

General Fund Outlook

Economic Landscape Relating to the City's Finances

There is uncertainty in almost every part of the economy. We are just beginning to see the impact of tariffs, the stock market is in a steady decline, interest rates are on the rise and consumers are concerned about inflation and the possibility of a recession.

In 2021 and 2022, spending flourished as the nation rebounded from the restrictions of the COVID-19 pandemic. In 2023 and 2024, economic growth slowed and for the City of Santa Cruz, this is reflected in the modest increases to sales tax revenue that we have seen in FY 2024 and FY 2025. In March of 2024, voters in the city approved Measure L, a half cent city sales tax, which is expected to generate up to \$8 million in sales tax revenue in FY 2025.

Property taxes in the City of Santa Cruz have had steady growth, with a five-year average of 4.6%. Concerns about the impact of rising construction prices due to tariffs and moderate levels of inflation are causing a reduction in the number of properties for sale in the City.

For the past two fiscal years, the City has had to defer its General Fund contribution to the Capital Investment Program (CIP) to present a balanced budget. However, given the urgency of infrastructure needs and the expectation that addressing them now will be more cost-effective than further delaying them, the City is investing \$3M into CIP projects in FY 2026. The City's ongoing revenues are sufficient to cover day-to-day operational expenses, but they are not enough to support additional funding for one-time CIP projects. For this reason, this \$3M transfer will be offset by one-time uses of prior year surpluses to maintain a balanced budget.

Californians continue to seek experiences in Santa Cruz, choosing our City's natural beauty and wide range of local businesses as a vacationing and shopping destination. The City's Lodging Occupancy Tax (TOT) is expected to increase in FY 2026 and beyond due to the construction and opening of new hotels. We have yet to see how strained relations with other countries may impact international tourism.

City's Financial Backdrop

In FY 2023, the City Council adopted a five-year strategic plan to create and maintain a vibrant, healthy, and resilient community for all. One of the focus areas is Fiscal Sustainability and Transparency with strategies identified that will ensure that the city is on a strong financial trajectory. The Measure L sales tax increase has been critical in maintaining fiscal sustainability. In FY 2021 – FY 2024, the City was able to initiate several new programs using one-time federal and state funding related to the COVID-19 pandemic. The on-going sales tax revenue generated by Measure L has allowed us to keep those programs going. In addition, we continue

FY 2026 Budget pursuing additional revenue streams, cost recovery, and changes to service delivery to stay fiscally strong and stable.

The City was in the process of repairing damage to the Santa Cruz Wharf from the December 2022 and March 2023 severe winter storms when, in December 2024, a large ocean swell event occurred and caused the partial collapse of the end of the Wharf. The City is pursuing reimbursements from FEMA, CalOES and FHWA for repairs to the Wharf and to West Cliff Drive sustained during storms in 2022, 2023 and 2024.

FY 2026 Outlook

The General Fund budget for FY 2026 is operationally balanced, but one-time transfers will be covered by past surpluses built up in the unrestricted reserves.

Revenue Assumptions

The Finance Department and the Economic Development and Housing Department utilize the services of HdL Companies to receive reliable, expert analysis on property and sales tax trends and projections. These projections along with the Santa Cruz County Auditor-Controller's Office Property Tax Estimates and historical trends are the foundation for the General Fund tax revenue budgets.

The following approaches were taken to budget revenues, compared with the FY 2025 budget (except where indicated):

- 4% increase in property tax revenues
- 1.6% increase in sales tax above a 4.2% decline in FY 2025
- 3% increase in franchise taxes and 2% increase in utility taxes
- 7% increase in Lodging Occupancy Taxes (TOT) due to the hotel, La Bahia, coming online in Fall 2025
- 13% increase in charges for services
- \$1M decrease in Cannabis business tax
- 5% increase in fines and forfeits and on parking meter collections
- 2% increase in rent revenues
- \$1M in additional funds from the Measure Z, a \$0.02 cent tax for every one fluid ounce of sugar sweetened beverages on distributors

Expenditure Assumptions

In FY 2026, the following were incorporated into the General Fund expenditure budget:

- 4% increase in personnel costs, which includes an increase in CalPERS unfunded liability costs and an anticipated 9% increase in City-covered medical insurance costs for employees

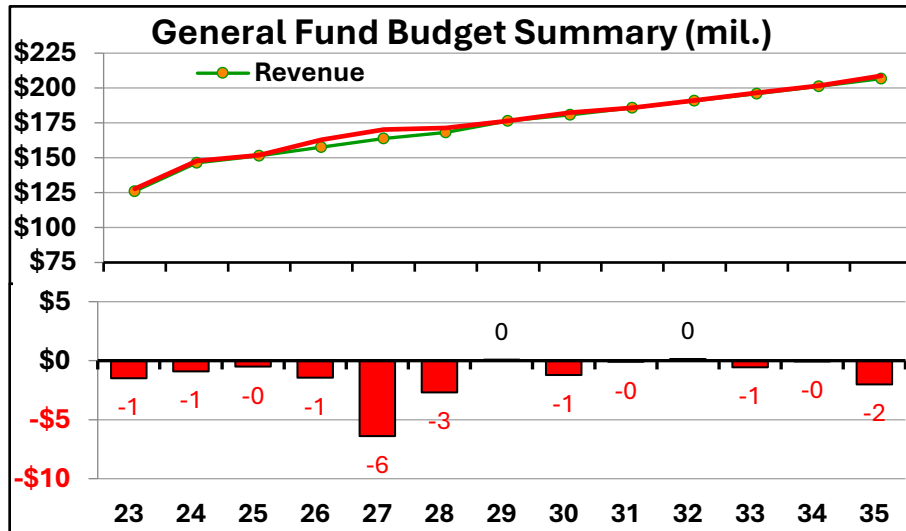
- A 56% decrease in debt service costs due to the conclusion of payments on City-owned debt
- A set aside of \$250,000 for Police Department vehicles and \$200,000 for Fire Department large apparatus/vehicle to stabilize the costs of those departments' large, one-time investments
- A \$1,000,000 transfer to the CIP- Streets Fund, \$1,000,000 to the Economic Development Trust Fund, and \$3,000,000 to the General Capital Investment Program Fund
- A 2% increase in departments' budgets for temporary personnel costs
- 2.5% in discretionary budgets for departments' services, supplies, and materials

Long-Range Financial Planning

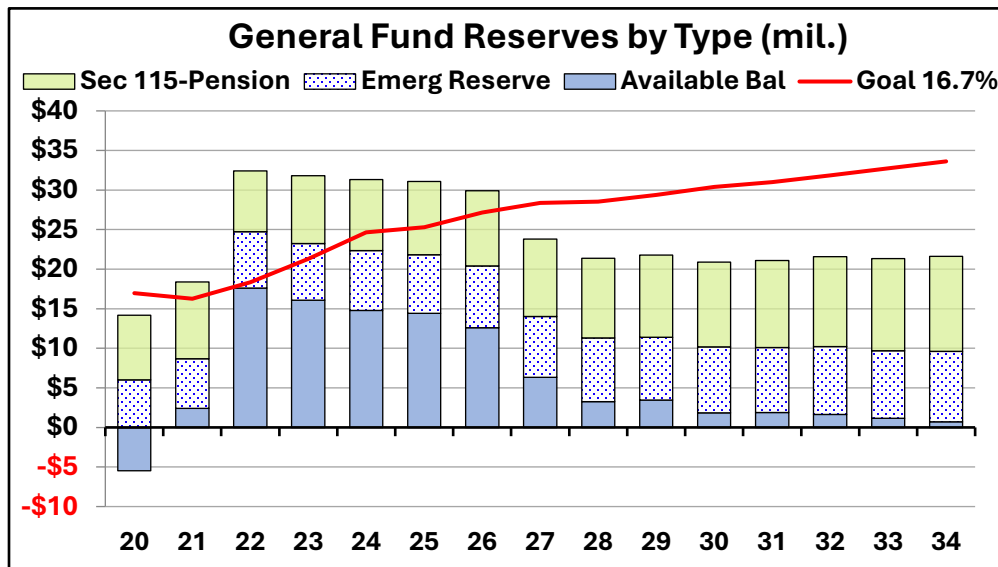
The City of Santa Cruz continues to take proactive steps to address its long-term financial challenges and achieve fiscal sustainability through careful planning, structural reforms, and new revenue strategies.

In November 2023, the City presented its Citywide Long Range Financial Plan (CWLRFP) developed in partnership with Baker Tilly. The CWLRFP offers short- and long-term strategies to improve the City's financial resilience, including: full cost recovery for services, implementation of new technologies, and diversification of the investment portfolio. A number of these strategies have been implemented or are currently underway, as evidenced by the City Council's recent adoption of an updated City Investment Policy, the passage of Measure L and Measure Z discussed above, updates to the Citywide Fee Schedule, and the current Citywide effort to implement a new Enterprise Resource Program (ERP) solution. These revenue tools are aimed at closing future budget gaps, restoring capital investment capacity, and aligning ongoing revenues with service demands.

The City projects that its spending in FY 2027 and FY 2028 may outpace revenues, but projects that beginning in FY 2029 revenues will outpace expenditures as new revenue strategies are implemented and with the infusion of TOT revenues from an expanded hotel base.



The difficult years in our short-term future will draw down on available General Fund reserves. Continued methods to increase revenues and to find efficiencies that will reduce expenditures are being sought to improve this outlook and bring the General Fund closer to its goal of having two months, or 16.7%, of operating expenditures in available reserve balances,



The City of Santa Cruz is confronting its long-term financial challenges with strategic foresight, voter-supported revenue measures, and structural reforms. While rising costs and limited taxing authority pose ongoing risks, the City's commitment to multi-year planning, fiscal discipline, and community investment positions us to navigate future financial uncertainty with resilience.