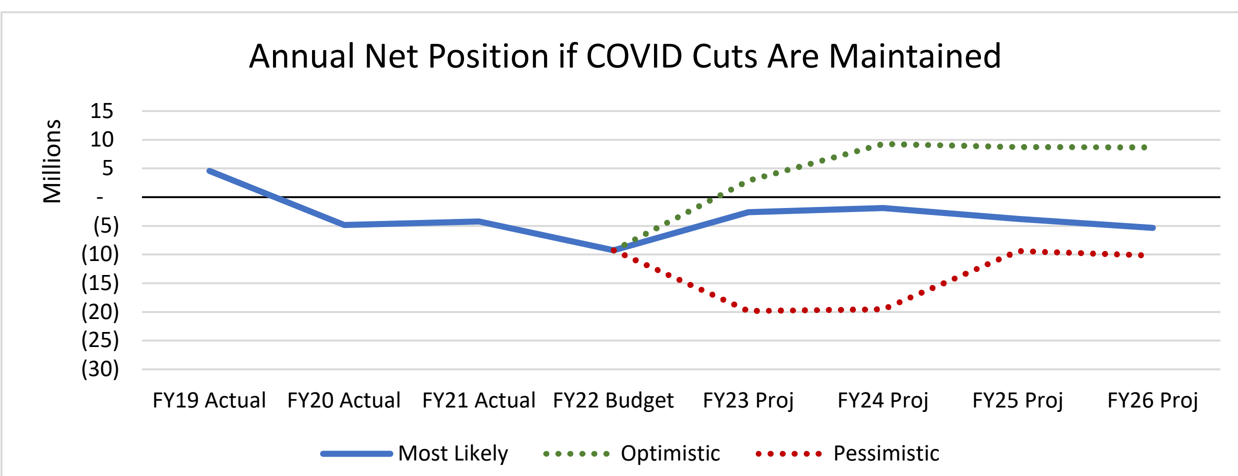
Expenditures are projected to increase at an average annual rate of 5.0% per year. This growth rate assumes that all frozen positions are added back in FY 2022/23, and all COVID operating budget cuts are restored. The growth rate also assumes that expenditure budgets are allowed to increase by historical growth rates and are not controlled by budgetary decisions or fiscal policy changes. Projected expenditures include retirement contribution increases, 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 most likely experience deficits each year:



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 $5 million per year, the annual net position moves closer to zero. The budget process for coming years 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. While recovery appeared strong in the spring and summer of 2021, the current resurgence with the Omicron variant leaves the future uncertain. The Most Likely forecast assumes that recovery will continue, while not at the pace observed during 2021.

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

Semi-Discretionary and Non-Discretionary Expenditures: 88% 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 and General Fund Reserves per Fiscal Policy
- Other Transfers Out per Fiscal Policy (includes General Plan reserve and Equipment Replacement reserve)

Discretionary Expenditures: 8% of total expenditures for forecast period

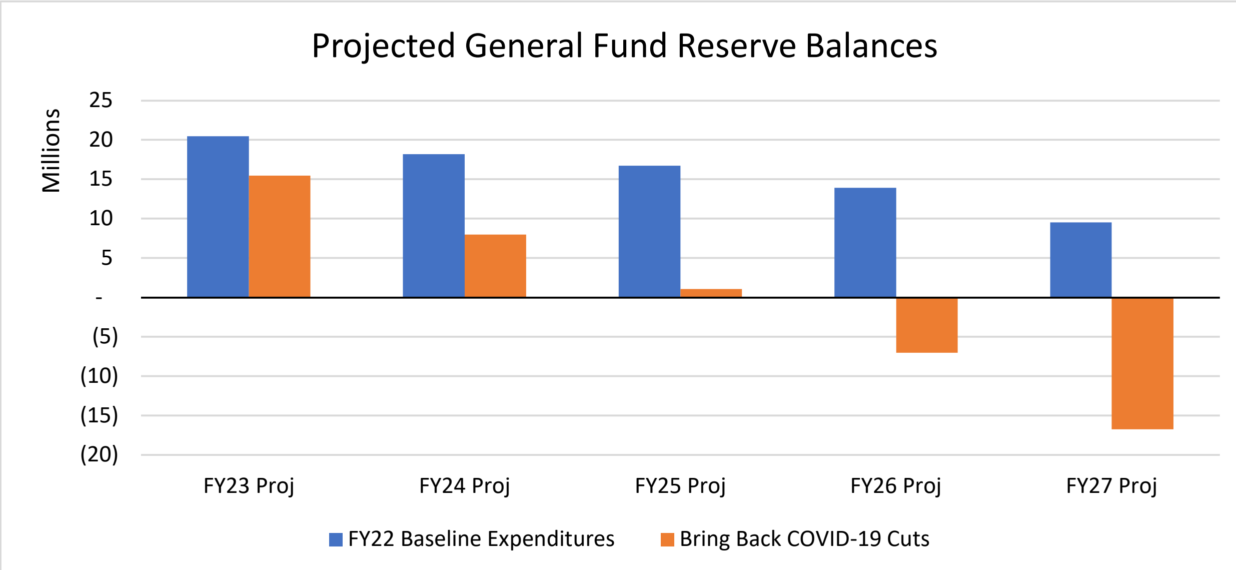
- Services and Supplies (includes professional services, travel/training, office supplies, etc.)
- Transfer to Sidewalks Program

COVID Cuts: 4% of total expenditures for forecast period

- The costs associated with adding back the positions frozen by Council in FY 212/2022, 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. This category also includes part-time employees, overtime costs, and operating costs that were cut in the FY 2020/21 budget and have not yet been restored.

Increases in labor costs, semi-discretionary services, and internal 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 five 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, 2021, 17 full-time positions were frozen by City Council, accounting for about $2.1 million of savings to the General Fund. Another $2.9 million of operating budget was cut in FY 2020/21 and not yet restored, bringing the total present value of COVID-related budget cuts to $5.0 million.

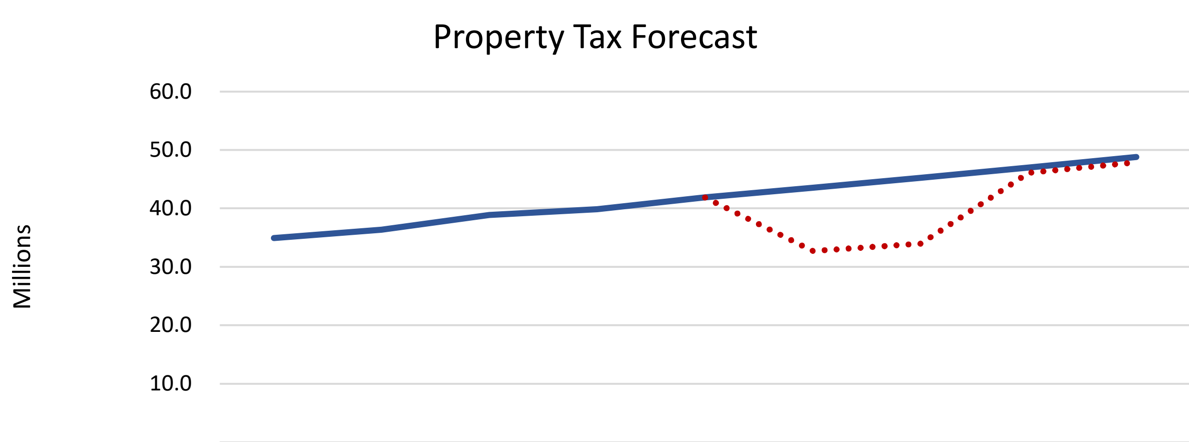
The chart above shows the estimated ending balance of the General Fund reserves in each year of the forecast. The blue columns show the estimated reserve balances if the COVID-related budget cuts are maintained in the future; current reserve balances are sufficient to cover the future deficits. The orange columns show the estimated reserve balances if the COVID-related budget cuts are reversed in FY 2022/23. In this scenario, the City does not have sufficient reserves to cover the future deficits and runs out of funding in FY 2025/26.

Controlling future expenditures is the key to maintaining reserves and ensuring the future fiscal health of the City.

Revenue Forecasts

Most Likely (in millions)	FY19 Actual	FY20 Actual	FY21 Actual	FY22 Budget	FY23 Proj	FY24 Proj	FY25 Proj	FY26 Proj	FY27 Proj
Property Tax	34.97	36.35	38.85	39.86	41.91	43.54	45.23	46.99	48.82
Sales Tax	19.39	16.96	18.81	18.52	20.60	21.43	22.07	22.74	23.42
Transient Occupancy Tax	22.66	16.75	11.72	16.12	26.34	27.41	29.72	30.49	31.10
Business License Tax	3.86	3.88	3.29	3.48	3.58	3.69	3.80	3.91	4.03
Other Taxes	2.57	2.50	2.71	2.38	2.40	2.42	2.45	2.47	2.50
Licenses and Permits	2.33	2.62	2.49	2.00	2.27	2.33	2.40	2.48	2.55
Charges for Services	5.94	5.95	4.87	5.34	5.69	5.78	5.86	5.96	6.05
Other Revenue	2.90	2.23	2.13	0.89	0.99	1.01	1.03	1.05	1.07
Transfers In	3.75	3.34	3.44	3.01	3.12	3.23	3.35	3.47	3.60
Total Operating Revenues	**98.37**	**90.58**	**88.32**	**91.59**	**106.90**	**110.84**	**115.91**	**119.55**	**123.14**

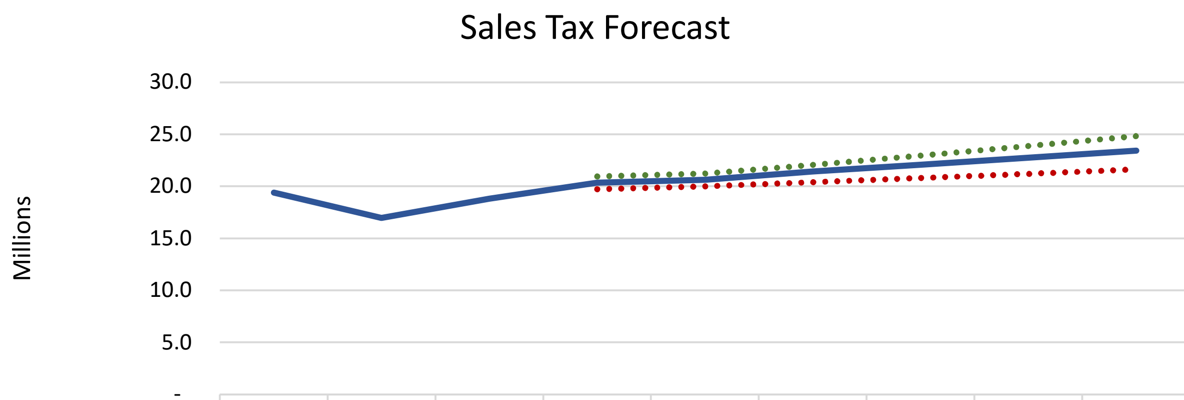
Property Tax Revenues



	FY19	FY20	FY21	FY22	FY23	FY24	FY25	FY26	FY27
Most Likely	35.0	36.3	38.9	39.9	41.9	43.5	45.2	47.0	48.8
Pessimistic				39.9	41.9	32.7	34.0	46.1	47.9

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. The Pessimistic forecast includes the potential loss of VLF revenue for two fiscal years if the Napa Valley Unified School District moves to Basic Aid without a legislative fix resolving this issue for the Napa jurisdictions.

Sales Tax Revenues



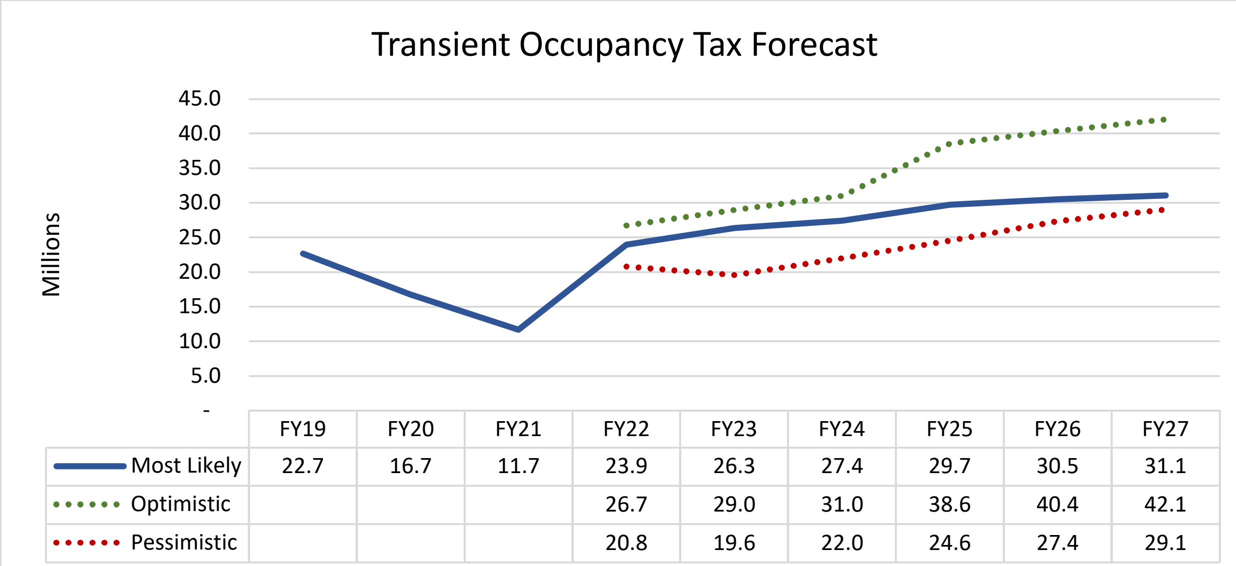
	FY19	FY20	FY21	FY22	FY23	FY24	FY25	FY26	FY27
Most Likely	19.4	17.0	18.8	20.3	20.6	21.4	22.1	22.7	23.4
Optimistic				20.9	21.2	22.1	23.0	23.9	24.8
Pessimistic				19.7	20.0	20.4	20.8	21.2	21.6

Sales tax is one of the City's most economically sensitive revenue sources and experienced a dip in FY 2019/20 due to 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 during the pandemic in its sales tax revenue from Restaurants and Hotels, along with General Consumer Goods and Fuel and Service Stations, it received 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 expenditures. 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	FY20	FY21	FY22	FY23	FY24	FY25	FY26	FY27
Most Likely	22.7	16.7	11.7	23.9	26.3	27.4	29.7	30.5	31.1
Optimistic				26.7	29.0	31.0	38.6	40.4	42.1
Pessimistic				20.8	19.6	22.0	24.6	27.4	29.1

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 drastically reduced TOT revenues for the City in FY 2019/20 and FY 2020/21. The forecast assumes that revenues will rebound to FY 2018/19 levels in FY 2021/22. The steep climb in revenue in the current year is due to recovery observed in calendar year 2021. However, Visit Napa Valley reports that revenue recovery is due to higher room rates, rather than increased occupancy. This revenue source will need to be closely monitored to determine if the recent growth observed is sustainable; the Most Likely forecast assumes that 2021 included pent-up demand that will slow down in future years.

Transient Occupancy Tax Revenue Most Likely Forecast (in millions)

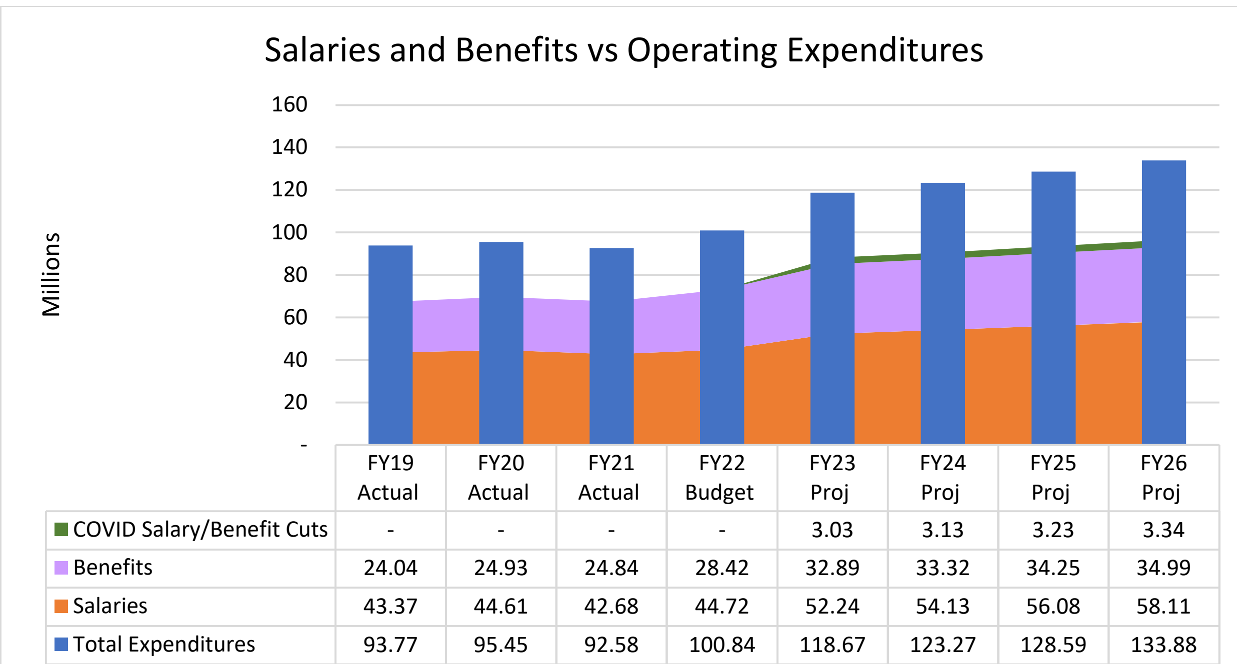
	FY19 Actual	FY20 Actual	FY21 Actual	FY22 Budget	FY23 Proj	FY24 Proj	FY25 Proj	FY26 Proj	FY27 Proj
Base TOT Revenue	19.66	14.37	9.83	11.89	19.62	19.91	20.21	20.51	20.82
New Development	3.00	2.38	1.88	4.23	6.73	7.50	9.51	9.98	10.28
Total	22.66	16.75	11.72	16.12	26.34	27.41	29.72	30.49	31.10
Year-over-Year % Increase		-26.1%	-30.0%	37.5%	63.5%	4.0%	8.4%	2.6%	2.0%

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 2022/23 through FY 2026/27. This rate is consistent with historical increases observed from FY 2015/16 thorough FY 2018/19. The New Development total includes recent hotel openings that are still ramping up to full occupancy, as well as projected future development.

Expenditure Forecasts

Most Likely (in millions)	FY19 Actual	FY20 Actual	FY21 Actual	FY22 Budget	FY23 Proj	FY24 Proj	FY25 Proj	FY26 Proj	FY27 Proj
Semi- & Non-Discretionary									
Salaries and Benefits	59.25	60.28	57.36	61.47	65.00	68.46	70.71	73.02	75.41
PERS UAL	8.17	9.25	10.17	11.67	13.05	13.63	13.62	14.09	14.35
Services & Supplies	5.81	6.85	6.85	7.71	8.53	9.43	10.43	11.53	12.75
Internal Services	5.63	6.60	6.80	7.25	7.94	8.59	9.31	10.13	11.04
Transfers to Reserves	2.97	3.05	1.88	3.53	3.99	3.86	4.07	4.76	4.92
Semi- & Non-Discretionary	81.83	86.02	83.06	91.63	98.50	103.97	108.13	113.52	118.47
Discretionary									
Services & Supplies	7.72	7.39	5.77	8.26	8.43	8.60	8.77	8.94	9.12
Other Transfers Out	4.22	1.67	0.00	0.95	0.90	0.90	0.90	0.90	0.90
Discretionary	11.94	9.06	5.77	9.21	9.33	9.50	9.67	9.84	10.02
Expenditures	93.77	95.08	88.84	100.84	107.83	113.47	117.79	123.36	128.50
Cost of Adding Back Frozen Positions and Operating Budget Cuts due to COVID-19					5.01	5.20	5.48	5.23	5.38
Total Expenditures	**93.77**	**95.08**	**88.84**	**100.84**	**112.84**	**118.67**	**123.27**	**128.59**	**133.88**

Salaries and Benefits vs Budgeted Operating Expenditures



Based on the assumptions used in the forecast model, salaries and benefits account for 73% 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 has had a negative economic impact on the City's elastic revenue sources. 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 decreased in FY 2020/21 as the City experienced its first full fiscal year during the COVID-19 pandemic. FY 2020/21 operating revenues were $84.4 million, just 86% of pre-pandemic FY 2018/19 revenue. The City responded to decreased revenue projections by reducing operating budgets, freezing full-time positions, and bringing one-time revenues into the General Fund to offset the operating deficit.

Looking forward, while the City's revenues are projected to increase, those increases could easily be outpaced by expenditure growth if these budgets are allowed to increase at historical rates. The City experienced strong revenue growth out of the Great Recession, averaging 6% annual growth from FY 2010/11 through FY 2018/19. The current forecast estimates average annual growth under 4% for the next five years.

Over the past several 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.

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 and scheduled UAL increases
- The City has substantial deferred maintenance costs for facilities and infrastructure 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.
- Growth of the City's baseline Transient Occupancy Tax has slowed and will need to be closely monitored.

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

Summary of Trends & Indicators

The FY 2011/12 through FY 2020/21 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	2017/18	2018/19	2019/20	2020/21	2021/22
Revenues per Capita	F	F	F	C	C
Property Tax Revenues	F	F	F	F	C
Sales Tax Revenues	F	F	F	W	C
Transient Occupancy Tax Revenues	F	C	C	U	C
Business License Tax Revenues	F	F	F	C	C
Fringe Benefits as Compared to Total Operating Expenditures	C	C	C	W	W
Salary Expenditures as Compared to Total Operating Expenditures	F	F	F	C	W
Capital Outlay as a Percentage of Operating Expenditures	F	F	F	F	F
Operating Position	F	F	F	U	U
Reserve Fund Balances	F	F	F	U	W
Liquidity Ratio	F	F	F	W	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 time to return to pre-pandemic levels.
2	Property Tax Revenues	C	Property values continue to increase, and the median sales price of housing remains high, however there is risk of potential loss of VLF revenue.
3	Sales Tax Revenues	C	Sales Tax revenues are rebounding faster than anticipated, but still require monitoring.
4	Transient Occupancy Tax Revenues	C	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. Strong growth has been observed in calendar 2021, with July-October revenues higher than the same time period in FY 2018/19. Planned new development will also bolster this revenue source in future years.
5	Business License Tax Revenues	C	Business license tax revenues are based on gross receipts of individual businesses. Revenues dropped in FY 2020/21 and will need to be monitored.
F: Favorable C: Caution W: Warning U: Unfavorable			

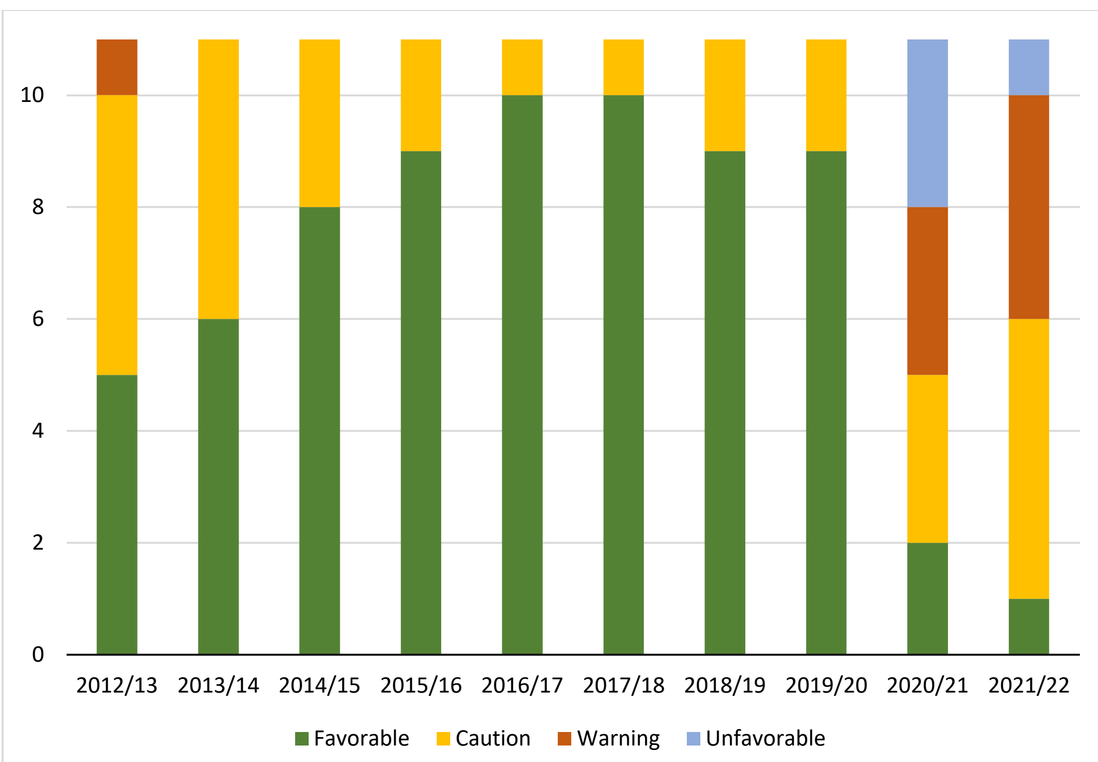
General Fund Expenditure Trends			
6	Fringe Benefits vs Total Operating Expenditures	W	Fringe benefit costs as compared to the city's total operating expenditures have stabilized through increased cost sharing and employee incentives to control the increased cost of benefits. However, the City's CalPERS 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	W	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 operating deficits in FY 2019/20 and FY 2020/21. Depending on the rate of recovery of the economy and actions taken on controlling expenditures, the City may need to draw on reserves for multiple years.
10	Reserve Fund Balances	W	The potential upcoming need to draw on reserves to support the General Fund would 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. Future usage of those reserves would 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	C	10.	Reserve Fund Balances	W
3.	Sales Tax	C	11.	Liquidity	W
4.	Transient Occupancy Tax	C			
5.	Business License Tax	C			

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

Rating Changes

The COVID-19 pandemic has created financial stress for the City, and while some indicators have been upgraded, many have been reduced or maintained at lower levels. Sales Tax and TOT revenues have been upgraded to Caution based on strong recent performance. Property Tax has been downgraded to Caution based on the potential loss of VLF revenue. Salary Expenditures have been downgraded to Warning given the large impact of these expenditures on the total operating budget, and the forecasted trend of expenditure growth outpacing revenue growth. Reserve Fund Balances have been upgraded to Warning as the City has not yet needed to pull funds from reserves to balance the General Fund budget.



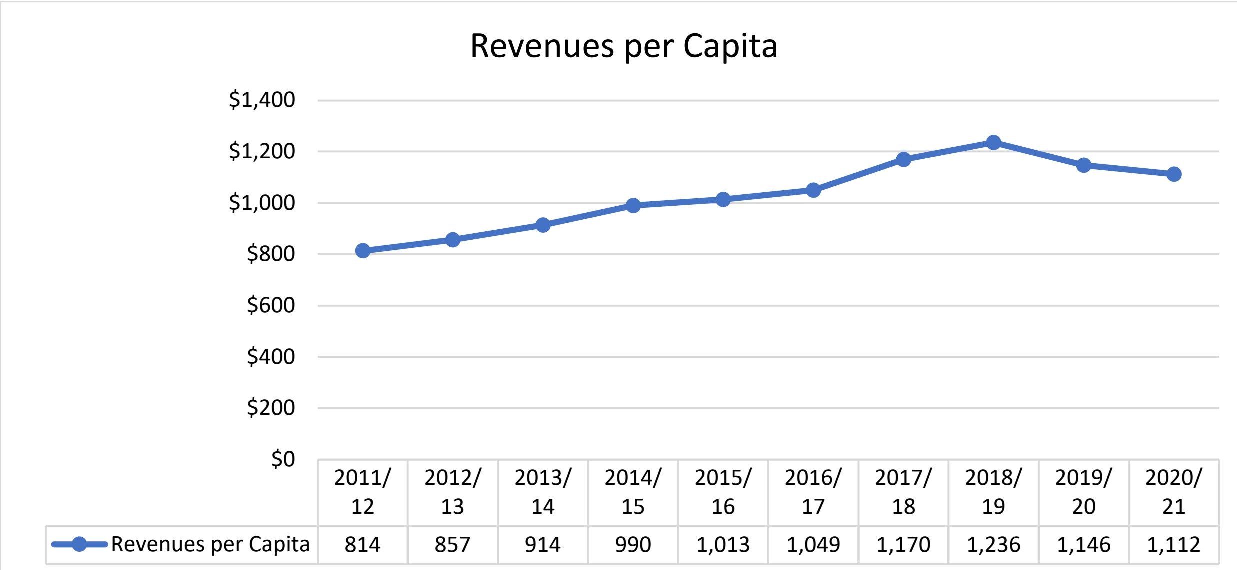
General Fund Revenue Trend Indicators

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



2022 Finding: Caution
2021 Finding: Caution

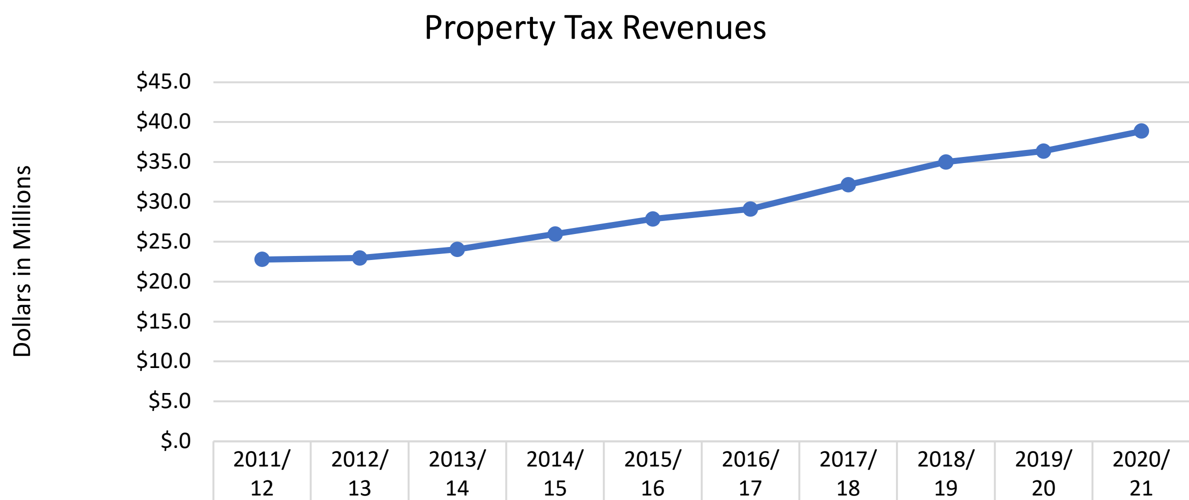
Description
Revenues per capita are a measure of the City's ability to maintain service levels.

Comments and Analysis
Prior to FY 2019/20, revenues per capita steadily increased as the City emerged from the Great 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 caused this indicator to decrease. General Fund revenue is estimated to recover to FY 2018/19 levels in FY 2022/23.

Population growth has been slow over this period, averaging 0.23% per year over the past ten years (about 1,600 new residents in total).

The 2021 rating of Caution has been retained in 2022 for this indicator as we monitor City revenues during the ongoing pandemic.

Indicator 2: Property Tax Revenues



	2011/12	2012/13	2013/14	2014/15	2015/16	2016/17	2017/18	2018/19	2019/20	2020/21
Property Tax	22.8	23.0	24.0	26.0	27.8	29.1	32.1	35.0	36.3	38.9

2022 Finding: **Caution**
2021 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.

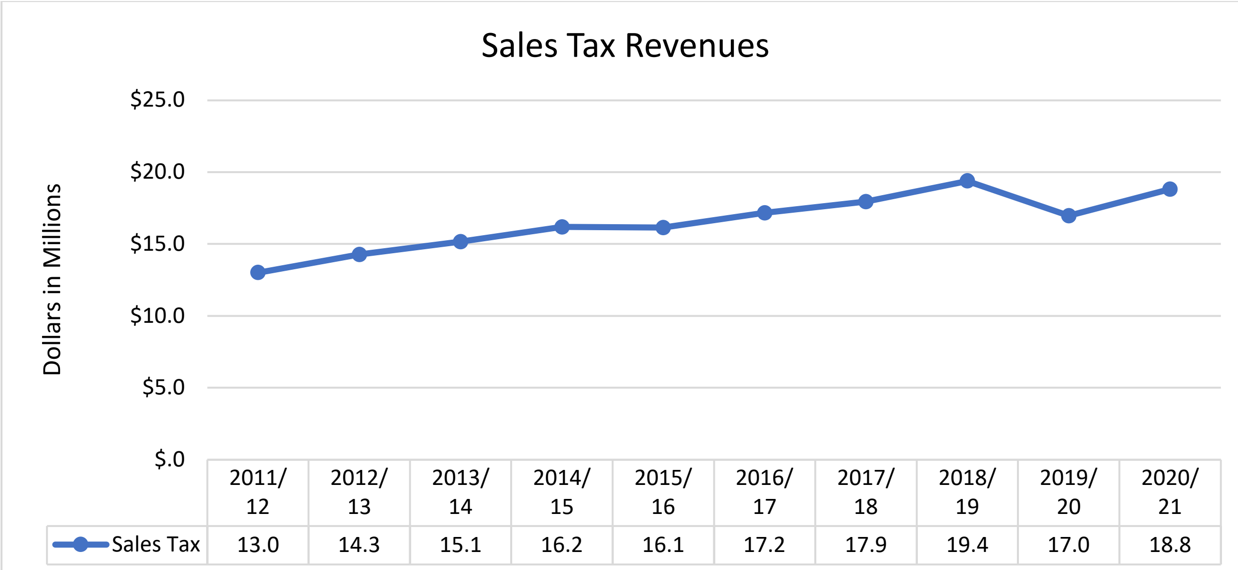
Comments and Analysis

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. The amounts shown in the chart above include Excess ERAF revenues included in the General Fund ($0.5-1.3 million per year), but do not include the additional $1.5 million of Excess ERAF added to the General Fund in FY 2020/21 to help balance the budget.

While property tax continues to steadily increase, the City is facing a potential loss of VLF revenue if Napa Valley Unified School District becomes a basic aid district. This possibility is included in the City's pessimistic forecast.

The 2021 rating of Favorable is downgraded to Caution for 2022, due to the possibility of losing VLF revenue in the future. The City continues to work with our state representatives and Napa County on a legislative action to correct this issue.

Indicator 3: Sales Tax Revenues



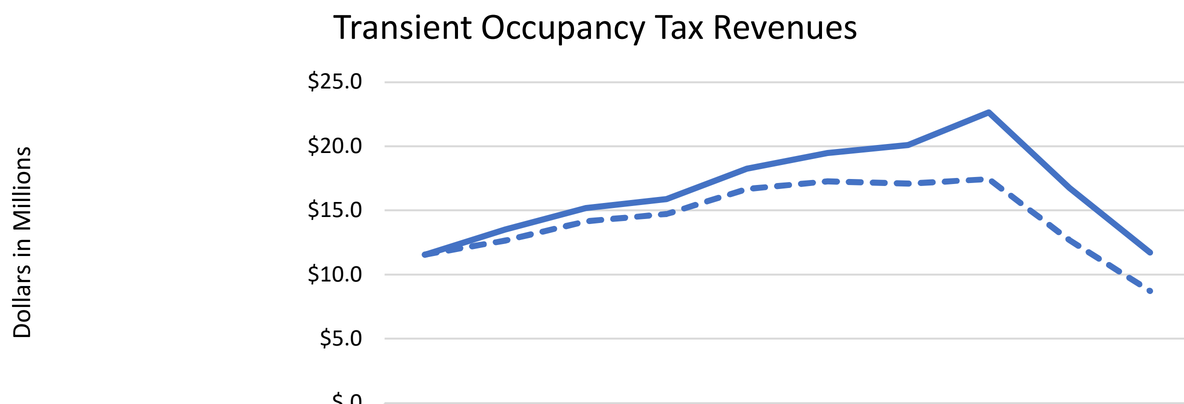
2022 Finding: **Caution**
2021 Finding: **Warning**

Description
Sales tax revenue is a strong indicator of the city's economic health. Sales taxes are typically 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. Sales tax revenues rebounded in FY 2020/21 as consumers switched to online purchases, resulting in higher revenues than anticipated at the beginning of the pandemic.

The 2021 rating of Warning is upgraded to Caution for this indicator due to the growth seen in FY 2021/22.

Indicator 4: Transient Occupancy Tax Revenues



	2011/12	2012/13	2013/14	2014/15	2015/16	2016/17	2017/18	2018/19	2019/20	2020/21
Baseline TOT	11.6	12.7	14.2	14.7	16.7	17.3	17.1	17.4	12.7	8.7
TOT with New Development	11.6	13.5	15.2	15.9	18.3	19.5	20.1	22.7	16.7	11.7

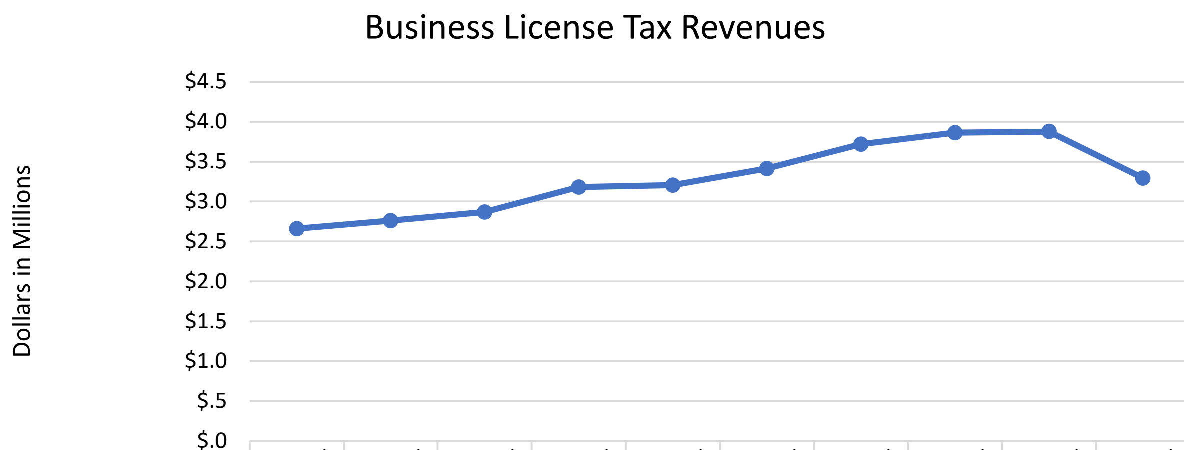
2022 Finding: Caution
2021 Finding: Unfavorable

Description
Transient occupancy tax revenue (TOT) is a strong indicator of the city's economic health. This revenue source is typically 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%. The "New Development" on the chart above designates new hotel development since the Great Recession.

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 led to initial steep declines in TOT revenue, with hotels shut down for periods of time and most people remaining home rather than traveling. However, strong month-over-month growth has been observed in calendar year 2021. If the growth trend continues, this revenue source could rebound in FY 2022/23.

The 2021 rating of Unfavorable is upgraded to Caution due to the revenue growth observed in calendar year 2021.

Indicator 5: Business License Tax Revenues



	2011/12	2012/13	2013/14	2014/15	2015/16	2016/17	2017/18	2018/19	2019/20	2020/21
Business License	2.7	2.8	2.9	3.2	3.2	3.4	3.7	3.9	3.9	3.3

2022 Finding: Caution
2021 Finding: Caution

Description
Business license tax revenue typically 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 steadily increased from the Great Recession to the onset of the pandemic. As this tax is based on business gross receipts, we saw a steep decline in the amount collected in FY 2020/21. Given the strong growth observed in sales tax and TOT, this revenue source will likely begin to recover in FY 2021/22.

The 2021 rating of Caution remains for 2022, as we wait to see the extent of the impact of the pandemic on local businesses.

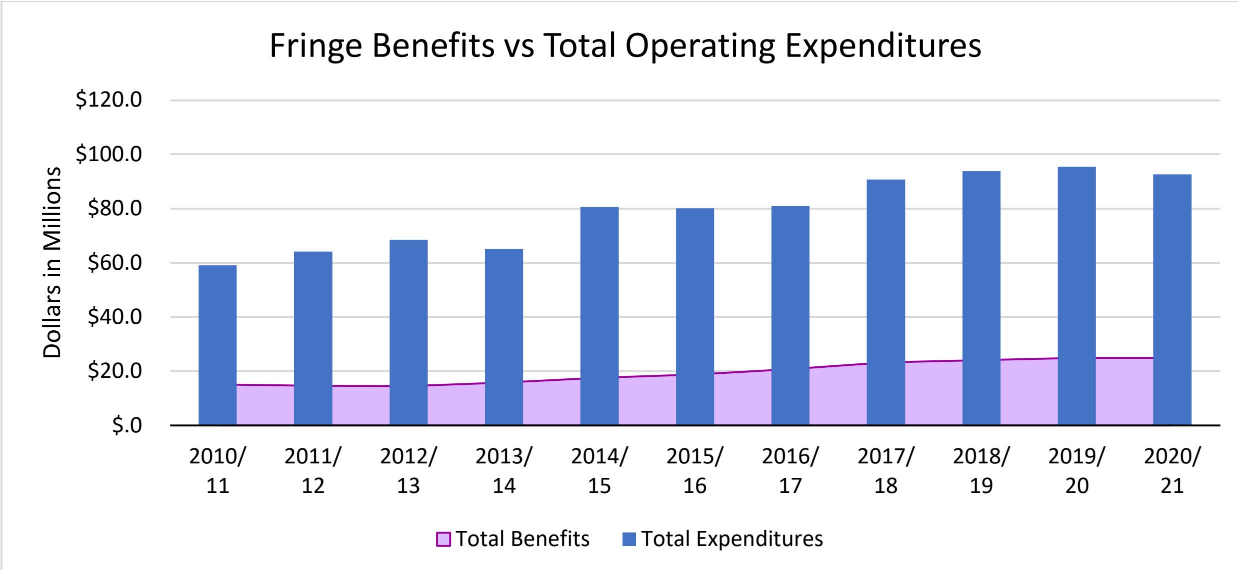
General Fund Expenditure Trend Indicators

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



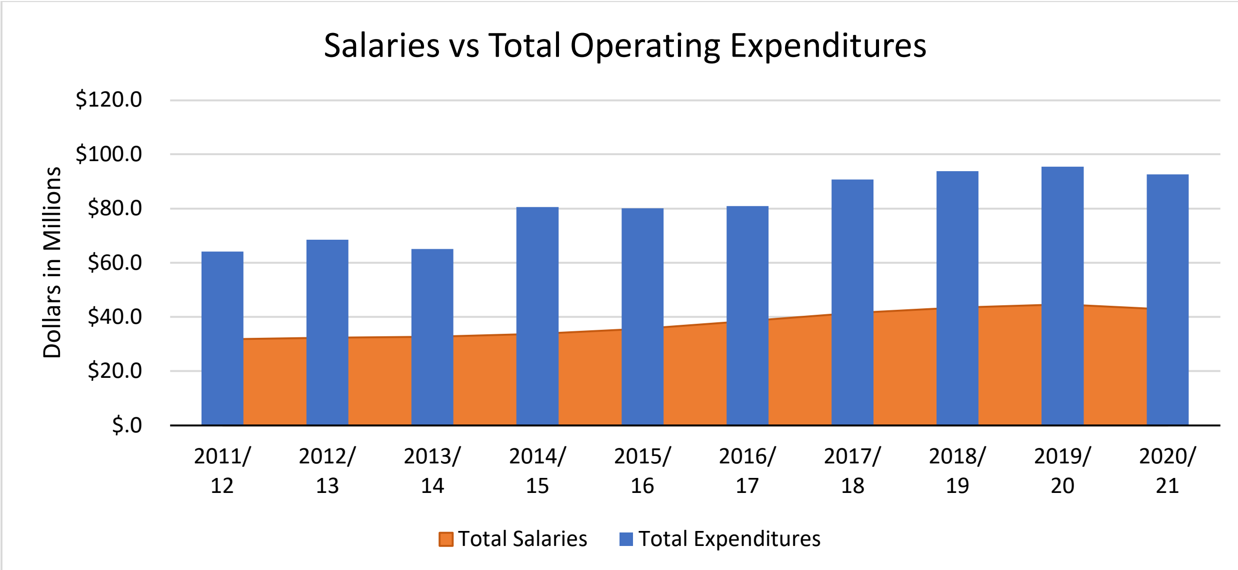
2022 Finding: Warning
2021 Finding: Warning

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 21-27% of the City's total operating expenditures over the past ten years. CalPERS adjusted its discount rate in November 2021 from 7% to 6.8% due to high investment returns, which will increase the City's costs. ~~Tthe~~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 slow revenue growth, which will cause the amount of fringe benefits as compared to total operating expenditures to increase.

The 2021 rating of Warning for this indicator is maintained for 2022. 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 27% of the City's operating costs), require strong and constant management of this indicator.

Indicator 7: Salaries vs Total Operating Expenditures



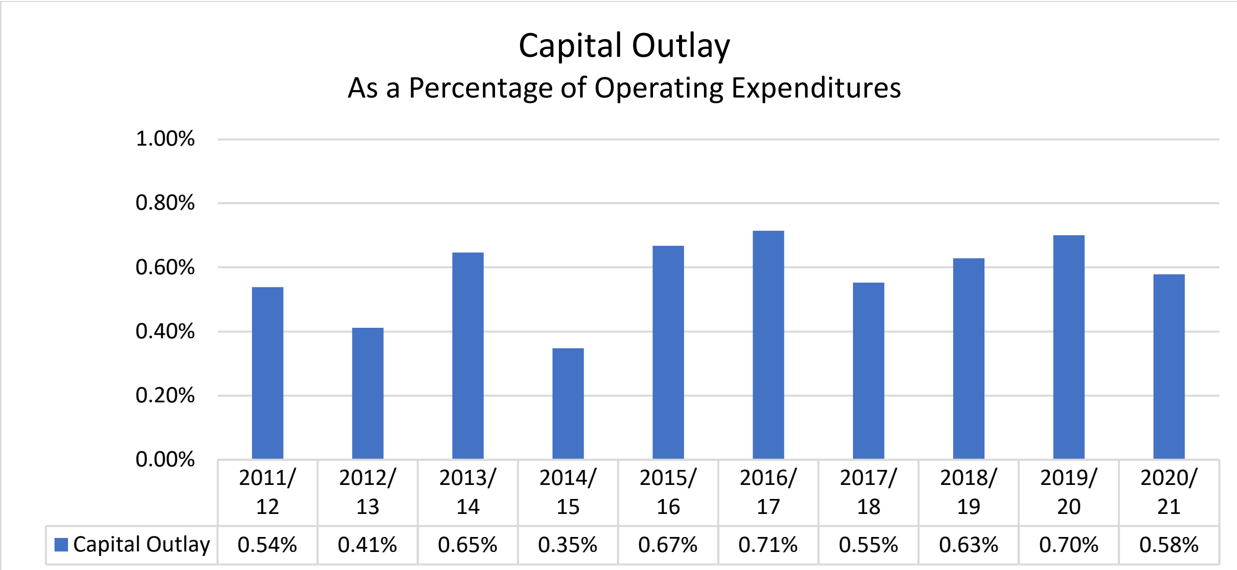
2022 Finding: Warning
2021 Finding: Caution

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 slow revenue growth, which will cause the amount of salaries as compared to total operating expenditures to increase. In FY 2020/21 and FY 2021/22 the City froze positions to reduce operating expenditures, a practice that may need to be continued into the future.

The 2021 rating of Caution is downgraded to Warning due to the concerning revenue and expenditure trends in this forecast. As salaries continue to rise and drive benefit costs upwards, it is unlikely the City's revenue will increase enough to cover the additional costs. The City will need to strategize how to control personnel costs while also providing public services and maintaining its position as an employer of choice for the area.

Indicator 8: Capital Outlay as a Percentage of Operating Expenditures



2022 Finding: Favorable
2021 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 $0.59 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.

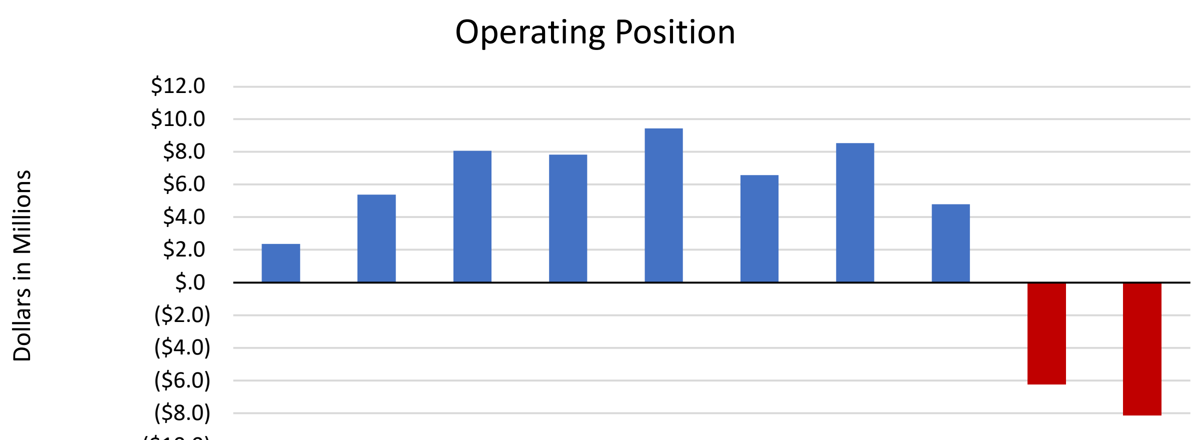
General Fund Operating Position Trend Indicators

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



	2011/ 12	2012/ 13	2013/ 14	2014/ 15	2015/ 16	2016/ 17	2017/ 18	2018/ 19	2019/ 20	2020/ 21
Operating Position	2.4	5.4	8.1	7.8	9.4	6.6	8.5	4.8	(6.2)	(8.1)

2022 Finding: Unfavorable
2021 Finding: Unfavorable

Description

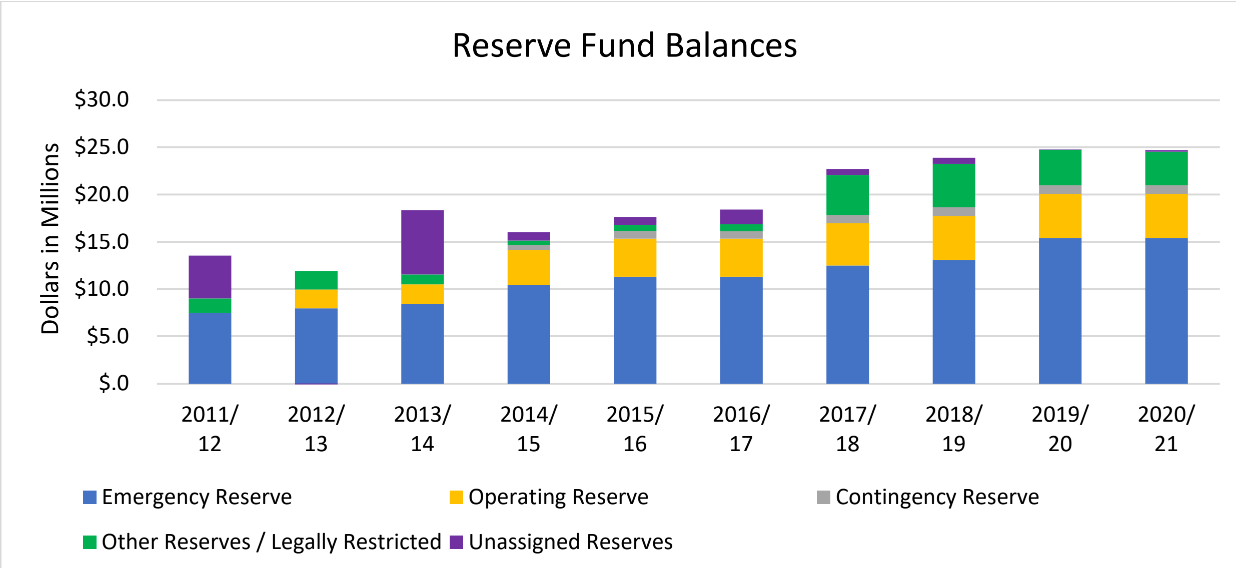
This indicator measures the City's ability to balance operating revenues, excluding fund balances from the prior year, against operating expenditures. When operating revenues exceed operating expenditures an operating surplus is achieved. A deficit occurs when the reverse happens, and the City is forced 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 Great 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 through FY 2020/21. The operating position shown above does not include one-time transfers and funds used to offset the operating deficits experienced in FY 2019/20 and FY 2020/21. Multi-million dollar operating deficits are anticipated in future years as the City works to

The 2021 rating of Unfavorable remains in 2022 due to the ongoing pandemic, as well as the forecasted trend of expenditure growth outpacing operating revenue growth.

Indicator 10: Balance of Reserve Funds



2022 Finding: Caution
2021 Finding: Unfavorable

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.

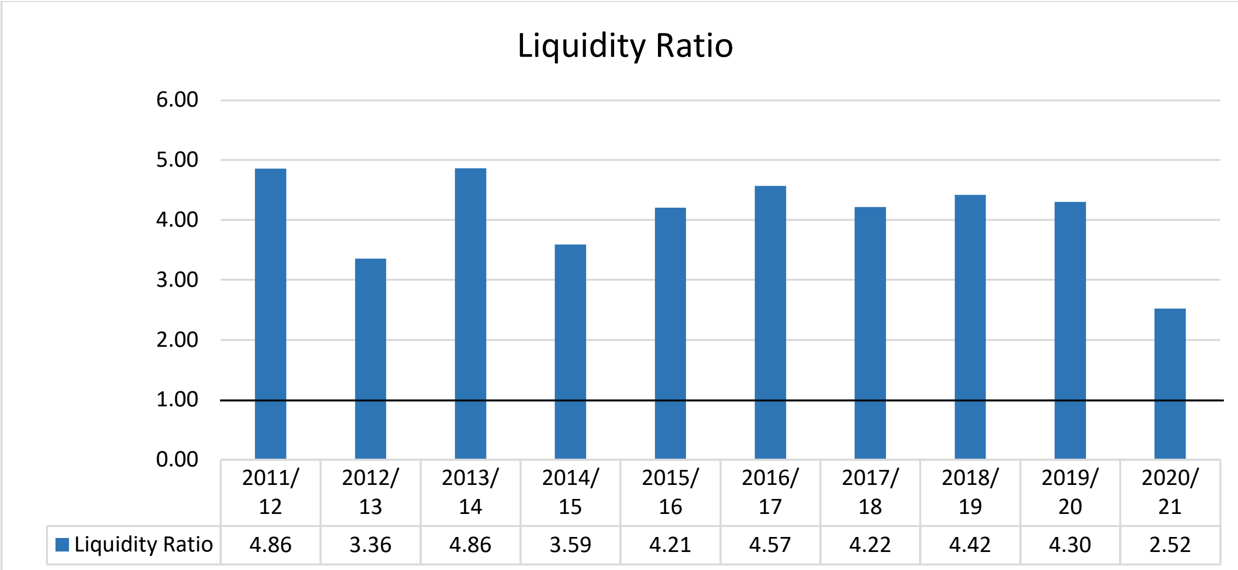
Comments and Analysis
The City has a fiscal policy designating an amount of annual operating expenditures as an emergency reserve and has achieved full compliance since the policy was first implemented in FY 2007/08 at 12% of operating expenditures and then increased in FY 2014/15 to 14%. Undesignated 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 assumed the use of $3.6 million from the Emergency Reserve, but expenditure controls and higher revenue than budgeted meant that no reserves were spent for the year. Looking forward, reserves could be needed to offset continued deficits.

Given the potential future needs to spend down reserves, without a plan to re-fund the reserves, this indicator continues to require close monitoring.

The 2021 rating of Unfavorable is upgraded to Caution for 2022 due to no reserve funds being spent in FY 2020/21, and the current over-funding of the Emergency Reserve.

Indicator 11: Liquidity Ratio



2022 Finding: Warning
2021 Finding: Warning

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 2.52 at the end of FY 2020/21, meaning the City's General Fund has enough current assets to cover its current liabilities more than twice over. This decline from FY 2019/20 to FY 2020/21 is due to the receipt of the as yet unspent American Rescue Plan Act funding, which increased the City's current assets by 27% but more than doubled its current liabilities. The City's liquidity has been buoyed by the cash in its General Fund reserves. If reserves are spent in future years, the liquidity ratio will decrease. Due to the potential usage of reserves in future years, this indicator has been maintained at Warning. Cash flow and liquidity will need to be closely monitored to ensure the City is able to stay solvent.