



CITY OF BANNING STAFF REPORT

TO: CITY COUNCIL

FROM: Robert Fisher, Acting City Manager

PREPARED BY: John Pinkney, City Attorney
Robert Fisher, City Manager

MEETING DATE: March 11, 2025

SUBJECT: Presentation by Michael Busch of Urban Futures Inc regarding City and Utility finances and steps needed to stabilize general fund and Electric Utility fund

RECOMMENDATION:

- 1) Direct staff to come back within 30 days with a timeline of actions necessary to stabilize the City's Electric Utility; and
- 2) Authorize the City Manager to negotiate with Urban Futures Inc on the development of a 10-Year General Fund Budget Forecast Model to include budget stabilization recommendations and options for City Council consideration.

BACKGROUND:

On December 20, 2025, the City engaged the law firm of Slovak, Baron, Empey, Murphy & Pinkney LLP (SBEMP) as interim City Attorney. Upon engagement, SBEMP recommended an independent financial consultant to review and evaluate the City's financial position and management practices as part of SBEMP's standard due diligence. SBEMP has worked with Urban Futures Inc. (UFI), a California based financial and municipal advisory firm and past Banning advisor to assess the City and Utility financial conditions.

JUSTIFICATION:

Throughout local government, management systems that operate in the realm of financial management are fundamental to economic, social and infrastructural growth and the development of local government entities. This is particularly relevant to a sustainable City of Banning. These systems include costing, budgeting, accounting, financial information, procurement, cash control, asset management and internal controls. Such systems, often referred to as fiscal sustainability policies, best practices and programs, have been developed to form part of the financial management system of controls in all well-run California public agencies. Financial management systems are a crucial element in the integrated governance systems which are meant to function as the foundation of effective, efficient and accountable local government in Banning and elsewhere.

In well run municipalities financial management systems are the foundation of good governance, which is the very opposite of corruption, graft, fraud, poor management of resources, nepotism, incompetency and general negligence of the basic principles of management and leadership. This implies that high quality financial management systems are the requirement of good governance. In this relationship, good governance is the basis on which municipalities exercise their authority to provide for the sustainable delivery of services which citizens expect, such as the building and maintenance of roads, public safety and essential utilities. Solid financial management and good governance guarantee a municipality's

financial viability. Thus, the performance of a municipality depends on good governance to ensure that sustainability can become a reality.

Financial viability is measured in terms of a municipality's capacity to meet its financial obligations in a sustainable manner. Mismanagement of resources is, in most cases, the result of weak human resources and financial management and the lack of a clear mission and leadership in public institutions. Admittedly, municipalities are expected to meet the challenges of an ever-changing financial environment to comply with the best practices common in the private sector.

The basic tool to manage municipal financial management is a municipal budget. It is imperative that municipal stakeholders, such as municipal officials and interest groups should have a sound basic knowledge of the budget and its challenges. The budget of any municipality, as developed by executive staff and presented to the City Council, must be transparent. Furthermore, it is the responsibility of the executive management of each municipality to employ practical financial measures to ensure that the municipal council approves sustainable strategies such as adopting credible budgets. A sustainable budget is a fiscal strategy which can continue to exist for the foreseeable future without any substantial change or spending to prevent a substantial deterioration in fiscal position. Furthermore, a sustainable budget would prevent sharp changes in rates, such as the recent rate adjustments for Electric Utility services of 13.9% for two consecutive years, while no adjustments were sought since 2013.

The General Financial State of Banning

The most accurate reflection of the financial situation in the City of Banning is in the auditor's annual reports, which is a very substantial barometer of the financial situation. UFI was recently provided with a summary of audited financial data indicating the confronting situation facing the city's administrative and political leadership. Data for the most recent fiscal year (2023-24) is unavailable, but we believe the trends may have improved but continue to reflect continuing challenges.

The audit reports covering FY 2018 through FY 2022 identified a growing trend of expenditures outpacing revenues in key funds including the General, Electric Utility and Internal Service Funds. Concurrent with citywide audit findings, the City's outstanding Series 2015 Electric Utility Refunding Bonds have been subject to downgrade on multiple occasions from its initial underlying rating of "A-" to its current rating of "BB-", junk status. In its rating disclosures, Standard & Poor's concluded the following:

- The three-notch downgrade reflects our view of the utility's lack of effective risk management and oversight as well as its failure to implement proper financial controls, as evidenced by its negative unrestricted cash balances for two successive years
- The negative outlook reflects our view of the uncertainty surrounding whether rate increases, and sufficient cost controls will adequately raise the utility's unrestricted cash position to produce credit-supportive coverage and as well as if financial audits will be produced on a timely basis,
- The downgrade reflects our view of the utility's continued weak financial position, demonstrated by insufficient debt service coverage (DSC), a negative \$4.9 million cash balance as of October 2024, and continued interfund borrowing with an uncertain repayment timeframe
- The negative outlook reflects our view that while management's fiscal 2025 budget projects improved DSC that meets the rate covenant and includes a recently approved rate increase (effective Nov. 1, 2024), the utility's ability to achieve and sustain this improvement remains uncertain given its historical performance. Furthermore, we believe the implementation of back-to-back 13.9% rate increases within fiscal years 2025 and 2026 will further pressure affordability and could impede progress on accounts receivable.

These factual findings reveal the need to address internal controls, a key element of financial management necessary to achieve sustainability. It is evident that to improve in these respects, the City must continue efforts in the pursuit of strengthening internal controls in the following three areas:

- firstly, leadership, which is expected to set the correct tone for effective governance;
- secondly, financial; and
- thirdly, performance management reports, which must be subjected to management checks and

balances to confirm credibility of information and governance, by strengthening financial teams and internal audit functions that will complement a 10-year Fiscal Sustainability Forecast Model.

Specific Findings

City staff provided a Citywide 5-Year Annual Cash Flow Analysis to UFI and subsequently verified against other financial documents for accuracy reflecting the following preliminary observations and assessments:

- General Fund has sustained a period of annual cash losses growing from \$1.13 million in FY 19-20 to a peak of \$4.485 million in FY 20-21 as well as an annual cash loss of over \$3 million in FY 21-22
- General Fund cash liquidity has declined from \$12.5M in FY 19 to \$3M in FY 22 impacting the City's actual cash reserves in the General Fund
- Electric Utility Fund is experiencing a significant financial reduction in cash liquidity and fund balance. In FY 19, the Fund had a balance of positive \$19M and now reflects a balance of negative (\$9M); the most significant loss recently occurred between FY 22 and FY 23 of \$13.4M; and
- Internal Service Funds are reflecting negative fund balances. Negative fund balances are often a reflection of budget pressures on operating funds with limited resources to pay true internal service costs and/or deficient budget preparation and management resulting from inadequate and timely budget adjustments based on actual cost for service.

In Addition to the above, we believe the following actions may have contributed to the financial condition that have impacted the City's overall fiscal health:

- Personnel costs related to substantial unanticipated public safety overtime, staffing increases in the Community Development Department, recent increases for compensation adjustments all funded by the General Fund, resulting in costs exceeding approved budget assumptions and available annual revenues;
- Internal fund borrowing from the General Fund, and other Business Activity Funds, to support negative cash balances in several funds including Electric Utility and Internal Service Funds; and

The above findings are not one-time expenses and suggest the City has been operating with a structural deficit. Aligning annual revenues with expenditures through a balanced budget is necessary for the City to meet a basic level of financial and operational sustainability.

Recommended Next Steps

Fiscal stability is more than a math exercise focusing on the numbers to ensure revenues and expenditures balance and net to zero. This process is focused beyond an annual budget cycle. It requires careful modeling of projected city revenues and expenses to develop a forecast that allows the City to understand its financial capacity and challenges in continuing the existing level of municipal services. Financial sustainability takes the forecasting process further by providing immediate and clear information on the financial impact of various economic scenarios, strategic initiatives, or operational decisions.

A select number of California cities are beginning to use the practice of long-term financial forecasting to understand the true costs of their obligations, to address structural deficits and to prepare for inevitable future economic downturns or uncertainties. Long-term forecasts are especially useful in helping elected officials, labor groups, commissions and members of the public understand how proposals will affect the City's fiscal solvency. Armed with a robust forecast, city leaders can identify critical unmet needs, develop options to close funding gaps and create plans that achieve the City's strategic objectives because they are aligned to a solid and continuously updated financial forecast and plan.

To proactively address the City's critical fiscal challenges and uncertain financial future, UFI is strongly recommending the City prepare a five-year forecast for its Electric Utility and a ten-year financial forecast for the General Fund. Additionally, both models should be accompanied by a set of action items as recommendations for City Council consideration necessary to stabilize the two funds.

Electric Utility

We understand a rate study has been initiated for the Electric Utility, and this may serve as its forecast model. We strongly encourage the study timeline to be accelerated and to focus on stabilizing the utility and immediate capital needs as a priority addressing the rate requirements necessary over the next five years to do so. Additionally, we believe the refunding of the Electric Utility's outstanding Series 2015 bonds can play an important role in the stabilization process. However, to realize full benefit the rate model extending out five years should precede the refinancing.

General Fund

Developing a robust, usable and customizable financial forecast requires significant time, understanding and expertise which the City does not currently possess. UFI recommends the following approach to the development of a 10-year forecast.

Model development includes the following four tasks:

1. Develop a Baseline Financial Forecast Model for the General Fund to provide the City with the analytic capacity and understanding of the City's present and future financial condition, and through adjusting assumptions, inputs and variables, enable the City to conduct rigorous fiscal analysis and provide immediate feedback on the short-and long-term financial impact of strategic choices and operational decisions. The model will be in Microsoft Office Excel® and can be expanded, refined and updated to address the City's changing needs, objectives and goals.
2. Analyze and model the City's various General Fund revenue streams, including assessing revenue restructurings or new revenue streams that enhance sustainability or reduce risk.
3. Analyze and model General Fund expenditure categories, cost drivers and program service delivery structures to identify opportunities for sustained cost reduction, containment and recovery.
4. Deliver a final report to the City Council with recommendations on the following: (a) restructuring at-risk or under-optimized revenue streams, (b) changes to financial structures or procedures that will enhance current revenue streams, (c) opportunities for new revenue streams to improve the City's fiscal stability, (d) actions to mitigate the impact of key cost drivers and achieve sustained savings, (e) restructuring program service delivery models, and (f) practices to realize efficiencies, improve cost recovery and lessen long-term expenses.

The proposed work will help the City of Banning to create a solid fiscal foundation and capacity to begin successfully addressing the structural issues within the Electric Utility and General Fund. The City of Banning cannot expect to remain solvent or successfully achieve its goals if financial considerations are left to the annual budget process or the fiscal analysis of individual projects or programs. The City Council's strategic initiatives, budgets and operational decision-making must be continually informed by and aligned with a long-term financial plan and fiscal structure. The proposed work will begin moving us down this critical path.

FISCAL IMPACT:

There are no fiscal impacts on the recommendations.

ALTERNATIVES:

- 1) Approve the recommended actions
- 2) Provide staff with alternative actions
- 3) Request additional information to be presented later

BUDGETED?:

No

CONTRACT/AGREEMENT:

No