

DRAFT

July 8, 2024

Honorable Mayor, Councilmembers, and members of the Sebastopol Community,

As the City Manager, I carry many responsibilities but none as important as ensuring that money entrusted to us by taxpayers is spent wisely, strategically, and in response to community needs.

With the dedication and valuable input from Budget Committee, we are pleased to present to you Fiscal Year 2024-2025 Operating Budget for the City of Sebastopol. The budget is the primary policy document that the City Council adopts each year. It also serves as an annual financial plan, a communication tool, and guides operations.

The document includes valuable data about the City and community, including our organizational structure. We have added mission statements from each Department, a summary of key accomplishments in the prior year, and goals for the new Fiscal Year. The intent is to provide a sense of what we are accomplishing and hope to accomplish with the public's dollars.

Types of Funds: This budget includes four types of operating funds:

- a. **City General Fund:** This is the City's primary operating fund. It funds most core City services, and the City Council has great flexibility in its use. It accounts for sources and uses of resources that (primarily) are discretionary to the City Council in the provision of activities, programs and services deemed necessary and desirable by the community. It accounts for all general revenues of the City not specifically levied or collected for other City funds, and the related expenditures. The major revenue sources for this fund are sales taxes, property taxes, franchise fees, business license fees, unrestricted revenues from the state, fines and forfeitures, and interest income. Expenditures are made for community development, parks, public safety (including police and fire), public works, and other services.
- b. **Enterprise Funds:** These funds include activities that typically operate largely as independent enterprises, or businesses. They have their own sources of funding, which must be used to support those activities. Enterprise funds are used to account for self-supporting activities that provide services on a user-charge basis. For example, many cities provide water treatment and distribution services to their residents. Users of these services pay utility fees, which the city deposits in a water enterprise fund. Expenditures for water services are charged to this fund. Wastewater is another example. The Water and Wastewater funds are Sebastopol's enterprise funds.
- c. **Special Revenue Funds:** These are funds to account for particular sources of revenue and related expenses. Unlike enterprise funds, the users of the funded services are not typically charged for the full cost of services. Special revenue funds are used to account for activities paid for by taxes or other designated revenue sources that have specific limitations on use according to law. For example, the state levies gas taxes and distributes some of these

funds to cities and counties. A local government deposits gas tax revenue in a special fund and spends the money for streets and road-related programs, according to law.

- d. Debt Service Funds: These funds accumulate assets, or funds, usually from operating funds for repayment of long-term debt. Debt service for a city government is the money needed to pay back the principal and interest on a city's debt over a specific time period. Example of Debt payments include the Fire Engine Lease Payment of \$238,000.

Budget Projections: Preparing the budget includes projecting revenues and expenses. We make these projections based on the best available information on prior revenues and expenses, and assumptions about economic projections and their consequences. As with any document looking ahead by up to a year, there is inherent uncertainty in our estimates. If needed, the City Council can revisit the budget during the course of the Fiscal Year and make adjustments. The budget committee is committed to conducting a mid year budget review. A mid-year budget review is an essential element in maintaining financial stability and transparency. The mid-year budget review process provides the City Council with an opportunity to review the General Fund, make the needed course corrections to achieve a more accurate budget for the current fiscal year (resulting in greater budget transparency), and can also help shape the development of the next Fiscal Years budget.

The 2024 Recommended Budget represents a deep and collaborative effort to understand financial forecasts, assess community needs, weigh sometimes competing priorities, and make difficult choices. The decisions are challenging because we're blessed with a workforce and highly engaged community who continually generate creative and enticing ideas to make local government and our community even better. While the possibilities for enhancing our services are endless, funding is not.

General Fund Revenues and Expenses: We are projecting General Fund revenues of \$14,354,463, an increase of \$1,017,862 from the adjusted FY 23-24 budget. Jurisdictions sometimes estimate revenues conservatively to reduce the risks of falling short. Our projections are 'middle of the road' meaning that they reflect our best estimates from key sources such as Property Taxes and Sales Taxes. The projections are not optimistic nor pessimistic.

The projections include \$714,344 less in funds transferred from the Water and Sewer funds to pay for administrative costs in Finance, Human Resources, City Administration, etc. This is the result of an analysis completed early in 2024 that showed a change in how we allocate the administrative costs is appropriate. It also reflects \$230,635 less in sales taxes. We are able to make up for that lost revenue largely because of substantial anticipated increases in building permits from development. We are projecting \$1.3 million from this source, an increase of \$1 million. While we are confident in these revenues for the current Fiscal Year and consider them likely again in the following year, they are not an on-going, stable source of revenue that we can count on in the long run.

We also anticipate greater revenue in the Planning Department budget. This assumes that more staff time will be spent on efforts for which we can receive and keep revenue, including using funds from grants to pay for staff time utilized for those grants.

The budget includes \$15,023,649 in General Fund expenses. This is a decrease of \$190,487 from the adjusted FY 23-24 budget. Spending at this level requires reducing services. We recognize that the City has made cuts in prior years, and cuts are proposed for this fiscal year. Cuts for this budget

include reductions in contract services for engineering, maintenance (including shifting a position in Public Works to focus on our water and sewer systems instead of City buildings), infrastructure and parks, funding to non profit partners, and reducing purchases of supplies, equipment and materials important to our work.

While there are reductions, the budget also includes spending to enhance and evolve the City's risk management protocols and solutions, and to promote the sustainability of the City organization, with \$116,525 to replace out-dated technology to ensure that we are positioning the City to protect ourselves from cyber fraud, by continuing to keep software updated and employees trained on cybersecurity controls and practices to protect our infrastructure from external intrusions and cyberattacks.

It also includes an additional \$300,000 to preserve our assets in designated reserve funds we have previously set aside. Following are the assigned reserve funds:

1. Buildings, facilities, and infrastructure reserve fund: \$1,040,235, after adding \$150,000. We will revisit the use of these funds during the Fiscal Year with the intention of funding some of our highest priorities. We have not yet identified particular projects.
2. Equipment, technology, and vehicle replacement reserve fund: \$811,636, after adding \$150,000. We will revisit the use of these funds during the Fiscal Year with the intention of funding some of our highest priorities. We have not yet identified particular projects.
3. Pension and OPEB reserves: \$3,328,269. We anticipate beginning to use these funds in three years, or Fiscal Year 26-27. Approximately 2/3 of these funds are in a trust with the ability to earn higher returns than normal City investments.

Overall, the budget reflects a deficit of \$669,186. While significant, the deficit is less than half of the \$1.7 million budgeted deficit for the prior year, FY 23-24. Closing a substantial gap in one year is challenging. This budget reflects that although we have closed a significant portion of the deficit, we need to do more to make Sebastopol sustainable – particularly since we are relying on what could be one-time, non-recurring revenue.

General Fund Balance and Reserves: The budget will reduce the unassigned General Fund balance to \$2,897,530. This is 19.3% reserve level. The City's policy is to maintain a minimum 15% of annual expenditures in available, or unassigned, General Fund balance, with a goal of 20%. This represents funds available for emergencies (such as natural disasters) or to help address unanticipated short falls in revenues or increases in expenses.

While the 19.3% balance falls within the City's policy levels, without further significant changes in revenues and/or expenses the balance will decline and could go to zero within three years. Prior projections estimated that this could happen by January, 2026; we now project that this could happen around the end of 2026. Our reliance on non-sustainable funding, such as the short-term increase in building fees, allows us to retain an acceptable General Fund balance for now without having to make dramatic cuts.

Retaining Positions: This budget illustrates the City's valuing our staff and our community by retaining all positions. It includes funding to fully staff our Police Department, including Police Officers and Dispatchers. Public safety is the primary responsibility of local government, and this budget reflects that perspective.

The budget also includes funding to fill a vacant Maintenance Worker II position in Public Works. We know that maintaining our infrastructure and the appearance of the City is important. While we are cutting expenses significantly in Public Works, this position will help us meet expectations from our residents for a clean, beautiful and welcoming City that will attract both businesses and tourists to our City,

This budget also includes funding for a pilot program in the Sebastopol Fire Department ahead of the consolidation pending review by the Fire Ad Hoc Committee. Approval of this pilot program would require City Council approval. The funding is proposed to utilize fire volunteers and create shifts for greater coverage. This will help to get the fire truck out the door sooner and reduce the time of service for calls.

Further information on changes is available below in Department-specific summaries, as well as in matrix documents for each Department.

Fiscal Outlook: Recurring expenses have exceeded recurring revenues for the last five years. We have used revenues that are no longer available, such as one time funding from Assemblymember Levine for flooding, Federal funding during COVID, and grants to fund on-going programs and services. We have also used substantial amounts of our General Fund balance. The FY 24-25 budget also relies on revenues that will not be available in the long-run, particularly building fees from a peak in building activity. Relying on revenues that will not continue and drawing on a diminishing fund balance are not sustainable.

In March of this year, the City Council received a presentation from Bob Leland of Baker Tilly on the City's fiscal outlook. Mr. Leland is a nationally recognized expert on local government finance and particularly in developing long-range models of cities' finances. His presentation demonstrated that bringing the City to financial sustainability requires addressing numerous challenges.

Our financial pressure includes challenges with revenues and expenses. On the revenue side, sales taxes represent our largest funding source. Yet despite a growing economy, these revenues have been stagnant in recent years. The change in how we allocate administrative costs among our utility funds and the General Fund noted above creates pressure as well. Mr. Leland noted the need for a large, sustainable new source of revenue.

The most promising source of large sustainable revenues is an addition to our sales tax. An additional ¼ cent would provide about \$760,000 year, and a ½ cent would generate about \$1.5 million year. And people who live outside of town and shop here pay these taxes, too – so the burden is not all on our residents.

On the expense side, we are experiencing increasing costs in health care for employees and in pension costs. The pension reform enacted several years ago is helping to relieve some of this pressure. As is true for our residents, inflation and higher utility costs affect the City as well. Mr. Leland also noted the need to invest substantially more in our assets – by \$900,000 year over time – to keep them from deteriorating. \$300,000 proposed in this budget reflects his recommendation for the first year of these investments.

The budget does not address the need for at least \$1.4 million in annual funding needed to modestly improve the condition of our streets.

The charts below summarize updated information from Mr. Leland that reflects adoption of the proposed budget and other key assumptions.

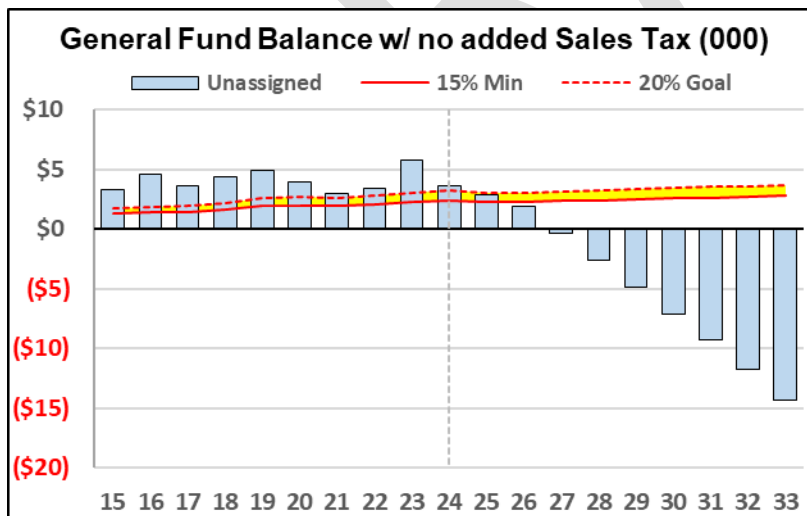
The results (Option A) demonstrate that the City General Fund will be in a deficit – with no unassigned fund balance – around the end of 2026 without new revenue and/or major spending reductions that would seriously threaten core City services.

Option B, a ¼ cent increase in the sales tax approved in November, 2024, would require an additional \$800,000 of reduced expenses beginning in FY 25-26, or one year. Alternately, the City could forego funding toward preserving assets, or a combination of the two.

Option C, a ½ cent increase in the sales tax in November, 2024, would provide sufficient funding to avoid major reductions and to preserve our assets. It would not provide additional funding to improve streets.

Option A: No Sales Tax and Adoption of Proposed Budget Scenario

1. Assumes adoption of proposed budget
2. FY 24-25 General Fund balance would meet minimum level while being below policy goal
3. The General Fund would run out of fund balance in FY 26-27, or within three years. Major reductions would be required, and there would be no funding available for preserving our assets.
4. No significant additional funding toward \$1.4 million needed to improve streets

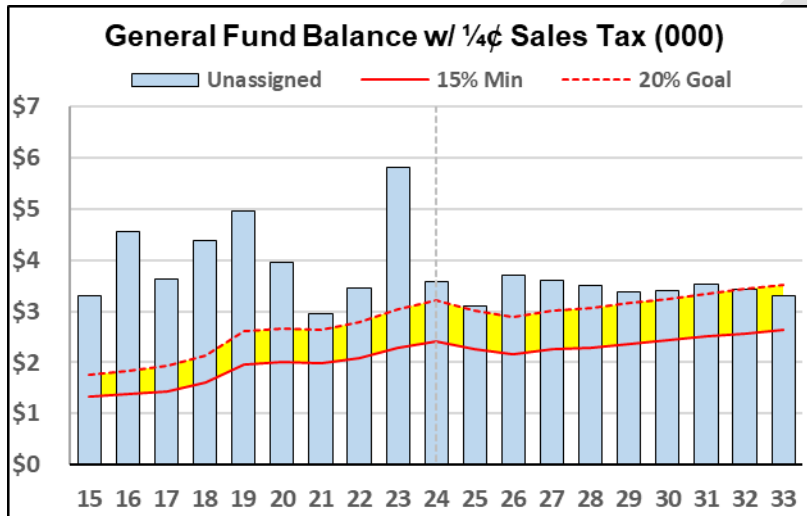


Option B: ¼ cent Sales Tax and Proposed Budget Scenario

1. Assumes adoption of proposed budget

2. Assumes additional \$800,000 of expenses reduced in FY 25-26
3. Assumes ¼ cent sales tax approved in November, 2024 with revenue beginning in Spring, 2025
4. Assumes use of pension trust begins in FY 26-27
5. Assumes \$300,000 toward asset preservation in FY 24-25, growing \$300,000/year to \$900,000 in FY 26-27, with inflation adjustment thereafter
6. No significant additional funding toward \$1.4 million needed to improve streets

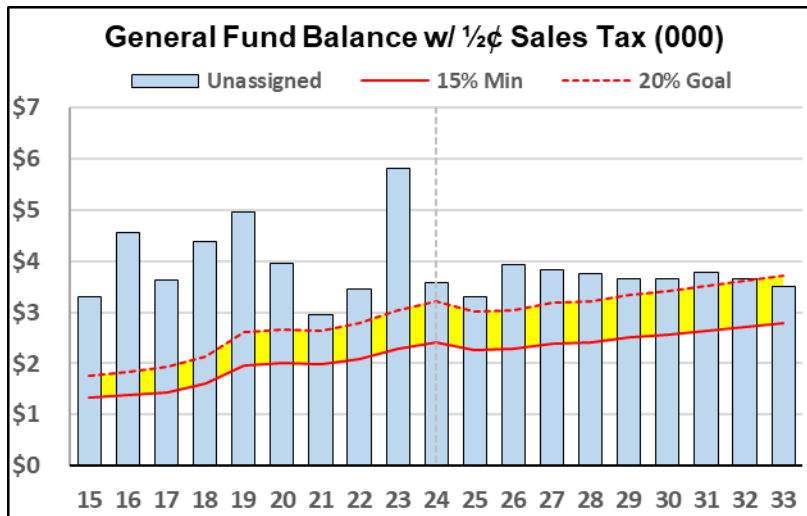
We would meet General Fund balance goals but have to make substantial cuts in expenses, or forego funding toward preserving our assets, or a combination of the two.



Option C: 1/2 cent Sales Tax and Proposed Budget Scenario

1. Assumes adoption of proposed budget
2. Assumes ½ cent sales tax approved in November, 2024 with revenue beginning in Spring, 2025
3. Assumes use of pension trust begins in FY 26-27
4. Assumes \$300,000 toward asset preservation in FY 24-25, growing \$300,000/year to \$900,000 in FY 26-27, with inflation adjustment thereafter
5. No significant additional funding toward \$1.4 million needed to improve streets

We would meet General Fund balance goals without having to make substantial cuts in expenses, while preserving our assets.



The challenges we face are not unique to Sebastopol, although they are more pressing than in many communities. There is a path forward – it is not an easy one, nor a quick fix. It will require reducing costs and increasing our revenues.

We understand that these decisions are about more than City Hall – this is about our community, our residents, our businesses, our non-profit organizations. We need to stabilize our situation – making significant cuts this year is a step in that direction. We need to reform our practices by investing in our assets and being more disciplined – this budget does that. And we need to work with our community to shape the kind of community we want to be.

Sebastopol is fortunate to have many committed, engaged residents, particularly for a small city. We look forward to continuing that engagement as we take on our financial challenges.

A Note on Future Hotels: We are hopeful that two proposed new hotels will come to fruition. Having only one hotel as we do now in a region where tourism is a primary industry suggests that we are missing opportunities. Hotels generate substantial economic activity that supports local businesses, as well as tax revenue from Transient Occupancy Taxes (or TOT), sales taxes, and property taxes. While we are hopeful, we are also reluctant to count on this revenue for either hotel until they are far closer to opening. The hotel market can be volatile, and the revenues too uncertain to count on at this point.

Changes in Department Budgets

The section below summarizes the most significant changes in the budgets for each Department. Not all changes are mentioned below; details are included in the matrix documents included with each Department’s budget.

The Budget Committee has considered the budget in depth. The two members, Vice Mayor Zollman and Councilmember Maurer, agree on most of the recommended changes. Where there are differences of opinion, we have identified them in discussion of the particular items.

Note that for the most part we do not discuss changes to salaries and benefits below as these are largely established by the City's salary schedule and benefit choices by employees. Details are available in more detailed back up materials. We have shifted the presentation of costs for unfunded pension liabilities in those materials by assigning them as Department expenses not tied directly to individual salaries or benefits as in the past. This revised approach this better reflects the City's actual liabilities.

City Council

- \$2,500 reduction in contract with PCA for video services for Council meetings
- \$4,000 reduction for legal hearing notices
- \$3,500 reduction in cost for Shuttle Fare program
- \$36,800 shift of the Homeless Outreach contract to the Police Department, which has lead responsibility for this role
- \$10,000 shift of contract costs for public communications to City Manager
- \$7,186 Increase in benefits which may occur with new Councilmembers
- \$10,000 increase for contract support for basic goal-setting session
- \$4,000 increase to fund membership in the Government Alliance for Racial Equity and organizations such as the NAACP, Latino Service Providers, and those representing differently abled members of our community.

City Manager

Additions include:

- \$52,000 for continued financial analysis work with Bob Leland of Baker Tilly, possible management review of Administrative Services to improve financial reporting, estimating expenses for capital projects, and other needs. Note that the Equipment, Technology, and Vehicle Reserve fund allocates \$23,000 for an analysis of financing needs for City fleet and identification of opportunities for operational improvements.
- \$10,000 for facilitator for performance evaluation
- \$6,000 for payment for prior work for Relaunch program, pending demonstration of compliance with contract requirements
- \$10,000 shift of contract costs for public communications from City Council to City Manager

City Attorney

- No significant changes

Assistant City Manager/City Clerk

- \$10,000 in reduced ballot measure expenses to reflect current plans
- No other significant changes

Administrative Services

- \$114,600 in reduced one time or occasional expenses for new server, cost allocation study, creation of Section 115 trust, and ballot measure expenses

- \$10,000 increase to reflect more accurately costs for software maintenance
- \$25,000 Shift of expenses for property tax services from non departmental budget
- \$3,000 increase for one person in City to attend Marin-Sonoma Leadership Academy or other training; note that Councilmember Maurer in the Budget Committee discussion expressed reservations about this item unless a particular person is identified. Vice Mayor Zollman supports including the funding in the budget.

Planning

- \$91,800 in reimbursement of staff time for revenue-generating work on development projects (\$21,000) and grants (\$70,800)
- \$50,000 for monitoring of ownership housing units, from the Housing Linkage Fee fund
- \$22,000 for monitoring of rental housing units from the Inclusionary Housing Fund

Councilmember Maurer noted a preference for having City staff do the monitoring for ownership housing if feasible; staff does not believe that is a viable option given the expertise and level of effort required. She supported using the \$22,000 for monitoring rental housing. Vice Mayor Zollman supported including funding for both efforts.

Note that this funding would come from the balances in these Funds, which will be insufficient to continue funding for future years.

Building

The revenues from increased building permit fees, which are reflected in General Fund revenue discussed earlier, is the most significant change. This reflects both an increase in the level of fees to more closely reflect costs, with a projected \$100,000 increase in revenue from normal building activity. \$800,000 increase from anticipated building of about half of the Canopy project. If other projects begin construction the revenues will increase further.

A normal year over the past ten years has averaged less than one new home per year and we are anticipating around 40+ this year and the same number next year before we drop back down to a normal year. There will be an associated increase (\$50,000) in expenses to cover the cost of the inspections needed for this project.

The building official contract has also increased \$50,000 to address the additional building related expenses such as review of plans, permits, inspections for these large development projects.

Engineering

The Engineering Department provides technical expertise to support the City's infrastructure such as streets, the water and sewer systems, and the storm water system. The biggest change in the budget is the proposed reorganization of the Public Works and Engineering Departments. The two departments will be combined when the Public Works Superintendent retires at the end of 2024 and will be called the Public Works Department. Upon retirement, the Public Works Superintendent position will be eliminated and replaced with a new Public Works Director/City Engineer. Between the two departments, the reorganization is estimated to save \$162,800 compared with the previous

fiscal year. This is shown in the table summarizing the changes from the reorganization at the end of the Engineering Department materials.

These changes include reducing GHD on-call engineering consultant costs by \$145,000, mostly in the second half of the year when the new Public Works Director/City Engineer is hired. We will rely on the Police Chief to take the lead as the Traffic Engineer as provided for in the City's Municipal Code. The reductions in consultant costs will result in slower response time to the public and other City departments, more reliance on the Public Works department head for questions pertaining to infrastructure within public right of way, attendance at fewer meetings, reliance on current staff for questions pertaining to engineering records, and not providing engineering consultation to the public for private property matters. Professional contract services line item is estimated to save approximately \$154,000 from previous year. (Note that this savings includes consultant services savings due to the reorganization described above.)

The Budget Committee added \$5,000 for Engineering assistance with the procurement of a new solid waste hauler if the assistance would be useful.

Fire

- \$156,223 reduction in salary by not filling the Fire Chief position
- \$136,799 in contract expenses for Fire Chief contract with Gold Ridge
- \$95,000 increase to fund contracts for costs related to fire consolidation with Gold Ridge
- \$40,000 increase in firefighter expenses to expand coverage. The budget would also shift \$40,000 previously used for retention of firefighters to expand coverage. The goal is to fund two fire personnel at the fire station twenty-four hours a day, seven days a week to improve response times and increase safety for firefighters.
- \$20,000 increase in Equipment to replace essential radios.

The budget includes \$11,000 to continue the Map Your Neighborhood (MYN) program. The Budget Committee expressed concerns with this program including the need for clear goals, more reporting on results, and expanded outreach to neighborhoods.

The budget includes \$100,000 for uses to be determined. Vice Mayor Zollman supported exploring opportunities to prevent residents from falls and associated injuries as well as collecting data on types/numbers of calls, building relationships with health care providers, and establishing a CERT (Community Emergency Response Teams) program. Councilmember Maurer did not support this use of the funds.

The Fire Department is in a period of transition with the Council's decision to pursue consolidation with Gold Ridge, with the Fire Ad Hoc Committee leading the City's efforts. Additionally, passage of the Measure H fire sales tax earlier in 2024 will generate about \$600,000 in revenue. The Measure H budget allocates about half of these funds toward the lease payment on a new fire engine (\$238,000), and toward an assessment of needs and options for an improved fire station (\$60,000). The budget does not reflect plans for spending the remaining \$300,000. We anticipate revisiting the budget as part of discussions on consolidation.

Measure H also requires that the City commit 10% to 11% of our General Fund budget to fire services as a Maintenance of Effort – a requirement to ensure that Measure H funds add to rather than replace existing funding.

Police

- \$122,830 reduction in expenses for improvements in Police Department building and equipment funded by the Police Endowment.
- \$20,000 increase to fund assessment and initial improvements of City's Emergency Operation Center (EOC) and emergency response ability
- \$4,465 increase with shift of remaining FY 23-24 warming center funds to Police Department from Fire Department
- \$11,500 increase with shift of a reduced contract for traffic and engineering to Police Department from Engineering (while reducing overall contract from \$23,000)
- \$8,000 increase (to \$16,000) to increase capacity for towing Recreational Vehicles

The City Council changes noted above include a shift of the Homeless Services Outreach contract (\$36,800) to the Police Department budget. Vice Mayor Zollman expressed disagreement with shifting funding to the Police Department budget to manage the contract with West County Community Services (WCCS) for homeless outreach; Councilmember Maurer supports this shift. The City Manager assigned responsibility for this contract to the Police Department in the Spring of 2024 because the Police Department has the greatest interaction with WCCS and those experiencing homelessness. This shift is included in the budget.

The Budget Committee discussed funding for two vacant positions in the Police Department, an Officer (\$121,000) and a Dispatcher (\$106,000). The budget includes funding for both positions, which Councilmember Maurer supported.

Vice Mayor Zollman opposed this use of the funds, preferring instead to fund the Specialized Assistance for Everyone (SAFE) program operated by Petaluma People Services Center in Petaluma, Cotati, Rohnert Park, Sonoma State University, and San Rafael. This is a program in which mental health and medical professionals provide responses to calls that would otherwise often be handled by a Police Department. He noted it as an example of prevention, a theme he emphasized during Budget Committee meetings. At the end of this letter is a memorandum from the Police Chief on this program.

Public Works

- \$218,213 reduction in salary due to numerous changes including retirement of Public Works Superintendent and consolidation of Public Works and Engineering Departments; the Engineering budget best explains the financial implications of the consolidation. The budget also reflects reallocating a Laborer to focus on water and sewer systems, which are funded by water and wastewater rates (see discussion below on Water and Wastewater funds). The position will no longer be funded by the General Fund, where the Laborer would support maintenance of City facilities.

- Also includes \$66,000 in reimbursement from grants and City's Building reserve fund for projects.
- \$64,000 reductions in maintenance-related contracts
- \$56,000 reduction in maintenance services and supplies
- \$52,000 increase in contract services with shift of West County Community Services Contract for Park Village to Public Works to better align responsibilities for contract with a Department.
- \$20,000 addition for Libby Park fencing materials at request of Budget Committee
- \$20,000 addition for replacing landscaping at the Police Department
- \$15,000 addition for more reflective sign poles at request of Budget Committee

Public Works will explore the addition of more bike racks in the downtown area with funding from their budget.

Senior Center

- \$38,250 reduction with elimination of financial support for operations

Additionally, reallocating the time of a Public Works Laborer position as noted above to focus on the water and sewer systems, and reduced funding for maintenance contracts, may reduce support for the facility.

Community Cultural Center

- \$76,600 reduction in support for general operation as the Center attempts to fully cover these costs without City assistance by January, 2025. The remaining \$58,300 is intended to provide six months of support during this transition.

Vice-Mayor Zollman opposed including the \$58,300 in funding, noting the need for all non-profits to reduce their reliance on City funding as a matter of equal consideration. Councilmember Maurer supported including the funding.

\$50,000 reduction in architectural design services; however, the Council approved at their July 2, 2024 Council Meeting, the Community Cultural Center Master Plan Project in the amount of \$85,000.00, from Fund 127, Flood Mitigation and approves \$70,000.00 for the SCCC Fire-Related Building Improvements, subject to a General Plan Consistency Finding by the Planning Commission, from Fund 127, Flood Mitigation.

Additionally, reallocating the time of a Public Works Laborer position as noted above to focus on the water and sewer systems, and reduced funding for maintenance contracts, may reduce support for the facility.

Ives Pool

- No significant change.

Reallocating the time of a Public Works Laborer position as noted above to focus on the water and sewer systems, and reduced funding for maintenance contracts, may reduce support for the facility.

Non Departmental

- \$154,000 shift of costs for contracts to Departments to better reflect how costs relate to Department responsibilities, and to increase accountability for managing contracts
- \$116,525 increase to address pressing needs for computer and server replacement and to increase cyber security

Changes in presentation and accounting

We have made some changes to the presentation of budget information this year to promote transparency. As noted in Footnote 11 in the table on General Fund Revenue Details, we have previously treated the payments to the General Fund from the Water and Sewer Funds as reimbursements which created the appearance of reducing General Fund expenses. This meant that the General Fund revenues and expenses were under-stated. We now record the reimbursements as revenues for the General Fund, providing a more accurate representation of revenues and expenses.

Additionally, in prior years we have counted some of the funds from voter-approved sales taxes as General Fund revenues. At the same time, we have accounted for other funds from these taxes not as revenue, but by reducing expenses in the Police and Public Works budgets, although this did not actually reduce expenses. This resulted in under-stating our actual General Fund revenues, and our actual expenses. We are now counting all of the revenues from these expenses as General Fund revenues.

Thus, readers may notice that the numbers in this budget book for prior years differ from the number in prior budget documents. While this may create some confusion, we believe that in the long-run this new method is a better way of accurately reflecting true revenues and expenses.

Water and Wastewater Funds

As discussed extensively in recent months, the City's water and wastewater systems are in poor shape. We have had minor failures, and want to avoid major problems which could leave residents without water or sewer service for days.

The Water and Wastewater Operating Funds rely mostly on rates paid by residents and businesses. Revenue from rates has been insufficient to cover operating costs, necessary significant capital investments, and sufficient levels of reserves. Over the next three years, we will need additional revenue of over \$9 million, with an approximate breakdown as:

- \$7.7M to cover operating deficits
- \$0.7M to fund essential capital projects
- \$0.8M to build reserves to a sufficient level, including high enough reserves to obtain debt to replace Well 4, which is showing signs of failure and is our highest-producing well,

The Water Operating Fund had a minimal balance at the end of FY 23-24, while the Wastewater Operating Fund required a General Fund loan of \$1.1 million to cover its deficit.

In response, in June the City Council approved substantial rate increases. These will add about \$2.5 million in revenue between the two funds in the first year, and more in later years.

Additionally, earlier this year we completed a Cost Allocation Plan to update how we allocate City overhead costs. This analysis showed that we should reduce the General Fund charges to these funds by about \$714,000/year (\$510,233 for the Water Operating Fund, and \$204,112 for the Wastewater Fund). These budgets reflect those changes. The reduction in revenue to the General Fund is noted earlier in the discussion on General Fund revenues.

While painful, the rate increases reflect action we need to take to put our systems and finances in good shape. They are an example of forging a new path and becoming more fiscally responsible. It took years of low rates and deferred maintenance to create the challenges our systems face, and it will take time to make up for both maintenance and financial challenges.

We are taking steps to avoid future steep rate increases. These include:

- a. Better tracking revenues and expenses so we can adjust in a timely manner if needed
- b. Creating 'master plans' to help us make the most cost-effective investments in our systems
- c. Assigning one of our Public Works staff to provide more frequent maintenance of our systems, which should lower our costs and the need for higher rates
- d. Committing to complete Cost Allocation Plans more frequently – at least every three years – to ensure that the Water and Wastewater Operating Funds are paying for their fair share of City overhead expenses, and no more.

With these actions we can improve the reliability of the water and wastewater systems, improve their financial conditions, and increase public confidence in our financial management practices.

A Final Note

As City Manager, I will continue to evaluate this budget as our financial situation evolves and affects our responsibilities to our staff and our community. Though much is beyond the City's influence, we will maintain a firm grasp on what falls within our control with a commitment to prudent, conscientious financial management. We will provide transparent and regular reporting to the Council and public.

Through robust community outreach, we will together ensure that diverse perspectives are heard and respected. Although we have made progress in managing our resources and services, we still have much to do.

I would like to thank the City Council for your leadership and our Executive Team and the entire staff of the City for providing outstanding services to our community. While we have challenges before us, your leadership and strong commitment to this wonderful community will create a path forward to a bright future.

I would like to express my appreciation for the hard work of the Budget Committee – Vice Mayor Zollman and Councilmember Maurer. They have spent extensive time reviewing the budget, and making improvements. Serving on the Committee requires a serious commitment of time and energy, and the budget is better for their deep engagement.

In addition, a budget requires countless hours of teamwork, collaboration, and patience to produce. The Department Directors' dedication, expertise, and willingness to continue to adapt to evolving circumstances in preparing this year's budget is a testament to their commitment to this organization and to the community. I recognize that this year's budget was challenging to develop and greatly appreciate this team's professionalism and commitment.

I would also like to thank Mary Gourley, the Assistant City Manager and City Clerk, for her steadfast assistance. Ana Kwong, our Department Head for Administrative Services, has provided extensive support and many long hours to complete this effort. My thanks extend to her as well, and to Miko Lim of her team for his behind-the-scenes hard work.

Most of all, thank you to the residents and businesses of Sebastopol. While not all will agree with every aspect of this budget, it is an honor to serve this community of thoughtful, engaged, and often passionate residents. I'm both excited and optimistic for the future as we continue on this journey together.

Don Schwartz
City Manager