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| **DATE:** | March 14, 2024 |
| **TO:** | Programs & Administration Committee<br>Planning Committee/Recycling Board |
| **FROM:** | Pat Cabrera, Administrative Services Director |
| **SUBJECT:** | Multi-Year Fiscal Forecast |

## SUMMARY

In fiscal year 2022, the Agency engaged the consulting services of Crowe LLP to perform fiscal forecasts and an analysis of the Agency's fund balance and reserves. This analysis was to help determine an adequate or minimum funding level for those resources. The analysis focused on the Agency's fee-based revenue structure and projected expenditures. Landfill tonnage-based fees are the primary source of revenue for the Agency's discretionary budget (similar to a general fund). Crowe also developed a forecasting model, including seven scenarios, that staff uses to update the projections each year to help determine funding trends and associated fiscal measures to support the Agency's operations and mission. At the March 14 Programs & Administration and Recycling Board meetings, staff will present an overview of the latest analysis and annual fiscal forecast.

## DISCUSSION

Key to the Agency's mission is to accelerate progress toward a circular economy, including advancing upstream waste prevention as well as material reuse, repair, and recycling. Consistent with our mission and other broader economic factors, solid waste disposal and the associated revenue will decline over time. Under the current revenue structure, maintaining consistent expenditures will at some point be fiscally unsustainable. As revenues decrease, or even if revenues remain flat, consistent or increased expenditures would over time lead to a structural deficit. As such, some threshold of fund balance is needed to fill in budgetary gaps while critical financial and programmatic decisions are made and implemented, such as reductions in certain expenditures and/or consideration of an increase, restructuring, or diversification of fees and other sources of revenue. Given the unique manner in which the Agency is funded, determining the appropriate fund balance threshold required a comprehensive analysis (Attachment 1) designed to provide fiscal guidance based on differing scenarios, as discussed below.

## FORECAST SCENARIOS

The main purpose of the initial Crowe analysis and development of the fiscal forecasting model was to help determine an adequate or minimum fund balance with reserves that the Agency should maintain that both supports advancement of the Agency's mission today, while also providing the means to plan for the future. To achieve this purpose, the consultants assisted with developing forecasting scenarios as described in the "Forecast Scenario Descriptions" table below (see page 9 of Attachment 1 for a more detailed description of each scenario). The Agency intended for these scenarios to cover a range of potential circumstances that could occur in the future and the potential impact of these scenarios on the Agency's reserves and fund balance. We are now and will continue to use these models as part of the annual multi-year forecast.

For purposes of the analysis, Scenario A represents the best case from a revenue perspective, descending to Scenario G which is the worst case, again from a revenue perspective. The basis for Scenarios A, B, C, and F is historical, meaning that a review of historical trends such as disposal changes over a specific time frame and/or impacts from the 2007-2009 recession were factored into the forecast. The basis for Scenarios D, E, and G is "goal-based," meaning that the trends reflect longer-term declines in tonnage based on policy goals, as articulated in the Recycling Plan adopted by the Agency's Recycling Board. The Agency's financial status has been closely tracking with Scenario C, and to refine our forecast for the coming fiscal year 2025 and beyond, staff added scenario C1 which maintains hard costs at FY 2024 levels for a total discretionary budget under $13 million.

**Forecast Scenario Descriptions**

| Scenario | Brief Description | Tonnage Change | Basis |
|---|---|---|---|
| **A. Status Quo with Growth** | Slight growth based on most recent five years | Increase | Historical |
| **B. Status Quo** | Tonnage stays flat | No Change | Historical |
| **C. Economic Cycle** | Declines based on most recent 15 years | Decrease | Historical |
| **CI. Economic Cycle – Static hard cost** | Declines based on most recent 15 years. No Hard Cost Expenditure Increase FY 2025 | Decrease | Historical |
| **D. Organics** | Achieve 75% reduction in landfilled organics by Jan 1, 2025 (FY 2025) using a FY 2021 baseline (SB 1383[1]), then tonnage stays flat | Decrease | Goal-based |
| **E. Organics and Recyclables** | Achieve 75% reduction in landfilled organics by Jan 1, 2025 (FY 2025) using a FY 2021 baseline (SB 1383), then 75% reduction in recyclables by FY 29/30 | Decrease | Goal-based |
| **F. Recession** | Tonnage declines similar to 2008 Recession to its recovery | Decrease | Historical |
| **G. Recycling Plan** | Achieve Recycling Plan goal of 100% diversion by 2045 | Decrease | Goal-based |

[1] Senate Bill 1383 Short-lived climate pollutants. Section 39730.6. Requires local government to reach a 75% reduction in organics landfilled by January 1, 2025. StopWaste is using a FY 21/22 baseline for the purposes of the projection.

## MINIMUM FUND BALANCES AND RESERVES

A component of this analysis was to help determine what the Agency should maintain as the minimum level of funding required per each forecasting scenario in order to continue to efficiently operate while decisions are made to address funding imbalances if needed. This calculation is described in detail on page 12 of the report. Included in the report is the assumption that three years of lead time is needed to undergo a process that addresses funding declines, whether that be through changes to the revenue structure or programmatic changes (i.e., reductions), which take time to implement effectively.

The analysis concluded that the minimum funding level is an amount equivalent to 1 to 1.4 times an average discretionary budget (depending on the scenario). The Agency currently meets that minimum with an additional 9-month surplus (above the minimum contingency funding levels). Therefore, the Agency would have sufficient surplus fund balance and reserves based on any of the seven scenarios to operate under an annual deficit for at least the next three years. The one exception is scenario G which is highly unlikely to occur within this time frame.

## KEY FINDINGS FROM THE SCENARIO ANALYSIS

The Crowe analysis provides a useful tool to the Agency to help identify a level of fund balance and reserves needed to efficiently operate while making critical decisions regarding its revenue structure or level of expenditures. Staff updated the projection models for the most recent fiscal forecast to include actual figures for last fiscal year (FY 2023) and budgeted figures for the current fiscal year. Based on actual figures and revenues to date, the Agency's fiscal trend closely matches Scenario C.

Here are the key findings from the Agency's latest fiscal forecast analysis:

- Under all eight scenarios, the Agency has accumulated fund balances and reserves, currently totaling approximately $24.5m, which provide a sufficient planning horizon to implement changes which address the structural imbalance between revenues and expenditures.
- Based on the current fund balance, the Agency does not require any fee adjustment at this time. However, reliance on tonnage-based fees under the current rates (as the Agency's primary source of discretionary revenue), will not be adequate to fund operations (assuming a similar expenditure plan), in the longer term.
- The longer-term forecast (through FY 2030-2032) shows a decline in all fund balances and reserves even in the best-case scenario, with some scenarios showing the Agency exhausting all fund balances and reserves by FY 2029-2032. That is because even in the scenario which shows revenue growth, it will not outpace expected inflationary impacts.
- The Agency's unique circumstances related to revenue generation and the complexity of adjusting the fees that generate Agency revenue expose the Agency to financial risk in the longer-term, which points to the benefits of maintaining higher fund balance than other area waste management authorities that have different, more nimble fee structures.
- The Agency will use the forecasting tools to inform its budgetary and policy decision-making going forward. With active monitoring of the Agency's fund balance, the Agency can proactively assess and manage potential surpluses or deficits.
- The Agency has already begun the process of analyzing options for diversifying and stabilizing revenues for the long-term.

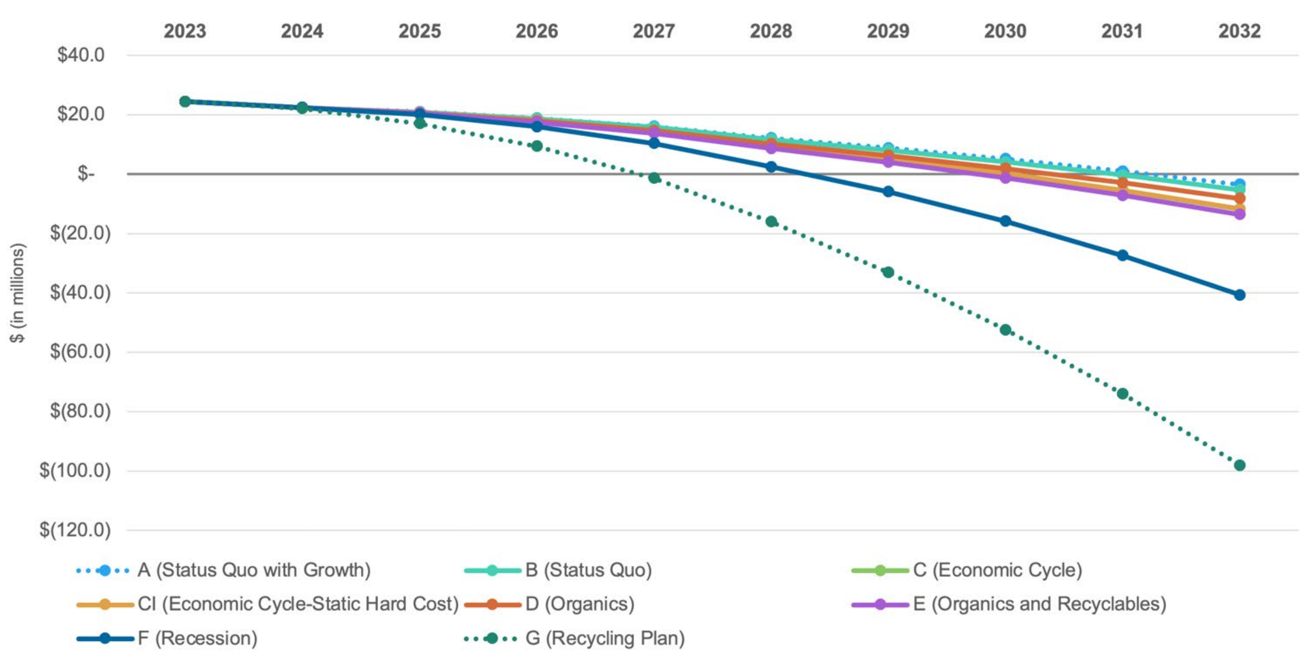
## LONGER TERM FORECASTS

While financial forecasting is a valuable tool, the forecasts are estimates that become less accurate the further out data are projected. However, extending the scenarios through FY 2032 still provides insight as shown below. Note these charts have been updated so are slightly different from the Crowe report. The table and chart below reflect estimated fund balance trends without interventions such as expenditure reductions or diversification of revenues.

**Projected Ending Fund Balance with Reserves (in millions) – Years 3, 6, and 9**

| Scenario | Base Year 2023 | Year 3 2026 | Year 6 2029 | Year 9 2032 |
|---|---|---|---|---|
| **A. Status Quo with Growth** | $ 24.5 | $ 18.8 | $ 8.8 | $ (3.5) |
| **B. Status Quo** | $ 24.5 | $ 18.7 | $ 8.1 | $ (5.3) |
| **C. Economic Cycle** | $ 24.5 | $ 18.0 | $ 5.3 | $ (11.8) |
| **CI. Economic Cycle-Static Hard Cost** | $ 24.5 | $ 18.1 | $ 5.4 | $ (11.7) |
| **D. Organics** | $ 24.5 | $ 17.9 | $ 6.3 | $ (8.2) |
| **E. Organics and Recyclables** | $ 24.5 | $ 17.5 | $ 4.0 | $ (13.6) |
| **F. Recession** | $ 24.5 | $ 16.0 | $ (5.9) | $ (40.7) |
| **G. Recycling Plan** | $ 24.5 | $ 9.4 | $ (33.1) | $ (98.1) |

**Projected Fund Balance with Reserves (FY 2023 through FY 2032)**



As previously mentioned, the longer-term forecast (through FY 2032) shows a decline in all fund balances and reserves even in the best-case scenario, with scenarios C-G showing the Agency exhausting all fund balances and reserves. That is because simple inflationary increases will outpace revenues in the best-case scenario, and more likely we will experience declines in tonnage-based revenues over time. While the Agency will take steps to minimize the risk of these longer-term forecasts, they do highlight the need for the Agency to continue to regularly update the forecasting models to help identify trends and to address this fiscal imbalance.

**BUDGET IMPACTS FOR FY 2025**

While the longer-term forecasts indicate that the Agency will need to restructure and diversify its revenue streams, the short-term forecasts show that even in the worst-case scenario the Agency is in a stable financial position. This is helpful in preparing for the upcoming budget in that the Agency has the flexibility to make additional investment in our programs that further our mission. As the chart below shows, the Agency can utilize its funding contingency to fill in the budgetary gaps between revenue and expenditures and still maintain an adequate surplus even in the worst-case scenario (Scenario G, which is highly unlikely) through FY 2027, and through FY 2029 in the more likely scenario (Scenario C). Note, this does not mean that the Agency will have exhausted the fund balances and reserves by these dates, only that the accumulated fund balance and reserves would no longer meet the minimum three-year funding contingency for that particular scenario.

**Fund Balance with Reserves (in millions)**

| Scenario | 2023 | 2024 | 2025 | 2026 | 2027 | 2028 | 2029 | 2030 | 2031 | 2032 |
|---|---|---|---|---|---|---|---|---|---|---|
| **A. Status Quo with Growth** | $ 24.5 | $ 22.4 | $ 21.0 | $ 18.8 | $ 16.1 | $ 12.2 | $ 8.8 | $ 5.1 | $ 1.0 | $ (3.5) |
| **B. Status Quo** | $ 24.5 | $ 22.4 | $ 21.0 | $ 18.7 | $ 15.8 | $ 11.7 | $ 8.1 | $ 4.1 | $ (0.3) | $ (5.3) |
| **C. Economic Cycle** | $ 24.5 | $ 22.4 | $ 20.7 | $ 18.0 | $ 14.6 | $ 9.8 | $ 5.3 | $ 0.2 | $ (5.5) | $(11.8) |
| **CI. Economic Cycle-Static Hard Cost** | $ 24.5 | $ 22.4 | $ 20.8 | $ 18.1 | $ 14.7 | $ 9.8 | $ 5.4 | $ 0.3 | $ (5.4) | $(11.7) |
| **D. Organics** | $ 24.5 | $ 22.4 | $ 20.6 | $ 17.9 | $ 14.7 | $ 10.2 | $ 6.3 | $ 1.9 | $ (2.9) | $ (8.2) |
| **E. Organics and Recyclables** | $ 24.5 | $ 22.4 | $ 20.6 | $ 17.5 | $ 13.8 | $ 8.7 | $ 4.0 | $ (1.3) | $ (7.2) | $(13.6) |
| **F. Recession** | $ 24.5 | $ 22.4 | $ 20.1 | $ 16.0 | $ 10.4 | $ 2.5 | $ (5.9) | $(15.9) | $ (27.4) | $(40.7) |
| **G. Recycling Plan** | $ 24.5 | $ 22.1 | $ 17.1 | $ 9.4 | $ (1.4) | $ (16.1) | $ (33.1) | $(52.4) | $ (74.1) | $(98.1) |

Staff is in the process of preparing the FY 2025 budget, which will be presented at the joint session of the Boards and the Energy Council on April 24, 2024. While the Agency will always exercise fiscal prudence, this analysis provides particularly useful information based on Agency priorities including SB 1383 implementation, and our ongoing efforts to build upstream waste prevention infrastructure, such as by advancing reusable foodware options to replace single-use disposables.

## PLANNING FOR THE FUTURE

As previously discussed, staff is currently analyzing various options to stabilize its core revenue and will be presenting findings to the Boards upon completion of the analysis, tentatively scheduled for July or September. Furthermore, the Agency is taking proactive measures regarding expenditures, such as by limiting hiring and carefully managing vacancies. The Agency will continue its practice of monitoring unfunded liabilities and making strategic discretionary payments when feasible to both ensure the adequacy of the pension and post-retirement benefits (OPEB) and reduce annual operating expenses.

## RECOMMENDATION

This item is for information only. Staff will continue to prepare and present annual fiscal forecasts using these forecasting models and advise the Boards of any changes in disposal trends which would require significant changes to Agency expenditures and/or revenues.

Attachment 1: Crowe report: Fiscal Forecasts and Fund Balance/Reserve Analysis