GENERAL FUND FINANCIAL FORECAST

FY 2015-16 – FY 2021-22

CITY OF SAN MATEO, CALIFORNIA

Current and long-range assessment of financial condition

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FORECAST OVERVIEW AND SUMMARY

OVERVIEW

The General Fund Financial Forecast provides a current and long-range financial assessment of revenues, expenditures, fund balance and emergency reserves. The primary objective of the Forecast is to provide the City Council and the community with an early financial assessment and identify any significant issues that may need to be addressed in the budget development process. While typically the forecast looks out five years, the scope of this forecast has been extended out to FY 2021-22 in order to fully capture the extent of recovery from the expiration of the Measure L temporary ¼ cent sales tax on March 31, 2018. The Measure L ¼ cent sales tax is forecast to peak in 2016-17 at $5.2. Fiscal year 2018-19 is the first full fiscal year after the expiration of Measure L and this forecast attempts to predict the extent of the recovery from that loss four years later in 2021-22.

The Forecast does not assume funding for infrastructure such as additional levee improvements, storm water pump station rehabilitation, or reduction in failed streets. A public opinion research firm will be conducting a survey of residents to determine the feasibility of potential revenue measures to address unfunded infrastructure needs. See section on unfunded infrastructure needs on page 11.

The forecast information presented in this document combines projected resources and current service expenditures to illustrate the financial impact to the annual results of operations and ending fund balance for the General Fund in any given year of the forecast period. Recent revenue trends and economic assumptions are used to develop these figures. Service expenditures required to sustain the current year level of services are used as the baseline throughout the forecast period. Many of these assumptions, projections, and cost estimates within this document are based on early and preliminary information that will be refined and changed as the FY 2015-16 Proposed Operating Budget is developed and presented to City Council.

It is important to keep in mind that a forecast is not a budget. A forecast is really just a vehicle that allows us to peer into the future and make predictions about what is likely to happen given certain assumptions. If future deficits are predicted then the forecast allows time to take corrective action to ensure finances remain sustainable.

SUMMARY

The Bay Area economy has improved markedly over the past few years. Key revenue sources such as Property Tax, Sales Tax, Transient Occupancy Tax and Property Transfer tax have experienced growth and all major indicators show that these revenues are expected to continue to increase in future years. Despite these positive signs, very significant fiscal challenges are expected in the upcoming years. Most notably, the expiration of the Measure L temporary ¼ cent sales tax in 2018 and increases to employer pension rates. The loss of

Measure L will have a $5+ million dollar impact annually which will reduce General Fund revenues approximately 5% annually beginning in 2018-19.

The California Public Employees Retirement System (CalPERS) is implementing a new retirement funding model beginning in 2015-16 which includes a strategy to have unfunded liabilities fully amortized in 30 years. While this will create a more fiscally sustainable pension system, the plan results in steep increases in employer costs over the next five years.

Given the assumptions in the Forecast, cumulative nominal growth in total sources will outpace total uses over the forecast period by $17.3 million drawing down the beginning fund balance of $12.9 million and creating a fund deficit of $4.4 million by the end of the forecast period in 2021-22. As shown in Table 1, annual deficits are forecast for each year of the forecast beginning in 2016-17 through 2021-22. If the beginning fund balance were to be used for unfunded infrastructure needs then other budget tradeoffs would be required beginning with the next 2 year business plan for 2016-18. The forecast includes $212,000 in required budget adjustments beginning in 2015-16 in General Fund lease costs for the 1900 O'Farrell building. There is an additional $358,000 in 2015-16 budget requests currently under consideration that, if recommended for approval, would further increase annual costs.

GENERAL FUND FORECAST

TABLE 1

GENERAL FUND FINANCIAL FORECAST SUMMARY

GENERAL FUND SEVEN YEAR FORECAST 2016 - 2022

		2014-15-16 Two Year Business Plan							
		2014-15 *Estimate*	**2015-16** *Revised Proposed*	**2016-17** Forecast	**2017-18** Forecast	**2018-19** Forecast	**2019-20** Forecast	**2020-21** Forecast	**2021-22** Forecast
1	**BEGINNING FUND BALANCE**	**11,932**	**12,969**	**14,206**	**12,867**	**10,542**	**5,981**	**1,354**	**(2,165)**
2									
3	REVENUES	98,727	100,866	103,298	105,499	104,750	108,168	111,454	115,024
4	TRANSFERS IN	1,518	954	954	954	954	954	954	954
5	**TOTAL RESOURCES**	**100,245**	**101,820**	**104,252**	**106,453**	**105,704**	**109,122**	**112,408**	**115,978**
6									
7	SALARIES & BENEFITS	68,027	71,372	75,666	78,679	81,702	84,688	86,641	88,516
8	OPERATING & CAPITAL OUTLAY	22,802	22,726	23,192	23,667	24,128	24,623	25,105	25,596
9	FY15/16 REQUIRED BUDGET CHANGES	0	262	212	212	212	212	212	212
10	TRANSFERS OUT	8,140	5,060	5,063	5,067	3,071	3,075	3,079	3,084
11	**SUB-TOTAL EXPENDITURES**	**98,968**	**99,420**	**104,133**	**107,625**	**109,114**	**112,599**	**115,037**	**117,408**
14	TRANSFER TO EMERGENCY RESERVE	0	(883)	(1,177)	(872)	(871)	(870)	(608)	(592)
15	LOW & MODERATE HOUSING SET ASIDE	(240)	(280)	(280)	(280)	(280)	(280)	(280)	(280)
16	ANNUAL SURPLUS OR (DEFICIT)	1,037	1,237	(1,339)	(2,324)	(4,561)	(4,628)	(3,518)	(2,301)
17	**ENDING FUND BALANCE**	**12,969**	**14,206**	**12,867**	**10,542**	**5,981**	**1,354**	**(2,165)**	**(4,466)**

As shown in Table 1, 2015-16 is projected to end with a surplus of $1.2 million increasing the beginning fund balance of $12.9 million to $14.2 million by the end of the 2015-16 fiscal year which then becomes the beginning fund balance in 2016-17. From 2016-17 through 2021-22 the General Fund is forecast to experience annual deficits slowly drawing down beginning fund balances and producing actual fund deficits beginning in 2020-21 and 2021-22. The size of annual deficits peak in 2018-19 and 2019-20 at $4.5 to $4.6 million, the first two fiscal years after the expiration of Measure L. Annual deficits begin to moderate in the final two years of the forecast with the final year showing a $2.3 million imbalance between total sources and total uses. Other significant assumptions used in this Forecast are as follows:

REVENUE ASSUMPTIONS

The annual change in revenue assumptions are shown below in Table 2. Assumptions for Property Transfer Tax are shown in dollars as opposed to percentages to be more meaningful and consistent with the policy to cap amounts budgeted for operating expenditures.

TABLE 2

Revenue Assumptions - Annual Change

	FISCAL YEAR						
REVENUES	**15/16**	**16/17**	**17/18**	**18/19**	**19/20**	**20/21**	**21/22**
Secured Property Tax	3.8%	4.8%	6.0%	3.5%	3.5%	3.5%	3.5%
Sales Tax	2.2%	3.9%	3.9%	3.9%	3.9%	3.9%	3.9%
Transient Occupancy Tax	4.9%	3.5%	3.5%	3.5%	3.5%	3.5%	3.5%
Property Transfer Tax	$8.1M	$8.7M	$8.5M	$8.8M	$9.1M	$9.2M	$9.6M
Business Tax	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%
Pari-Mutual Tax	2.0%	1.0%	1.0%	1.0%	1.0%	1.0%	1.0%
Fines & Forfeitures	0.0%	1.1%	1.1%	1.1%	1.1%	1.1%	1.1%
Interest Income & Rents	1.7%	37.0%	27.0%	21.3%	0.3%	0.3%	0.3%
Franchise Fees	3.0%	4.0%	5.0%	5.0%	5.0%	5.0%	5.0%
Miscellaneous Revenues	-42.9%	2.0%	2.0%	2.0%	2.0%	2.0%	2.0%
Service Charges	0.5%	4.4%	4.5%	4.5%	4.5%	4.5%	4.5%
Interfund Charges	2.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%

- Property tax – growth in secured property tax is expected to be 3.8% to 4.8% in the next few years peaking in 2017-18 at 6.0%. The increased activity in building within the City is expected to be phased into the tax roll over the next few years. Beyond 2017-18 steady growth of 3.5% is forecast.

- Sales tax – The basic sales tax is projected to grow 2.2% in 2015-16 and 3.9% annually thereafter. Total sales tax receipts are projected to grow 6.7% next year including a one-time true up from the state triple flip replacement payments. Prop 57 Economic Recovery Bonds used to balance the State budget in 2004-05 called for the re-designation of ¼ cent of the local sales tax as the source of repayment. The Prop 57 bonds will be retired in 2014-15 and will result in a one-time true up payment in 2015-16. With the expiration of triple flip sales tax backfill payments in 2015-16 the full 1% local sales tax will resume. The first year of the sales tax shift (2004-05) only 3 quarters of backfill payments were received. To correct for that partial year payment in that first year a one-time true-up payment of $2.1 million will be received in 2015-16. The decline in 2018-19 is due to the expiration of the Measure L temporary ¼ cent sales tax.

- Property Transfer Tax – the amount budgeted for operating expenditures is capped by Council policy using a formula averaging the current year estimate with the prior two years inflated by 4.25% which is the long-term growth rate in this revenue source. Obviously, actual figures are not available for future years so the formula for any given year was applied to the prior three years and inflated by 4.25%. The amount budgeted in 2015-16 is $8.1 million trending upward to $9.6 million in the final year of the Forecast.

- Interest Income & Rents – Interest income is expected to rise due to improving investment rates beginning in 2016-17. In nominal dollar terms interest income is forecast to increase from $285K in 2015-16, $399K in 2016-17, $496K in 2017-18, and $602K in 2018-19 and essentially leveling off for the remaining years in the Forecast.

OPERATING TRANSFERS FROM GAS TAX FUND

Highway Users Tax Account (HUTA) aka Gas Tax – The Forecast reflects operating transfers in from the Gas Tax Fund of $1.5 million in 2014-15 decreasing to $954,000 in 2015-16 and remaining at that level each year through the forecast period. The State collects and distributes the "gasoline tax" by dividing revenues into four sections and then allocating a portion to cities and counties by various formulas using a combination of population, number of registered vehicles, and maintained road miles. San Mateo has typically received approximately $2.7 million annually from gas tax and has budgeted $1.2 million annually for street paving and $1.5 million for General Fund street related operating costs. For 2015-16, the State has estimated a decrease of 24% in gas tax due to falling gas prices and reduced consumption. In response, the forecast assumes that $1.2 million for street paving will remain unchanged with the shortfall resulting in a reduction in funding for General Fund street related operating costs.

EXPENDITURE ASSUMPTIONS

Salary Costs
Negotiated salary increases of 2% effective July 2015 have been included for SEIU Maintenance, SMCEA, and Fire bargaining groups. In addition, negotiated salary increases of 2% effective July 2015 and July 2016 have been included for the Management bargaining group and negotiated increases of 2.5% effective July 2015 and July 2016 have been included for the Safety Management bargaining group. Total salary and benefit costs will increase markedly by 6% in 2015-16 and another 4% in 2016-17 due to a combination of these negotiated increases and PERS rates resulting from the CalPERS direct rate smoothing policy changes and changes in mortality assumptions.

Pension Costs
In April 2013 the CalPERS Board of Administration approved changes to actuarial assumptions which will significantly increase employer rates that state and local government employers pay for their plans. The policy changes, termed "direct rate smoothing", will modify both smoothing and amortization policies with the goal in mind to have all plans 100% funded within 30 years. Rate increases will ramp up for the first five years beginning in 2015-16. The policy changes include modifying the smoothing from a 15-year rolling period to a five-year direct smoothing rate. The amortization period changes from a 30-year rolling period to a 30-year fixed period. In addition to these increases, CalPERS updated demographic assumptions for mortality to reflect recent experience which also increases employer rates. Table 3 below reflects San Mateo employer rate projections provided by the City's consulting actuary, Bartel Associates, and assumes no gains or losses during the forecast timeframe.

TABLE 3

	SAFETY		NON-SAFETY	
	Employer PERS Rates	increase/decrease from prior year	Employer PERS Rate	increase/decrease from prior year
2014-15*	41.4%		16.5%	
2015-16*	44.1%	2.7%	18.2%	1.7%
2016-17**	47.2%	3.1%	19.6%	1.4%
2017-18**	48.8%	1.6%	20.6%	1.0%
2018-19**	50.7%	1.9%	21.7%	1.1%
2019-20**	52.5%	1.8%	22.7%	1.0%
2020-21**	52.4%	-0.1%	22.5%	-0.2%
2021-22**	52.1%	-0.3%	22.4%	-0.1%
	51.7%	-0.4%	22.4%	0.0%
** Actual rates*				
*** Projected rates assuming no gains or losses*				

The employer rate projections above include the impact of various pension reform measures. The City of San Mateo implemented a second tier retirement formula effective December 9, 2012 for classic members hired on or after that date. Subsequent to that action the state legislature adopted the Public Employees' Pension Reform Act of 2013 (PEPRA) effective January 1, 2013 for all new employees hired on or after that date. As a result, there is now a three tier system with tier 1 using the highest compensation over 12 months and tier 2 and 3 using the highest average compensation over 36 months as applied to the formula's below in Table 4.

TABLE 4

Group	Tier 1 Plan	Tier 2 Plan	Tier 3 Plan
Safety	3% @ 50	3% @ 55	2.7% @ 57
Non-Safety	2% @ 55	2% @ 55	2% @ 62

Rate projections in Table 4 also include the assumed long-term rate of return on investments of 7.5% as approved by the CalPERS Board. Historical investment returns for CalPERS are shown in Table 5 below.

TABLE 5

CalPERS Historical Investment Returns	
10 years	7.2%
5 years	12.5%
3 years	10.4%
FY 2013-14	18.4%

Health Benefit Costs
Annual increases to health premium cost was provided by Bartel Associates, the City's consulting actuary and ranges from 7.5% trending down to 5.0% in the final year of the forecast period.

Operating & Capital Equipment
Overall operating and capital equipment rental costs are forecast to increase 2% annually.

OPERATING & CAPITAL TRANSFERS

Transfers from the General Fund to the Capital Improvement Program (CIP) and the Fire Protection Fund are outlined below in Table 6. Beginning in 2013-14 an additional $2 million ($4 million total) was allocated for citywide street reconstruction and rehabilitation to "catch-up" from the suspension of street funding during the recession. The Forecast assumes General Fund contributions of $4 million for five years through 2017-18 then funding is reduced to $2 million annually. The transfer to the Fire Protection Fund is necessary to cover the cost of non-fee supported costs such as fire prevention education.

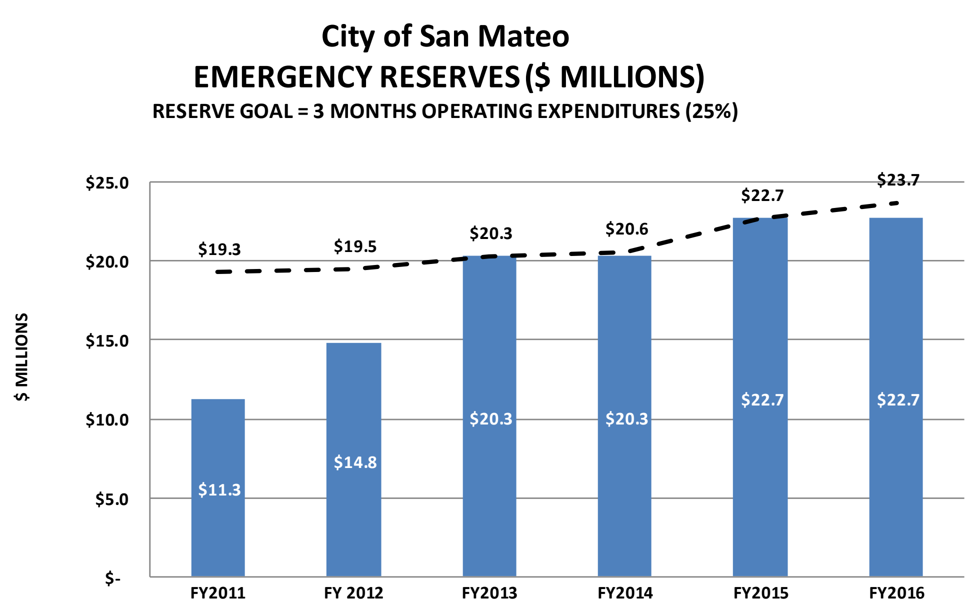
TABLE 6

Operating & Capital Transfers	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21	2021-22
Capital Transfers							
Citywide Street Reconstruction/Rehabilitation	4,000,000	4,000,000	4,000,000	2,000,000	2,000,000	2,000,000	2,000,000
Citywide Sidewalk Repair Program	500,000	500,000	500,000	500,000	500,000	500,000	500,000
Building Component Replacement Program	410,000	410,000	410,000	410,000	410,000	410,000	410,000
Citywide Playground Equipment Replacement	15,000	15,000	15,000	15,000	15,000	15,000	15,000
Citywide Bicycle/Pedestrian Improvements	10,000	10,000	10,000	10,000	10,000	10,000	10,000
Total Capital Transfers	4,935,000	4,935,000	4,935,000	2,935,000	2,935,000	2,935,000	2,935,000
Operating Transfers							
Fire Protection Fund	124,625	128,364	132,215	136,181	140,267	144,475	148,809
Total Operating Transfers	124,625	128,364	132,215	136,181	140,267	144,475	148,809
Total Transfers	5,059,625	5,063,364	5,067,215	3,071,181	3,075,267	3,079,475	3,083,809

EMERGENCY RESERVES

Table 7 shows the growth in emergency reserves from 2010-11. Emergency reserves for the current fiscal year, 2014-15, stand at $22.7 million, equal to 3 months (25%) operating expenditures. In 2010 City Council adopted a policy of maintaining reserves equal to 3 months operating expenditures as a best practice recommended by the Government Finance Officers Association (GFOA). Under Council direction $11.4 million in year-end surplus funds since 2010-11 have been used to increase emergency reserves from $11.3 million to the current $22.7 million. To maintain policy level reserves in FY 2015-16 it is estimated an increase of $1 million would be required to bring the reserves up to $23.7 million.

TABLE 7



	FY2011	FY 2012	FY2013	FY2014	FY2015	FY2016
Emergency Reserves	$11.3	$14.8	$20.3	$20.3	$22.7	$22.7
Reserve Goal	$19.3	$19.5	$20.3	$20.6	$22.7	$23.7

UNFUNDED INFRASTRUCTURE NEEDS

North Shoreview and North Central Flood Control Improvements

On October 16, 2012, FEMA issued a Physical Map Revision (PMR) which removed approximately 8,000 homes in neighborhoods south of San Mateo Creek from the Special Flood Hazard Area. Unfortunately, approximately 1200 properties, located in the areas north of San Mateo Creek, including the North Shoreview and a portion of the North Central neighborhoods, remained in the flood zone. The cost of projects to protect these properties is estimated to be approximately $22.5 to $23.5 million. The remaining projects include:

- Rehabilitation of Coyote Point and Poplar Pump Stations ($15M to $16M)
- Northern Levee Improvements ($7.5M)

With the approval of the 2014-2016 Business Plan, the City Council authorized the allocation of $750,000 for completion of design and environmental clearance for the Poplar Avenue and Coyote Point Pump Stations Project; and an allocation of $250,000 to advance the design of the Northern Levee Improvements Project. Both projects must be completed in order to remove the majority of the 1200 properties from the flood zone. No funding sources have been identified to fund the construction of these projects.

Failed Street Repairs

The City of San Mateo owns and maintains approximately 192 miles of streets. The 2012 replacement value of these assets is approximately $350 million dollars. The City utilizes the Pavement Management Program (PMP) to maintain the integrity of the overall street network. The PMP is a computerized tool that allows the City to optimize decisions regarding the use of available funds to extend the life of the existing pavement. The optimization is based on the Pavement Condition Index (PCI) and emphasizes preventative maintenance to extend the serviceable life of pavement that is in good condition (PCI above 70). Reduction in the number of miles of failed street is not part of the optimization strategy.

Since the full implementation of the PMP in 2001, the City has been able to invest approximately $3.5 million to $4.5 million into the annual paving program. Appropriate street maintenance has been performed on approximately 20 miles of streets annually and the City's overall PCI has significantly increased from 56 to 72.

While regional focus on the overall condition of streets (PCI) makes sense, use of PCI as the only performance measure for optimizing the City of San Mateo paving program does not fully address local priorities. In particular minimizing the number of miles of failed streets is equally important to the City Council and community as a performance measure. The City Council has committed to look for ways to accelerate the repair of approximately 18 miles of failed streets while maintain funding for the annual paving program.

The City currently funds $4.0 million for an annual paving program to rehabilitate streets. The $4.0 million annual paving program is funded by the General Fund ($2.0M), State Gas Tax ($1.2M), and Measure A Transportation Funds ($800K). This level of funding needs to be maintained to prevent any further deterioration of streets. A program of street reconstruction to rebuild streets that have already failed has not been funded until recently. General Fund contributions of $2.5 million in 2012-13 and $2.0 million in 2013-14 have reduced the lane miles of failed streets from 20 to 18. An additional $2.0 million has been allocated in the current 2014-15 General Fund budget. However, it is estimated that it would require an investment of $35 million ($7 million each year for 5 years) to make a significant reduction in failed streets. If the $2.0 million General Fund contribution continues for the next 5 years, then an additional $25 million would be required, or $5 million each year.