

STAFF REPORT

Discussion Agenda Item

DATE: May 4, 2026

TO: Honorable Mayor and Council Members

FROM: Aaron Felmlee, Finance Director

THROUGH: Amy Nilsen, City Manager

SUBJECT: **Fiscal Year 2026-27 Proposed Budget**

STAFF RECOMMENDATION:

1. Receive a detailed presentation of the Enterprise Funds portion of the Fiscal Year (FY) 2026-27 Proposed Budget; and
2. Answer outstanding questions from the first special budget workshop and provide direction to the City Manager in regards to the Museum.

EXECUTIVE SUMMARY:

The total FY 2026–27 Proposed Budget is \$54,087,866 with \$9,441,279 in General Fund expenditures. The total proposed budget represents an increase of \$18,712,765 with an increase of \$895,815 to the General Fund. The total budget increased primarily due to the Wastewater Treatment Plant Compliance Upgrade project which accounted for an increase of \$17,500,000. The General Fund portion of the increase is primarily due to the following:

- \$420,000 for health insurance
- \$87,000 for liability insurance
- \$40,000 for a new phone system
- \$200,000 for Police Officer and Sergeant pay increases
- \$110,000 for the Senior Planner position
- \$550,000 for the General Plan update

These increases are partially offset by the decreases below:

- \$223,000 due to the ongoing hiring freeze for one Police Officer position and one part-time Community Services Officer position
- \$20,000 due to the elimination of the Business Improvement budget
- \$75,000 due to departments reducing services and supplies budgets
- \$180,000 due to pursuing a lease of the River Lodge and eliminating the full-time River Lodge Manager and currently vacant River Lodge Coordinator positions
- \$24,000 due to the partial closure of the Museum

Below is a chart that shows the total general fund revenue and expenses for FY 2026-27 compared to prior years.

Fund Balance History	2024-25	2025-26	2025-26	2026-27	Change vs.
	Actual	Budget	Estimate	Proposed	PY Budget
Beginning Available Balance	\$ 7,538,935	\$ 7,358,192	\$ 7,358,192	\$ 5,403,621	\$ (1,954,571)
SOURCES:					
Revenues:					
Taxes and Fees	7,609,107	7,174,275	7,193,625	7,328,104	153,829
Non-recurring Receipts	329,492	290,468	315,568	375,000	84,532
Transfers from Other Funds	-	700,000	700,000	1,000,000	300,000
Total Sources	7,938,599	8,164,743	8,209,193	8,703,104	538,361
USES:					
Operating Budgets:					
Pay and Benefits	5,205,269	5,690,129	6,887,560	5,968,581	278,452
Service and Supplies	2,126,563	2,206,941	2,511,341	2,782,207	575,266
Capital Outlay	82,924	-	-	50,000	50,000
Projects	204,051	20,000	20,000	-	(20,000)
Debt Service	-	-	-	-	-
Development Fund Support	216,781	138,217	241,935	244,542	106,325
River Lodge Fund Support	153,275	263,989	308,521	145,486	(118,503)
Transfers to Other Funds	130,479	226,188	194,407	250,463	24,275
Total Uses	8,119,342	8,545,464	10,163,764	9,441,279	895,815
Net Annual Activity	(180,743)	(380,721)	(1,954,571)	(738,175)	(357,454)
Ending Available Balance	\$ 7,358,192	\$ 6,977,471	\$ 5,403,621	\$ 4,665,446	\$ (2,312,025)

The amount needed to come from reserves for FY 2026-27 is \$738,175, comprised of \$550,000 for the General Plan and \$190,000 for one-time employee stipends. Below is a chart that shows the general fund current reserve amount and policy.

Reserve Policy			
A. Economic Contingency Reserve			
<i>Set-aside funds for unexpected loss of revenue or economic downturn; 5% of revenues; provides time to adjust services to changing revenues</i>			435,155
B. Capital Improvement/Infrastructure Reserve			
<i>Set-aside funds for unexpected major infrastructure failure</i>			500,000
C. Operating/Working Capital Reserve			
<i>Provides cash flow for tax and grant collection period; days of expenditures</i>			180
			4,655,973
D. Reserved Fund Balance - PARS Section 115 Trust			
			171,665
E. Remaining unreserved Fund Balance/Operating Contingency			
			(1,097,347)
Estimated FY26-27 Ending Fund Balance			\$ 4,665,446

The proposed FY 2026-27 has been developed to present the City’s recommended operating programs and Capital Improvement Projects while keeping in mind the City’s fiscal constraints. Staff prepared the budget with the intent of delivering the highest possible level of service to the community within the resources available, guided by the following principles:

- Current services will be preserved at existing levels to the highest degree possible.
- The budget will comply with State Constitution, City Charter and Municipal Code provisions.
- Working capital balances will be examined to ensure balances are healthy enough to protect the City from any future uncertainties.
- Recurring expenditures will be aligned with recurring revenues to support long-term fiscal sustainability.
- Department budgets will reflect the most accurate and realistic estimates of operational costs.

This year’s budget development occurred against a challenging fiscal backdrop. The City of Fortuna has experienced several consecutive years of structural financial strain driven by stagnant or declining revenues and rapidly increasing operational costs, particularly in public safety, insurance, and core community services. Since FY 2021–22, the City’s largest revenue sources that once grew modestly each year have instead flattened or contracted. At the same time, major cost drivers, most notably insurance, have risen sharply due to market conditions outside the City’s control.

These opposing trends have created a tightening budget environment in which maintaining service levels requires difficult choices. Despite extensive line-item review and cost-containment efforts, the City faces a widening gap between recurring revenues and expenditures. As a result, the Proposed Budget includes targeted reductions and operational adjustments necessary to preserve core services and maintain fiscal stability.

Staff’s comprehensive analysis provides confidence that the FY 2026–27 Proposed Budget maximizes the services that can be delivered with available resources while positioning the City to navigate ongoing financial pressures responsibly.

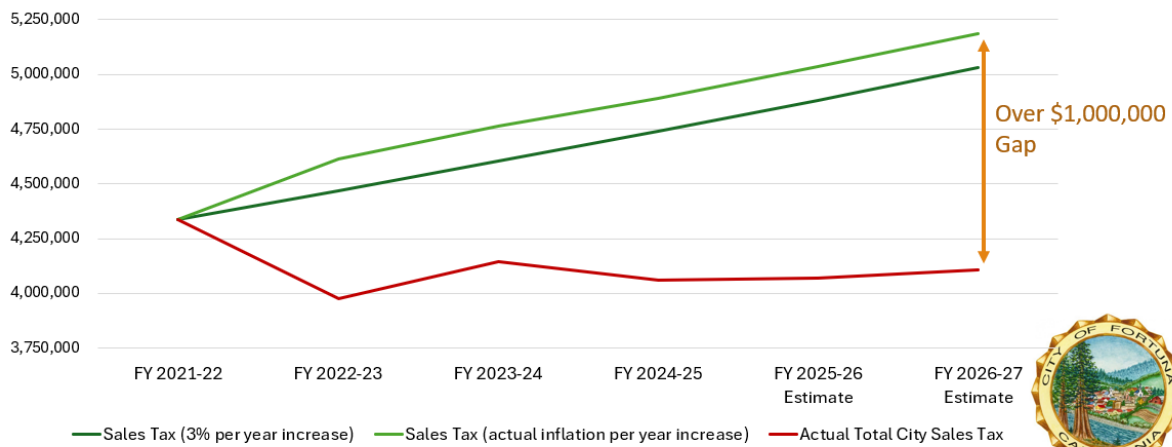
DISCUSSION:

1. How Fortuna Reached this Fiscal Crossroads

a. Sales Tax Revenues Are Not Keeping Pace With Inflation

The City’s largest unrestricted revenue source is sales tax, and sales tax has not kept up with inflation. Under normal inflation, revenues would have increased to \$5.2M by FY 2026–27. Actual projected revenues are only \$4.1M. This results in a gap of over \$1,000,000. This means the City effectively lost the purchasing power of nearly one million dollars over a five-year period. See below chart.

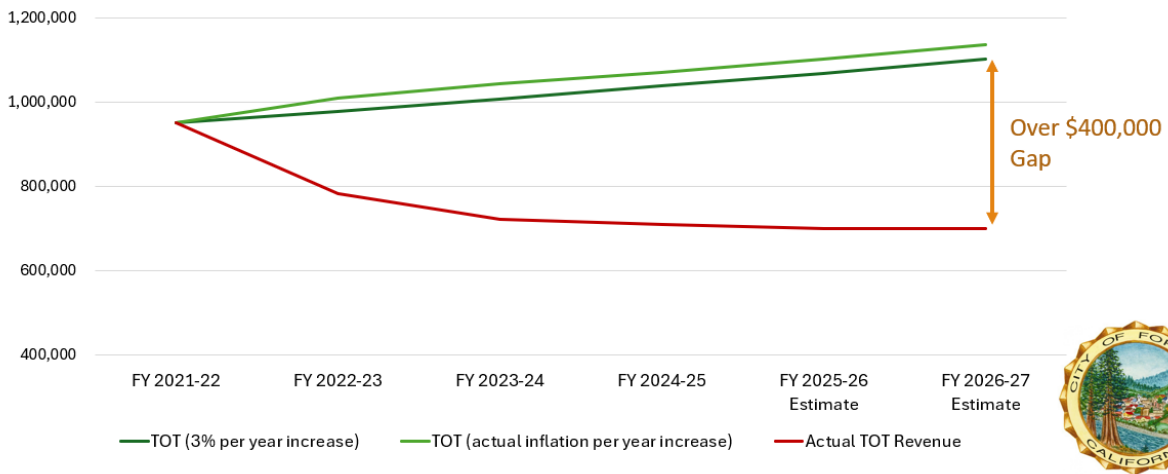
Sales Tax Trend (including Measure E)



b. Transient Occupancy Tax (TOT) Revenues Have Declined Significantly

Traditionally, TOT helps fund City services and tourism-related impacts. The City’s TOT revenue has dropped sharply since FY 2021–22. Expected inflation-adjusted TOT for FY 2026–27 is approximately \$1.1M. Actual projected TOT is \$700,000, a gap of over \$400,000. This decline appears linked to regional lodging patterns and reduced tourism activity. See below chart.

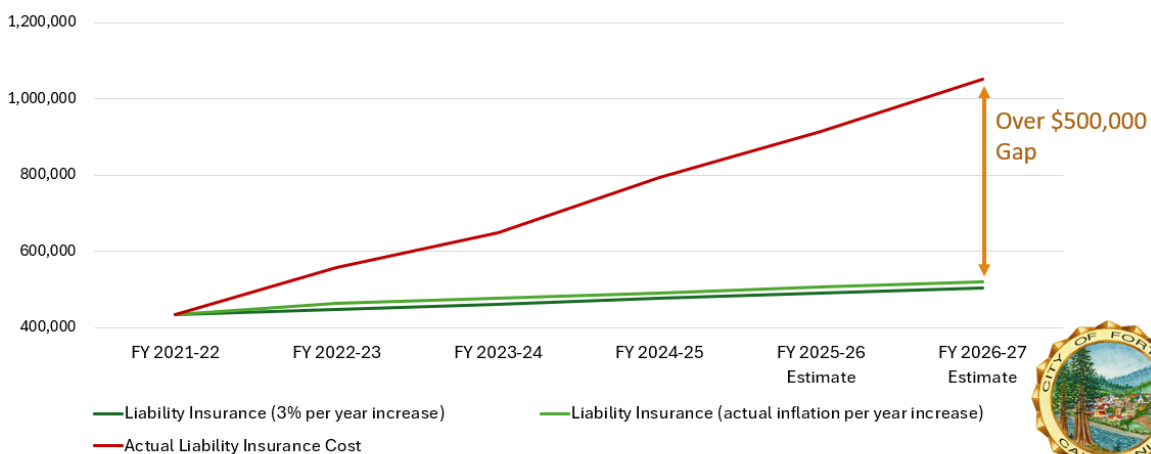
Transient Occupancy Tax (TOT) Trend



c. Liability Insurance Costs Have Skyrocketed

Liability insurance, an unavoidable cost, has increased more dramatically than any other major expense category. Actual costs for liability insurance in FY 2021–22 were \$435,894. Projected costs for FY 2026-27 is \$1,051,372, an increase of over \$615,000, or over 140%. The resulting gap compared to inflation-adjusted expectation is over \$500,000. These increases are consistent with statewide trends affecting municipal risk pools. See below chart.

Liability Insurance Trend



The result of these three trends is a General Fund structural budget deficit. These combined trends demonstrate rising costs and flat to declining revenues. To help address these trends

the use of reserves and a hiring freeze has previously been put into place. In addition, during budget preparation departments were requested to come up with 10% cut reductions to their service and supply budgets. These measures still left the General Fund short of a balanced operating budget and so staff came up with service reductions that will be discussed in greater detail below.

2. Measure E Impact to the General Fund

Total budgeted revenues for Measure E for FY 2026-27 is \$1,944,000, an increase of \$60,000, or 3%. One of the ways staff closed the operating deficit was to increase the amount of General Fund support Measure E provides. Measure E General Fund support increased from \$700,000 in FY 2025-26 to \$1,000,000 in FY 2026-27. After taking into account the full-time positions that Measure E funds, this left \$86,000 of discretionary funding for the Measure E committee to allocate to one-time projects. These projects have historically included high value projects such as the K-9 program, encampment outreach and cleanup services, code compliance, storm drain repair, street repair, and park equipment and enhancements.

To fund these projects this year's Measure E recommendation included utilizing Measure E funds that have gone unspent and therefore to reserves in years past. The estimated amount at the end of FY 2025-26 that Measure E will have put into reserves since inception is \$3,500,000. The Measure E Committee and City Council have previously given direction to keep reserves at 365 days of operating expenditures in the Measure E Fund which would be approximately \$1,950,000. This leaves \$1,550,000 that has been put into reserves by Measure E above and beyond the stated reserve target. The proposed budget includes allocating approximately \$800,000 from reserves this year to be spent on one-time cost projects.

3. General Fund Reserves

By comparison, the General Fund does not have excess reserves above the Council approved reserve levels. The FY 2026-27 proposed budget includes approximately \$550,000 from reserves for the General Plan Update and \$190,000 for employee stipends.

The General Fund is estimated to start FY 2026-27 with approximately \$5.4 million and end the year with \$4.65 million due to the General Plan and employee stipend costs coming from reserves.

The General Fund Reserve policy calls for an economic contingency reserve of 5% of revenues which equates to about \$435,000, a Capital Infrastructure reserve of \$500,000, and 180 days of operating expenses reserve which equates to about \$4,640,000. The total of all of those comes to a reserve policy amount of \$5.6 million which means the ending balance of \$4.65 million leaves the City short by about \$950,000 of the reserve policy.

The Council can choose to remove the economic contingency and/or the capital infrastructure contingency from the reserve policy to reduce that shortfall. The Council can

also include in the budget adoption motion to waive the reserve requirement for the FY 2026-27 budget year.

4. Steps Included in Proposed Budget to Reduce Deficit

The proposed FY 2026–27 budget includes a series of expenditure reductions and measures designed to address the projected General Fund deficit. These actions reflect a combination of operational adjustments, staffing controls, and service level reductions intended to minimize financial impacts while maintaining core City services.

- Hiring Freeze to remain in place for FY 2026-27. Total savings to the General Fund will depend on which positions end up having vacancies and for how long.
- Eliminated entire budget for Business Improvement. Total savings to the General Fund - \$20,000
- Departments reduced services and supplies budgets by up to 10% - \$75,000 savings to the General Fund
- Froze 1 currently vacant part-time Community Services Officer position. Total savings to the General Fund - \$33,000
- Froze 1 currently vacant full-time Police Officer Position (will leave 2nd Detective specialty position vacant) – Total savings to the General Fund - \$190,000
- Lease the River Lodge to another local public agency with time/costs allotted for a smooth transition period. This includes eliminating the full-time River Lodge Manager and currently vacant River Lodge Coordinator positions. Total savings to the General Fund - \$180,000
- Did not implement full-time Transit Supervisor position. Total savings to the General Fund - \$70,000

In total over \$500,000 in reductions have been included in the FY 2026-27 proposed budget. These reductions along with the increase from Measure E of \$300,000 put the General Fund at a balanced operating budget, one-time costs of \$740,000 for the General Plan and employee stipends however, would still need to come from reserves.

5. Staffing and 34-hour work week

A review of departmental performance data demonstrates that the transition from a 40-hour to a 34-hour workweek has been successful. Across all reporting divisions, service levels, customer activity, and operational outputs have remained stable or improved following implementation. Key indicators, including invoices processed, agenda items completed, building and planning activity, recreation participation, and customer service interactions, show no decline in productivity.

Some specific metrics provide the clearest quantitative comparison. Post-implementation data show that daily walk-in customers served increased by 35%, utility bills paid online increased 28%, and payroll checks issued increased 4%. Notably, employee leave usage declined 38% after the schedule change (July – December 2025 compared to July – December 2024). Additionally, the City recognized a decrease in recruitments of 57%

between January – June 2025 compared to July – December 2025. These suggest improved employee morale, reduced burnout, and greater schedule sustainability.

Overall, the data indicates that the 34-hour workweek has preserved organizational productivity and reduced staff turnover, providing a more consistent level of service. The reduced schedule is functioning effectively and sustainably without compromising public service delivery, which will be key as the City applies the hiring freeze for a second fiscal year.

6. River Lodge Analysis

Staff presented a detailed analysis of the River Lodge for the Council at the September 2, 2025 Council meeting. At that time the Council directed staff to keep the River Lodge and pursue marketing opportunities to help address the recurring deficit that the River Lodge facility has operated in for many years.

Please reference the below chart that shows both the revenue and expenses for the River Lodge for FYs 2021-22 through 2025-26 as well as the amount of funds required by the General Fund which totals nearly \$1,000,000 for the 5 years shown.

	FY 2025-26 Budget	FY 2024-25 Activity	FY 2023-24 Activity	FY 2022-23 Activity	FY 2021-22 Activity
Revenue	(194,000)	(209,402)	(181,778)	(186,601)	(129,299)
Expense	469,439	376,082	346,477	362,809	322,840
	275,439	166,680	164,699	176,208	193,541

Staff have held bi-weekly meetings regarding the River Lodge since the September Council meeting with the goal of decreasing the amount of General Fund support provided to the River Lodge and pursue enhanced marketing. To date staff have not found an avenue to make the River Lodge bring in enough revenue to cover expenses.

Due to this and the need for the General Fund to reduce expenses due to increased fiscal pressure as explained above staff have included in the FY 2026-27 proposed budget to lease out the River Lodge facility. The FY 2026-27 budget includes reduced staffing levels that represent the River Lodge transition from City control to another local agency. This reduced the amount the General Fund supports the River Lodge by \$180,000.

Staff are requesting the City Council make a motion to provide direction to the City Manager to pursue leasing the facility immediately. Starting that process now and not July 1, when the new budget year starts, will allow the potential for a long-term lease by the end of the calendar year and the ability to more smoothly transition some of the already scheduled events. In the event that no lease can be effectuated staff will return with alternative recommendations such as permanently closing the River Lodge based on the budget; or the potential need to add positions and funds back into the budget to effectively operate the River Lodge facility through the entire fiscal year. During the April 27th FY

2026-27 Proposed Budget Workshop, City Council approved the City Manager to pursue leasing the River Lodge facility to local public agencies/nonprofits and return to Council to discuss the long-term viability of the River Lodge if no deal is established by a 5-0 vote.

7. Transit Analysis

Staff presented on the Fortuna Transit system operations and provided alternative options to keep the Fortuna transit system fiscally viable at the February 2, 2026, Council Meeting. At that meeting Council chose the option to open the transit system to the general public, allocate a full-time transit supervisor position, and re-evaluate the system again in FY 2027-28.

Staff recently received updated transit development act (TDA) and state transit assistance (STA) funding amounts from Humboldt County Association of Government (HCAOG) who facilitate the distribution of those funds to the City. The updated numbers were \$70,000 less than projected and presented to the Council on February 2. Below is a summary of TDA allocations that the City has received over the previous 6 fiscal years showing steady declines.

Year	Amount	% Change
FY 21-22	603,691	
FY 22-23	541,214	-11.5%
FY 23-24	479,315	-12.9%
FY 24-25	470,986	-1.8%
FY 25-26	458,733	-2.7%
FY 26-27	414,085	-10.8%

Due to this funding decrease staff put the recruitment of the full-time transit supervisor position on hold to re-evaluate the fiscal viability of the Fortuna transit system. However, it should be noted that a dedicated Transit Supervisor has the potential to pursue transit related funding such as Federal Transit Administration Section 5310 – Enhanced Mobility of Seniors and Individuals with Disabilities program, while the current staffing model does not allow for grant writing, and there will be limited compliance, staff oversight, and training.

Below is an updated fiscal analysis of the Fortuna transit system without the full-time transit supervisor.

<u>Sources:</u>	Current FY 25-26	FY 26-27	FY 27-28	FY 28-29	FY 29-30	FY 30-31
Bus Fares	20,000	24,000	24,480	24,970	25,469	25,978
TDA Allocation	419,877	414,085	418,226	422,408	426,632	430,898
Regional Funds (STA, SGR, LCTOP)	-	100,000	100,000	100,000	100,000	100,000
City TDA Street Funds	-	100,000	-	-	-	-
Transfer In (Measure E)	12,000	12,000	12,000	12,000	12,000	12,000
	451,877	650,085	554,706	559,378	564,101	568,876
<u>Uses:</u>						
Pay and Benefits	227,046	209,393	230,333	239,149	248,325	257,876
Service and Supplies	49,939	110,764	115,296	120,147	125,346	130,922
Contract Services - HTA	204,554	214,782	225,521	236,797	248,637	261,069
Depreciation	-	100,000	-	-	-	-
	481,539	634,939	571,150	596,093	622,308	649,867
Surplus (Deficit)	(29,662)	15,146	(16,444)	(36,715)	(58,207)	(80,991)

The Fortuna transit system is only fiscally viable in FY 2026-27 and then turns to a deficit in FY 2027-28 and grows to an over \$80,000 deficit by FY 2030-31. These deficit amounts would need to be covered by the General Fund which does not have the current capacity to do as explained above.

Additionally, funding from the Humboldt Transit Authority (HTA) that was originally anticipated for the purchase of two new buses, was not approved by the HTA Board. The HTA Board recommended an operational analysis of which service provider could provide service to Fortuna more efficiently. HTA is waiting to see if Fortuna is interested in receiving an operational analysis. In the meantime, in order to purchase one of the buses the City Council would need to authorize the use of transit development act (TDA) street paving funds that have been received in prior fiscal years for the purchase of an approximate \$100,000 bus.

For these reasons staff are recommending that the City Council direct the City Manger to pursue sustainable long-term viable options for the Fortuna Transit system such as working with HTA on an operational analysis for them to potentially operate the Dial-a-Ride system in Fortuna. During the April 27th FY 2026-27 Proposed Budget Workshop the City Council approved this motion 4-1.

8. Museum Analysis

The Museum has been identified as a discretionary, non-core service within the City's General Fund. Annual operating costs range between \$27,500 and \$32,500, with the primary expense attributable to the part-time Museum Curator position. This position is budgeted at approximately 1,200 hours annually and is responsible for the day-to-day operations of the Museum, as well as support for the Historical Commission.

The Museum currently maintains a donation fund balance of approximately \$22,000, accumulated through community contributions over several years. For FY 2026–27, staff

recommends utilizing these restricted donation funds to support the cost of the part-time Museum Curator position. To extend the sustainability of the donation funds, staff evaluated an alternative operational model that includes a seasonal closure of the Museum from October through April. This approach would reduce staffing needs and could allow the available donation funds to support the curator position over a two-year period, albeit at reduced service levels and hours.

Implementation of a seasonal closure would also have operational impacts on the Historical Commission. Historically, the Museum Curator has provided administrative and logistical support to the Commission. As such, reduced staffing capacity would require that the Historical Commission either be placed on temporary hiatus or formally disbanded during this period.

At the April 27 Special Budget Workshop, the City Council received public comments from the Museum Curator, members of the Historical Commission, and community members expressing strong support for maintaining Museum operations. Council subsequently directed staff to explore alternative options to allow the Museum to remain open year-round, including reviewing operational models used by other jurisdictions such as the Ferndale Museum.

The Ferndale Museum is not operated or funded by the City of Ferndale but instead functions as a charitable nonprofit organization established in 1979. The organization relies on community support, receiving approximately \$50,000 in donations in calendar year 2024, and supplements funding through memberships (approximately 750 members) and fundraising events, including “Night at the Museum” programs with suggested donations.

Based on this model, staff recommends exploring the transition of the Depot Museum to a nonprofit structure under Internal Revenue Code Section 501(c)(3). Under this approach, the City would transfer the Museum collection to a newly formed nonprofit entity and lease the Depot Museum facility to that organization. The nonprofit would assume responsibility for ongoing operations, maintenance, and programming, with funding derived from donations, memberships, and fundraising activities.

This model would provide greater flexibility in fundraising compared to the City’s current limitations. For example, the City is restricted under California law from conducting certain types of fundraising activities, such as raffles, whereas a qualified nonprofit organization may conduct such activities in compliance with applicable state regulations. This model also creates legal, financial, operational and governance independence from the City.

Staff is recommending Council direct the City Manager to work with interested community members in order for them to initiate the transition of the Depot Museum to a nonprofit 501(c)(3) organization, including development of agreements for the transfer of the Museum collection and lease of the facility, and to return to Council with final agreements for approval. Additionally, the use of Museum donation funds should be utilized to support operations during the transition period.

9. Alternate Cut Scenarios

Should the City Council determine not to proceed with some or all of the deficit reduction measures included in the proposed FY 2026–27 budget (as outlined in Section 4 and detailed further in Sections 6, 7, and 8), additional reductions would be necessary to address the projected General Fund shortfall.

The following alternative scenarios are provided for Council consideration:

- Eliminate a Parks Maintenance Worker II position. Total potential savings to the General Fund - \$79,500
- Eliminate a Street Maintenance Worker II position. Total potential savings to the General Fund - \$64,000
- Reduce or eliminate the annual Chamber of Commerce in-kind support of the Monday Club and River Lodge usage. Total potential savings to the General Fund - \$10,000
- Institute a voluntary retirement incentive program with a financial incentive for employees to retiree and the position is left vacant once the employee retires. The eligible positions would need to be identified as positions primarily funded by the General Fund and operational necessity. This approach would result in unspecified service level reductions depending on which positions are vacated and not refilled.

10. Conclusion

Staff originally projected a General Fund deficit increase of over \$800,000 primarily due to revenues not growing, health insurance increases of 32%, and liability insurance increases of 25%. Staff have included over \$500,000 in cost cutting measures into the General Fund proposed budget and an increase of \$300,000 to the General Fund from Measure E to balance out the increased costs.

FINANCIAL IMPACT:

The total FY 2026–27 Proposed Budget is \$54,087,866 with \$9,441,279 in General Fund expenditures. The total proposed budget represents an increase of \$18,712,765 with an increase of \$895,815 to the General Fund. Additional information can be found in the attached FY 2026-27 proposed budget document.

RECOMMENDED CITY COUNCIL ACTIONS:

1. Receive a detailed presentation of the General Fund portion of the FY 2026-27 Proposed Budget and review Council questions
2. Open Public Comment
3. Close Public Comment
4. Motion to direct the City Manager to work with interested community members in order for them to initiate the transition of the Depot Museum to a nonprofit 501(c)(3) organization, including development of agreements for the transfer of the Museum collection and lease of the facility, and to return to Council with final agreements for

approval. Additionally, the use of Museum donation funds should be utilized to support operations during the transition period.

ALTERNATIVE TO STAFF RECOMMENDATIONS:

- a. The City Council could choose to keep the Museum open year-round and paid for from the General Fund as it is currently. This would add over \$24,000 back into the General Fund budget. Council would need to provide direction on alternative budget cuts or fund the additional \$24,000 from reserves.

ATTACHMENTS:

- A. FY 2026-27 Proposed Budget