

# **Novato's Chronic Fiscal Deficits: A Call to Action**

## **June 8, 2023**

### **SUMMARY**

The City of Novato (City) is a lovely place to live. It offers many outdoor recreational opportunities, a wide range of housing, and the friendly community spirit of a small town. However, the City has inherent fiscal challenges, in part because of its relatively recent incorporation in 1960. It lacks some of the revenue sources upon which many other cities rely, and the area's independent special districts impact both Novato's revenues and operations. Such long standing factors are impediments to Novato's financial sustainability.

Novato is confronted with chronic and ongoing structural financial deficits. Its current revenues do not cover its operating expenses and have not in recent years. For the current fiscal year ending June 30, 2023, Novato's budget is \$49.1 million, and its deficit is now projected to be over \$1.9 million. For the last several years, Novato has faced difficult decisions about how to meet its residents' service expectations with its limited financial resources. Budget cuts have reduced staffing levels, leaving fewer people to do the same or a greater amount of work and leading to reduced services for its residents. There have been lapses in the City's financial management to the detriment of Novato and its residents.

While Novato's City Council has known for more than a decade about its financial challenges and looming deficits, they have not taken sufficient measures to resolve them. This report describes Novato's inherent limitations on raising revenue. The report also reviews decisions that have exacerbated and those that have reduced its deficits. The Grand Jury offers recommendations for promptly addressing the need to put Novato's financial house in order.

To correct these deficiencies, the Grand Jury recommends that the City implement accepted financial controls; that it establish comprehensive records management systems; that it create a new position of an independent internal auditor; that it review all properties that it owns to identify opportunities to generate revenue; and that it aggressively investigate all possibilities to increase long term revenue, including increasing the sales tax.

### **BACKGROUND**

Novato was incorporated in 1960 and is the northernmost city in Marin County. Occupying 28 square miles, it is Marin's largest city geographically. With a population of about 53,000 residents, it's the County's second most populous city.<sup>1</sup> The median household income is

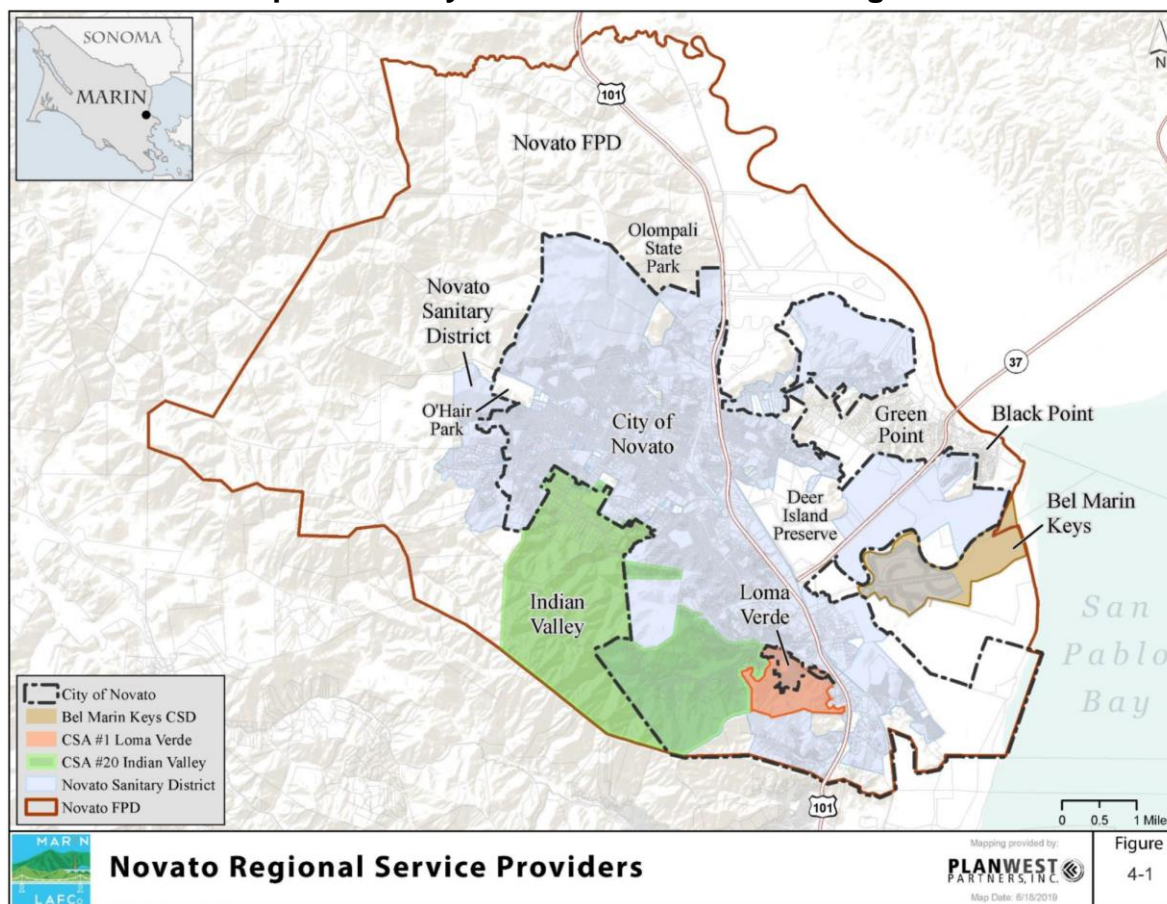
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<sup>1</sup> [www.census.gov/quickfacts/fact/table/novatocitycalifornia,CA/PST04022](https://www.census.gov/quickfacts/fact/table/novatocitycalifornia,CA/PST04022), Accessed on 4/23/23.

\$108,000, substantially lower than the \$131,000 for the County overall.<sup>2</sup> Over 63 percent of residences are owner-occupied.

Considered a desirable place to live, Novato offers outdoor recreational opportunities, a wide range of housing from affordable apartments to luxury estates and rural farms, and a wealth of community activities. Its Vintage Oaks shopping center includes major national retailers, car dealerships, and smaller local businesses. The greater Novato community includes unincorporated areas and special districts which overlay the city limits.

**Map 1. The City of Novato and Surrounding Areas**



Source: Marin LAFCo, Novato Municipal Services Review 2020, pg. 24.<sup>3</sup>

## Special Districts in the Novato Area

The map above from the Marin Local Agency Formation Commission's (LAFCo) 2020 Municipal Service Review of Novato, helps illustrate the complexity of factors that both complicate and compromise the governance of the City.<sup>4</sup> Novato's city limits are outlined in a dashed black line, and the lower left corner provides a key to the delineation of the six overlapping districts and areas within and around the City.

<sup>2</sup> [www.census.gov/quickfacts/marincountycalifornia](http://www.census.gov/quickfacts/marincountycalifornia), Accessed on 4/23/23.

<sup>3</sup> [www.marinlafco.org/files/ca1e33357/Novato+MSR+Final+Report.pdf](http://www.marinlafco.org/files/ca1e33357/Novato+MSR+Final+Report.pdf), Accessed on 4/2/23.

<sup>4</sup> [www.marinlafco.org/novato-region-municipal-service-review](http://www.marinlafco.org/novato-region-municipal-service-review), Accessed on 4/23/23.

This maze of boundaries and partially overlapping areas is primarily explained by Novato's history. Until the 1940s, the area was rural, including many farms. To provide local services, the citizens formed three independent special districts: the Novato Sanitary District (1925), the Novato Fire Protection District (1926), and the North Marin Water District (1948). When Novato was incorporated as a city in 1960, the city limits were established within preexisting special districts. These districts independently provide essential services but share none of their tax and service revenue with the City. While the districts depend on the City's infrastructure for some of their operations, they do not contribute directly to defray such costs. Novato is solely responsible for maintaining its streets and other infrastructure within the city limits. Likewise, residents living in Novato's unincorporated islands depend on City streets and access City amenities without contributing to their costs through property taxes. The LAFCo report summarizes this predicament: "... pockets of unincorporated territory that are surrounded or substantially surrounded by incorporated cities, typically known as "islands," create governance and service delivery inefficiencies and deficiencies."<sup>5</sup>

## **Novato's Financial Condition: A Long-Standing Concern**

This is not the first report about Novato's financial difficulties; there are many that precede it. For more than a decade, the City Manager's letter accompanying every approved City budget has expressed concerns about the City's long term fiscal sustainability (see Appendix A). The City's exhaustive and detailed 2014 Fiscal Sustainability Plan outlined Novato's inherent revenue limitations, projected long term deficits, and proposed solutions including an extension of the 0.5 percent sales tax increase.<sup>6</sup> Although the pandemic certainly exacerbated Novato's financial challenges, the pandemic is not solely responsible for its ongoing structural financial deficits. That responsibility rests primarily with the members of the Novato City Council.

The recent quadrennially required report from Marin LAFCo suggested that Novato "...look at other sources of long-term revenue to help offset these rising costs." Regarding the fiscal year 2019-2020 (FY20) budget, Marin LAFCo concluded: "The city will either need to reduce personnel costs to a level that would offset future expenditure increases and/or evaluate and implement multiple revenue growth strategies that will generate sufficient revenue to meet the future projected expenditure increases to the General Fund."<sup>7</sup>

## **Local Sales Tax Measures and Oversight**

The City Council has taken some steps to increase revenue. In 2010, Novato enacted Measure F, a 1/2 percent sales tax for a five-year period. In November 2015, Novato's City Council decided to renew the tax but lowered the rate to 1/4 percent, thereby halving the

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<sup>5</sup> [www.marinlafco.org/files/ca1e33357/Novato+MSR+Final+Report.pdf](http://www.marinlafco.org/files/ca1e33357/Novato+MSR+Final+Report.pdf), Accessed on 4/23/23.

<sup>6</sup> [www.novato.org/home/showpublisheddocument/13554/635774142357330000](http://www.novato.org/home/showpublisheddocument/13554/635774142357330000), Accessed on 4/23/23.

<sup>7</sup> [www.marinlafco.org/files/ca1e33357/Novato+MSR+Final+Report.pdf](http://www.marinlafco.org/files/ca1e33357/Novato+MSR+Final+Report.pdf), Accessed on 4/25/20.

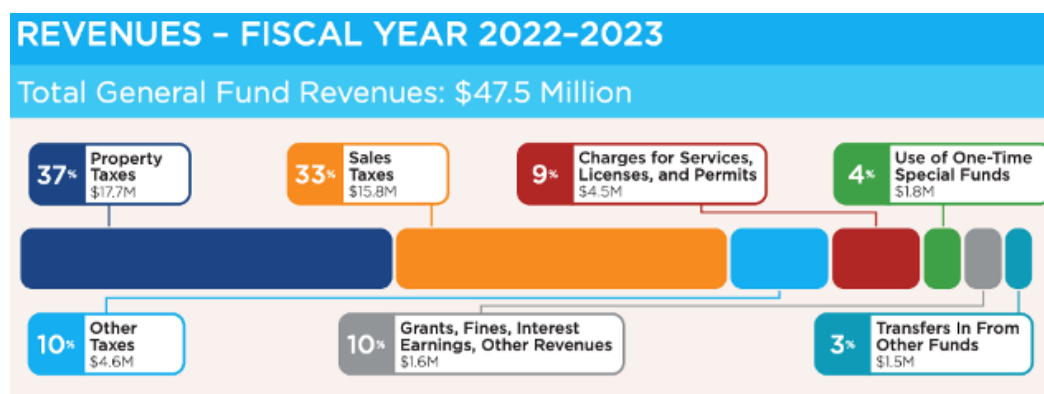
potential revenue. While the new measure, Measure C, does not have an expiration date, it does not generate enough revenue to balance the budget.

Measures F and C mandated that a Citizens Advisory Committee monitor the distribution of the local sales tax funds. Over time, the committee has been given additional duties and was renamed the Financial Advisory Committee. In October 2022, the Financial Advisory Committee was renamed the Finance Advisory Commission (the “Commission”). Currently, the mission of the Commission is to “...provide regular feedback, insight, recommendations, and report periodically to the City Council on a variety of financial matters such as financial policies, long-term fiscal sustainability, budgets, and forecast assumptions.”<sup>8</sup>

## Novato's Revenues

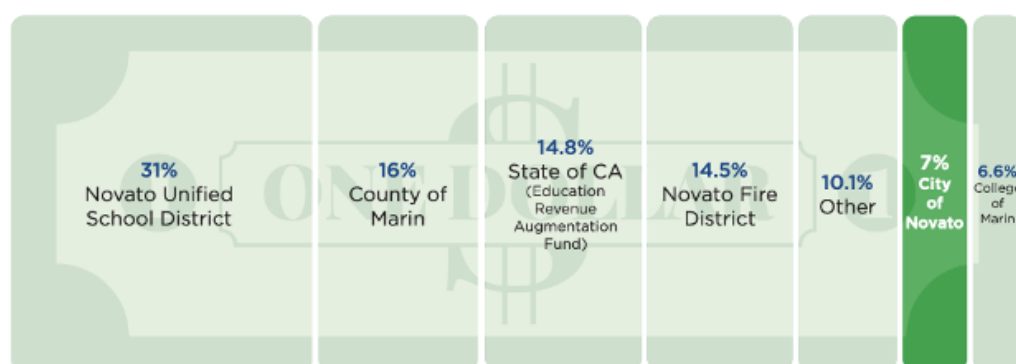
As shown in Figure 1, about 80 percent of Novato's revenue comes from taxes. Its property tax revenues are slightly greater than its sales tax revenues. Other taxes (such as the Transient Occupancy or “hotel” tax) and fees contribute a much smaller portion.

**Figure 1. Novato's Budgeted Revenue Sources – Fiscal Year 2022-2023**



### Distribution of Property Tax

How each dollar you pay is distributed.



Source: Adopted Annual Budget, Fiscal Year 2022-23<sup>9</sup>

<sup>8</sup> [www.novato.org/home/showpublisheddocument/35081/638036020674030000](http://www.novato.org/home/showpublisheddocument/35081/638036020674030000), Accessed on 4/23/23.

<sup>9</sup> [www.novato.org/home/showpublisheddocument/34983/638009945823400000](http://www.novato.org/home/showpublisheddocument/34983/638009945823400000), Accessed on 4/23/23.

## **Property Tax Constraints**

In the 1970's Novato was growing, and property tax revenues were increasing. During that period, the City Council significantly cut the City's property tax rate. In 1978, California voters passed Proposition 13 which locked in the assessment and distribution of property tax receipts.

Therefore, Novato receives just 7 percent of the basic property tax collected from its residents. This is one of the City's most severe impediments to its financial stability. Novato's share of the basic property tax is the lowest of any major municipality in Marin; San Rafael receives 12.2 percent; Larkspur, 21.7 percent; and Mill Valley, 25.8 percent. This limitation on property tax revenues forces the City to find other revenue to finance services comparable to those in other Marin communities. Figure 1 (bottom panel above) illustrates how Novato's property taxes are distributed to various entities. The Novato Fire District receives twice as much revenue as does the City, which maintains seven departments. The College of Marin, which serves about 9,000 students from throughout Marin, receives approximately the same amount as the City, which serves 53,000 people.

## **APPROACH**

To investigate Novato's financial condition, the Grand Jury reviewed both public and non-public records, the City's financial projections, the independently audited financial statements of the City and the opinions of its independent auditors, the City's investment policies, and all City budgets from 2011 to present. Selected City Council and Finance Advisory Commission agendas, minutes, and accompanying documentation were reviewed, as were video recordings of City Council and Finance Advisory Commission meetings. Comprehensive interviews were conducted with current and past City Council members and City staff, municipal government consultants, attorneys, and contractors. This report was completed in April 2023.

Although perhaps relevant for future consideration, this report does not discuss adjustments of base property tax distribution proportions, and consolidation or annexation of special districts or unincorporated areas.

## **DISCUSSION**

### **Novato's Ongoing Structural Financial Deficit**

Novato's approved budget for the fiscal year ending June 30, 2023 (FY23) anticipated expenditures of \$49.1 million with a deficit of \$1.6 million. The deficit has been termed by City officials as "structural," meaning that no revenue sources are projected to cover the shortfall. This is the third consecutive year of deficits for Novato.

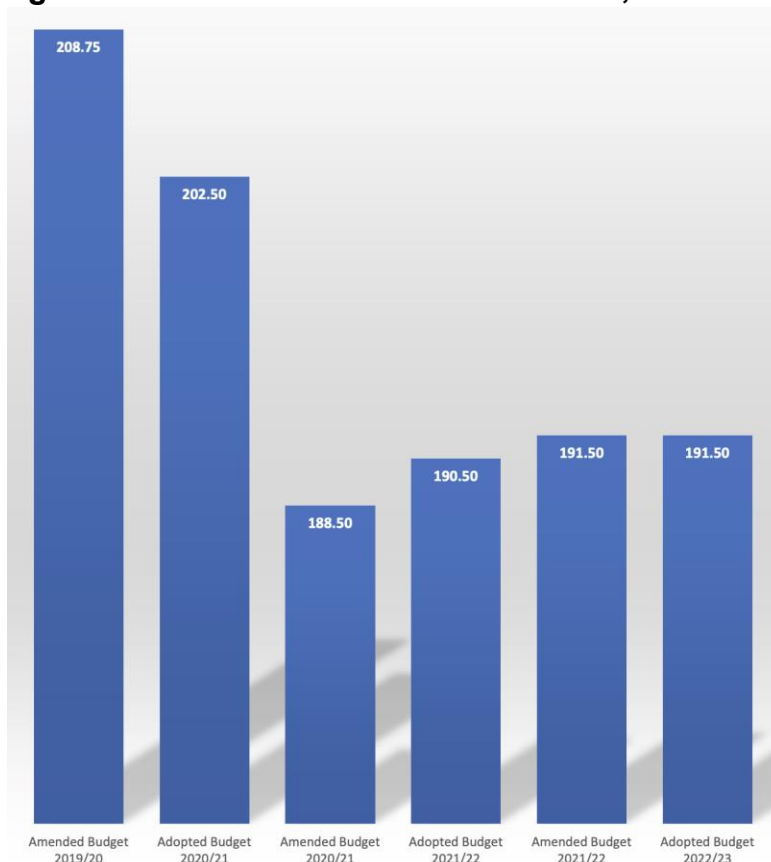
In his "State of the City" presentation on April 6, 2023, the Novato City Manager stated: 1) that the FY23 deficit had increased to \$1.9 million; 2) the structural deficit is likely to persist

for several years to come; and, 3) it is likely to grow.<sup>10</sup> Facing significant cuts in an already reduced employee base with consequential cuts in services, Novato's structural financial deficit must be addressed.

## Impact on Staff and the Community

The structural deficit has impacted City staff and the community. In 2008, the City had 231 employees. The City currently has 191.5 full-time equivalent positions filled, despite a larger population and increased demand for services.<sup>11</sup>

**Figure 2. Novato's Personnel Allocations, 2020-2023**



Numbers shown are full time equivalents.

Source: [www.novato.org/home/showpublisheddocument/34983/638009945823400000](http://www.novato.org/home/showpublisheddocument/34983/638009945823400000), page 60, Accessed on 4/23/23

One result of the ongoing budget deficits is that the City continues to experience difficulties with hiring and retention. Due to budget issues Novato has cut staffing so fewer people now carry the same or greater workload. With its budget constraints, Novato is unable to pay wages and benefits comparable to cities of similar size in the Bay Area. Several staff explained that turnover continues to be high. As a result of staff reductions and turnover,

<sup>10</sup>

[novato.granicus.com/player/clip/1912?view\\_id=7&meta\\_id=149823&redirect=true&h=1527c543b308e48b2346d72b045440c2](http://novato.granicus.com/player/clip/1912?view_id=7&meta_id=149823&redirect=true&h=1527c543b308e48b2346d72b045440c2), Accessed on 4/20/23.

<sup>11</sup> [www.novato.org/home/showpublisheddocument/34983/638009945823400000](http://www.novato.org/home/showpublisheddocument/34983/638009945823400000), page 60 Accessed on 4/18/23.

many City departments are staffed with recent hires who are unfamiliar with their jobs, institutional history, and city culture.

Employment expenses comprise approximately 70 percent of the City's budget, or approximately \$35 million. The City has begun negotiations with unions representing its employees and the resulting new contracts are expected to significantly increase the deficit. If the new contracts with the unions contain just a 3 percent increase in wages and benefits, that would add approximately \$1 million to the deficit each year, an increase of 47 percent on FY23's \$1.9 million deficit.

City staff and Council members noted that the reduction and turnover of employees has adversely affected the performance of City services. There have been delays in service requests, including the processing of various permits. The Public Works Department lacks sufficient staff to maintain some of the City's infrastructure, such as streets. The Pavement Conditions Index of Novato's total street network decreased from a "Fair" rating of 72 in 2017 to 66 in 2022. Currently, 38 percent of the network is in "Good" condition while more than one-tenth is in a "Poor" or "Failed" condition.<sup>12</sup>

## **Records Management System**

The City lacks comprehensive records management systems. One consequence is that the City is not aware of all the properties it owns or leases, or the agreements to which it is a party. A stark example is the City's December 2022 "emergency" purchase of corporation yard space that it had occupied, and believed it owned, for 30 years. The actual owner, Frontier Telecommunications Co., notified the City last August that it intended to sell the entire parcel as a whole, only one acre of which was being used for the corporation yard. Rather than lose a portion of its corporation yard, the City was effectively forced to buy the entire parcel for \$5.9 million. Novato made the purchase by borrowing \$4.9 million from its vehicle fleet fund, \$500,000 from its general fund, and \$400,000 from Measure F sales tax funds.<sup>13</sup>

Comprehensive records management systems are essential to the operation of any city. Such systems provide accessible and accurate records of its financial transactions, assets, liabilities, leases, and other financial and legal documents. The City has taken a first step by procuring a new records system for the City Clerk's office.

## **Financial Staffing, Controls, and Oversight**

The City's inadequate financial controls are reflected by the substantial delays in producing audited financial statements for FY20, FY21, and FY22. Attrition in 2019 in the Finance Department left only two employees. While understaffed, the Finance Department was

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<sup>12</sup> [www.novato.org/home/showpublisheddocument/35660/638182063363963415](http://www.novato.org/home/showpublisheddocument/35660/638182063363963415), Accessed on 4/27/23.

<sup>13</sup> [www.marinij.com/2022/12/09/novato-closes-5-8m-land-purchase-to-retain-corporation-yard/](http://www.marinij.com/2022/12/09/novato-closes-5-8m-land-purchase-to-retain-corporation-yard/), Accessed on 4/9/23.

unable to maintain accurate, timely, and complete records, which in turn led to inadequate financial controls, incomplete records, and a loss of financial accountability.

A consequence of the inadequate record keeping meant that conducting the City's required annual independent financial audit would be much more complicated and delayed because of lost or misplaced records, and staff's faded memories of transactions. For over a year, the standard practice of monthly reconciliations was not performed. Hence, a reconstruction of transactions would take much more time. For example:

- For the fiscal year ending June 30, 2018 (FY18), the City Manager was unable to present to the City Council the City's Comprehensive Annual Financial Report (CAFR) by the City's independent financial auditors (Auditors), for the fiscal year ending June 30, 2018, until April 30, 2019, a full ten months after that fiscal year ended.<sup>14</sup>
- For the next fiscal year ending June 30, 2019 (FY19), the CAFR from the Auditors was not presented to the City Council until February 1, 2021, nineteen months after that fiscal year ended.<sup>15</sup> The Auditor's FY19 Management Letter (a separate and required letter from an auditor to the audited entity) alerted the City Council that the Auditors "...became aware of deficiencies in internal control other than significant deficiencies and material weaknesses and matters that are opportunities for strengthening internal controls and operating efficiency."<sup>16</sup>
- For the next fiscal year ending June 30, 2020 (FY20), the CAFR was not presented to the City Council until February 21, 2023, thirty-one months after that fiscal year ended.<sup>17</sup> The FY20 Management Letter from the Auditor contains the same quote as the previous year's Management Letter.<sup>18</sup> A separate letter by the Auditor to the City Council dated February 21, 2023, noted that "The completion of the audit was delayed due to personnel turnover and the fact that processes utilized for closing and financial reporting of financial activity for the fiscal year were not effective. In addition, management informed the auditors that there was a significant breakdown of internal controls through most of the fiscal year due to the turnover."<sup>19</sup> Fiscal 2020 is the most recent fiscal year of completed financial audits of the City.

It should be noted that all the foregoing CAFRs were "clean," meaning that they were materially accurate in all respects. However, that does not change the fact that they were all significantly late. The Finance Department is under new leadership and has been actively recruiting staff with municipal finance experience, but it continues to have difficulties

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<sup>14</sup> [www.novato.org/home/showpublisheddocument/29024/636966290655170000](http://www.novato.org/home/showpublisheddocument/29024/636966290655170000), Accessed on 4/7/23.

<sup>15</sup> [www.novato.org/home/showpublisheddocument/32151/637491744047800000](http://www.novato.org/home/showpublisheddocument/32151/637491744047800000), Accessed on 4/7/23.

<sup>16</sup> [legistarweb-production.s3.amazonaws.com/uploads/attachment/pdf/818769/Attachment\\_3\\_-\\_Management\\_Letter.pdf](https://legistarweb-production.s3.amazonaws.com/uploads/attachment/pdf/818769/Attachment_3_-_Management_Letter.pdf), Accessed on 4/7/23.

<sup>17</sup> [www.novato.org/home/showpublisheddocument/35449/638127587521587818](http://www.novato.org/home/showpublisheddocument/35449/638127587521587818), Accessed on 4/7/23.

<sup>18</sup> [legistarweb-production.s3.amazonaws.com/uploads/attachment/pdf/1808367/Attachment\\_3\\_-\\_Management\\_Letter\\_-\\_2020.pdf](https://legistarweb-production.s3.amazonaws.com/uploads/attachment/pdf/1808367/Attachment_3_-_Management_Letter_-_2020.pdf), Accessed on 4/7/23.

<sup>19</sup> [legistarweb-production.s3.amazonaws.com/uploads/attachment/pdf/1808367/Attachment\\_3\\_-\\_Management\\_Letter\\_-\\_2020.pdf](https://legistarweb-production.s3.amazonaws.com/uploads/attachment/pdf/1808367/Attachment_3_-_Management_Letter_-_2020.pdf), Accessed on 4/9/23.



locating qualified personnel. Despite new staff and a huge backlog, the Finance Department has been slowly catching up.

The Auditor's FY21 field work (their onsite examination of financial records at the Finance Department) is scheduled for two weeks in the second half of August 2023, with the goal of delivering FY21's CAFR before December 31, 2023. The schedule for the field work on the audits for FY22 and FY23 has not yet been determined, but the stated goal for those completed audits is summer 2024 and early 2025, respectively. One consequence of the delayed annual audits is that the City is technically not in compliance with various covenants with its lenders and debt instruments. It should be noted that the timing of completion of the audits is not completely under the Finance Department's control, as there is a well-known national shortage of accountants and auditing firms are heavily booked.

These events and delays over multiple years should have been largely foreseeable and preventable with proper oversight provided, and operational discipline imposed, by the City Council. A common solution used by governments and private enterprises alike is an internal audit group (not the same as, and distinct from, outside independent auditors), charged with acting as "watchdogs" over the financial and other operations of the organization to make sure that processes are being done correctly and on time.

## **Finance Advisory Commission**

As discussed in Background, the Finance Advisory Commission (Commission) is an outgrowth of the citizen oversight mandated by Measures C and F, which enacted the local sales tax. The current mission of the Commission is "...to provide regular feedback, insight and recommendations and report periodically to the City Council on a variety of financial matters such as financial policies, long-term fiscal sustainability, budget and forecast assumptions."<sup>20</sup> The Commission also continues to act as the official citizens oversight committee as required by Measures C and F.<sup>21</sup> However, the Commission does not routinely participate in City Council meetings.

In 2022, the Commission consisted of seven voting members, who met monthly, and generated minutes for each meeting. The Commission included members with a spectrum of financial expertise such as a certified public accountant, a vice president and marketing manager with a regional bank, and university director of finance and business services. The Commission has not generated a report since the Fiscal 2017-2018 Annual Report.

In the fall of 2022, the Commission analyzed and voted on two financial proposals that the City was considering. These proposals and the votes of the Commission are notable because the City Council chose *not* to follow the Commission's recommendations. These proposals

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<sup>20</sup> [www.novato.org/home/showpublisheddocument/35081/638036020674030000](http://www.novato.org/home/showpublisheddocument/35081/638036020674030000), Accessed on 4/9/23.

<sup>21</sup> [www.novato.org/government/commissions-committees-boards/novato-citizens-finance-advisory-oversight-committee](http://www.novato.org/government/commissions-committees-boards/novato-citizens-finance-advisory-oversight-committee), Accessed on 4/9/23.

involved loans totaling \$5 million to the North Bay Children's Center and to Homeward Bound:

1. On October 20, 2022, the seven Commission members voted unanimously that the City Council reject the loan proposal.<sup>22</sup> However, on October 25, 2022, the Novato City Council voted 3-2 to enter into the loan agreement with the North Bay Children's Center.<sup>23</sup>
2. On November 17, 2022, the seven Commission members voted unanimously to recommend that the City Council reject the loan proposal.<sup>24</sup> However, on December 6, 2022 the Novato City Council voted 3-2 to enter into the loan agreement with the Homeward Bound Veterans Project.<sup>25</sup>

Details on the loans and the Commission's deliberations can be found in Appendix B.

Given the ongoing financial deficit facing the City, the Commission's oversight and advisory role is particularly important. Based upon these two examples, and interviews conducted by the Grand Jury, it is evident that the Commission's opinion doesn't carry sufficient weight with the City Council.

## **City Properties**

Illustrative of the City's inadequate record keeping, no one in the City was able to provide a current and comprehensive list of City-owned properties. However, it is clear that Novato owns a substantial amount of property, including 50 acres of parks and an additional 300 acres of open space. Its developed property includes buildings occupied by the City, facilities leased or rented by others, and vacant structures. It appears that of an estimated 40 buildings, at least one-third are vacant or otherwise not in active use.

Available property information and interviews of City staff and elected officials led the Grand Jury to conclude that Novato's portfolio of properties is not being optimally managed. There are clear needs to decrease wasteful spending and resolve liabilities related to old and long-vacant structures. Selected properties could be sold to generate sufficient funds so that other properties could be transformed into revenue sources. For example, surplus Hamilton properties have been sold in recent years. Most recently, the City arranged for the purchase and redevelopment of the Bachelor Officers' Quarters and Old Hamilton Gym.<sup>26</sup> In contrast, the Lieb Property, 10-acres obtained in 2016 for \$1.56 million, cannot be sold until October 2026 due to a restrictive purchase agreement.<sup>27</sup>

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<sup>22</sup> [www.novato.org/home/showpublisheddocument/35127/638047168631030000](http://www.novato.org/home/showpublisheddocument/35127/638047168631030000), Accessed on 4/20/23.

<sup>23</sup> [novato.granicus.com/DocumentViewer.php?file=novato\\_2b6df3b448a6a08915d0611c39e18d6d.pdf](http://novato.granicus.com/DocumentViewer.php?file=novato_2b6df3b448a6a08915d0611c39e18d6d.pdf), Accessed on 4/20/23.

<sup>24</sup> [www.novato.org/home/showpublisheddocument/35328/638097302454530000](http://www.novato.org/home/showpublisheddocument/35328/638097302454530000), Accessed on 4/20/23.

<sup>25</sup> [novato.granicus.com/DocumentViewer.php?file=novato\\_156822645aee0ef9700f93324b5951cb.pdf](http://novato.granicus.com/DocumentViewer.php?file=novato_156822645aee0ef9700f93324b5951cb.pdf), Accessed on 4/20/23.

<sup>26</sup> [novato.granicus.com/MinutesViewer.php?view\\_id=7&clip\\_id=1740](http://novato.granicus.com/MinutesViewer.php?view_id=7&clip_id=1740), Accessed on 4/20/23.

<sup>27</sup> [www.novato.org/Home/ShowDocument?id=19231](http://www.novato.org/Home/ShowDocument?id=19231), Accessed on 4/24/23

## Marin Valley Mobile Country Club

Since 1997, Novato's properties have included the Marin Valley Mobile Country Club (MVMCC), a 55-plus senior community of 315 manufactured homes situated on a secluded 63 acres south of Hamilton Field. MVMCC's website describes the park as providing affordable housing "...in a self-sustaining community that operates with no financial support from local, county, state, or federal funds."<sup>28</sup> However, City financial documents and a staff report presented to the City Council on March 28, 2023, show that the park is neither self-sustaining nor independent of local government funds.<sup>29</sup> Both the Grand Jury's investigation and the staff report conclude that unless action is taken by the City Council, 1) operating and other essential expenditures will continue to exceed revenues at MVMCC, and 2) reserve funds designated for MVMCC will be exhausted within five years, leaving the City's taxpayers to cover the deficits.

Many factors, including insufficient oversight and delayed actions by the City, have contributed to this situation. The financial impact is demonstrated at many levels by multiple sources.

- Novato's 2022-2023 Adopted Budget shows that in the past four fiscal years MVMCC's expenses have exceeded revenues by a total of more than \$3.6 million.<sup>30</sup> An independent analysis indicated that MVMCC operated at a loss with annual capital expenditures significantly impacting the extent of the deficit in those four years.<sup>31</sup>
- Over \$200,000 per year (about \$662 per residence) of utility costs are not fully recovered through pass-through charges to residents, leaving the balance to be paid by the City.<sup>32</sup>
- Since 1997, the City has relinquished the bulk of oversight and decision-making to the Park Acquisition Corporation (PAC), which is essentially the MVMCC homeowners' association. A Delegation Agreement assigns the PAC responsibilities, such as hiring of a park management company, preparing annual budgets, accumulating funds for long term maintenance, and submitting financial reports to the City.<sup>33</sup> The City Council consistently defers to the PAC regarding rental increases.
- The City intended MVMCC to be financially self-sufficient with revenues coming entirely from tenants' pad rental fees. Yet at PAC's request, the City Council has not raised rental fees since 2016, freezing rental income despite increasing park expenditures.<sup>34</sup>

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<sup>28</sup> [marinvalley.net/marin-valley/about/](http://marinvalley.net/marin-valley/about/), Accessed on 4/20/23.

<sup>29</sup> [novato.granicus.com/MetaViewer.php?view\\_id=7&clip\\_id=1908&meta\\_id=149692](http://novato.granicus.com/MetaViewer.php?view_id=7&clip_id=1908&meta_id=149692), Accessed on 4/20/23

<sup>30</sup> [www.novato.org/home/showpublisheddocument/34983/638009945823400000](http://www.novato.org/home/showpublisheddocument/34983/638009945823400000), page 131, Accessed on 4/20/23.

<sup>31</sup> [novato.granicus.com/MetaViewer.php?view\\_id=7&clip\\_id=1908&meta\\_id=149692](http://novato.granicus.com/MetaViewer.php?view_id=7&clip_id=1908&meta_id=149692), Accessed on 4/20/23.

<sup>32</sup> [novato.granicus.com/MetaViewer.php?view\\_id=7&clip\\_id=1908&meta\\_id=149692](http://novato.granicus.com/MetaViewer.php?view_id=7&clip_id=1908&meta_id=149692), Accessed on 4/20/23.

<sup>33</sup> [novato.granicus.com/MetaViewer.php?view\\_id=7&clip\\_id=1908&meta\\_id=149692](http://novato.granicus.com/MetaViewer.php?view_id=7&clip_id=1908&meta_id=149692), Accessed on 4/20/23.

<sup>34</sup> [novato.granicus.com/MetaViewer.php?view\\_id=7&clip\\_id=1908&meta\\_id=149692](http://novato.granicus.com/MetaViewer.php?view_id=7&clip_id=1908&meta_id=149692), Accessed on 4/20/23.

- In March 2022, the City Council again assisted MVMCC by appropriating \$3 million of the City's one-time funds from the American Rescue Plan Act (ARPA) for the MVMCC sewer system improvement projects. This was one third of the \$9.1 million ARPA funds allocated to the entire City of Novato.<sup>35</sup>
- While MVMCC is described as “affordable housing,” just 41 percent (131) of rented spaces are required to be occupied by low- or moderate-income residents. Current monthly rates average \$634, range from \$518 to \$937, and do not vary by tenant income level.<sup>36</sup> Thus, all park residents benefit from the City Council's decisions to maintain low rental fees and subsidize costs.
- In a recent three-year period (2020-2022), 28 MVMCC homes were sold for prices ranging from \$110,000 to \$717,000 with a median of \$347,000.<sup>37</sup>

Even if enacted immediately, incremental rental fee increases that meet rent control requirements cannot provide the revenue needed by MVMCC's projected financial needs.<sup>38</sup> It is simply too little, too late. However, as the staff report notes, larger rent adjustments are allowable to 1) pass through the cost of necessary capital improvements, or 2) ensure the City receives “a fair and reasonable rate of return.”<sup>39</sup> Such adjustments may be essential in this situation.

The City's current debt service payment for MVMCC is about \$651,000 a year and the loan balance of \$2.3 million is scheduled to be paid in full in December 2026.<sup>40</sup> The City's most recent (2023-2031) Housing Element Update states that Novato will “Consider measures such as refinancing the Marin Valley Mobile Country Club to further save money and to permit the financing of future needed capital improvements to the park.”<sup>41</sup> This, in concert with corresponding rent increases, is a logical option to examine.

In response to the recent staff report regarding the park's financial sustainability, the City Council approved a workshop study session between City staff and MVMCC residents. Staff and Council members shared with the Grand Jury a broad spectrum of possibilities to address MVMCC's financial condition, including investigating whether the property might be sold. Regardless of what solutions are considered, Novato is not in a financial position to take on more deficits. Delays in rectifying MVMCC's financial instability are not in the best interest of the City or MVMCC residents.

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<sup>35</sup> [legistarweb-production.s3.amazonaws.com/uploads/attachment/pdf/1273501/G.8\\_cc22-052\\_MVMCC\\_Pump\\_Station.pdf](https://legistarweb-production.s3.amazonaws.com/uploads/attachment/pdf/1273501/G.8_cc22-052_MVMCC_Pump_Station.pdf), Accessed on 4/20/23.

<sup>36</sup> [novato.granicus.com/Viewer.php?view\\_id=7&clip\\_id=1908&meta\\_id=149693](https://novato.granicus.com/Viewer.php?view_id=7&clip_id=1908&meta_id=149693), Accessed on 4/20/23.

<sup>37</sup> [www.zillow.com/novato-ca/sold/](https://www.zillow.com/novato-ca/sold/), Accessed on 4/20/23.

<sup>38</sup> [novato.granicus.com/Viewer.php?view\\_id=7&clip\\_id=1908&meta\\_id=149692](https://novato.granicus.com/Viewer.php?view_id=7&clip_id=1908&meta_id=149692), Accessed on 4/20/23.

<sup>39</sup> [novato.granicus.com/Viewer.php?view\\_id=7&clip\\_id=1908&meta\\_id=149692](https://novato.granicus.com/Viewer.php?view_id=7&clip_id=1908&meta_id=149692), Accessed on 4/20/23.

<sup>40</sup> [novato.granicus.com/Viewer.php?view\\_id=7&clip\\_id=1908&meta\\_id=149692](https://novato.granicus.com/Viewer.php?view_id=7&clip_id=1908&meta_id=149692), Accessed on 4/20/23.

<sup>41</sup> [www.novato.org/home/showdocument?id=35310&t=638095538412570000](https://www.novato.org/home/showdocument?id=35310&t=638095538412570000), Accessed on 4/20/23.

## Sales Tax

An increase in Novato's local sales tax would provide significant additional revenue for the City's general fund. After Proposition 13 restricted property tax growth, local governments sought additional revenue sources. Governments shifted costs from their general funds with no restrictions on their use to special funds that would pay for linked services. For example, cities began to require payments for documents sought from police departments, levied higher fees for building and other permits, and demanded payments for tree removal. A major source of post-Proposition 13 revenue, however, remains a locally determined sales tax. Property tax collections have been the most dependable source of local government revenue because property values have grown over the past several decades producing a steady, reliable revenue source, though property taxes fluctuate as population and mortgage interest rates change over time. Many cities turned to a local sales tax to increase revenue. Some Marin County cities have raised their local sales tax rates substantially, but Novato has not. Its 8.5 percent sales tax is the second lowest among cities in Marin, as shown in Table 1.

**Table 1: Sales Tax Rates**

	<u>Tax Rate</u>
Greenbrae, San Anselmo, San Rafael	9.25%
Corte Madera, Fairfax, Larkspur, Mill Valley	9.00%
Ross, Sausalito	8.75%
Novato	8.50%
Belvedere/Tiburon	8.25%

Source: <https://www.sales-taxes.com/ca/marin-county>, Accessed on 4/2/23.

As discussed above in Background, in 2010 Novato's Measure F implemented a local sales tax of 0.50 percent for a period of five years. While in effect, it generated an average of \$4.7 million annually. Measure C extended the local sales tax indefinitely but lowered the tax rate to 0.25 percent in 2016. That tax generated approximately \$2.5 million annually through FY19. Since then, the economy has grown and sales tax revenues have increased.

**Table 2. Novato Measure C Sales Tax Revenues**

\$ Millions					
FY18	FY19	FY20	FY21	FY22	FY23
\$2.62	\$2.65	\$2.70	\$2.64	\$3.10	\$3.31

Source: FY23 Budget<sup>42</sup>

Table 2 shows that Measure C's ongoing revenues have substantially increased in recent years. However, the revenue is insufficient to eliminate the City's ongoing and increasing financial deficit. Of note, a substantial portion of sales taxes come from non-Novato residents making purchases in Novato. Based on the above data, for every 1/4 percentage point

<sup>42</sup> [www.novato.org/home/showpublisheddocument/34983/638009945823400000](http://www.novato.org/home/showpublisheddocument/34983/638009945823400000) Page 39, Accessed on 4/20/23.

increase in local sales tax Novato would, assuming taxable sales remain relatively constant, gain over \$3 million annually.

If Novato's sales tax rate was raised an additional 3/4 of a percentage point to equal that of San Rafael's 9.25 percent rate, the incremental increase in revenue would be approximately \$10 million annually. This would more than cover the City's present annual structural deficit and anticipated future deficits.

## **FINDINGS**

- F1. The City of Novato is facing an ongoing structural financial deficit.
- F2. The City Council has not adequately pursued options for ongoing sources of revenue, including increasing its local sales tax.
- F3. The City's financial deficits have resulted in reductions in City staff, and difficulties in hiring and retaining employees.
- F4. The City's financial deficits have resulted in a reduction of City services.
- F5. The City's financial deficit will significantly increase once new labor contracts go into effect.
- F6. The City's Finance Department's inadequate staffing resulted in insufficient financial controls, incomplete records, and a loss of financial accountability.
- F7. The City lacks comprehensive and functional records management systems.
- F8. The City lacks a plan to optimize revenue from its existing properties, including the sale of City owned properties. The City owns many properties that are vacant or in disrepair, and others where ongoing expenses exceed income.
- F9. The City has not provided sufficient financial and operational oversight of the Marin Valley Mobile Country Club. The property operates at a substantial deficit, has ongoing deferred maintenance, and presents increasing administrative and financial burdens on the City.
- F10. The City's Finance Advisory Commission has the responsibility, but lacks the authority, to effectively oversee the City's financial condition and operations.

## RECOMMENDATIONS

- R1. By December 31, 2023, design and begin implementation of a plan to address Novato's ongoing structural financial deficit. This plan should include resources, staff, and systems necessary to institute strong financial controls to improve its financial condition and to enable timely independent financial audits.
- R2. By December 31, 2023, the City Council, in consultation with the Finance Advisory Commission, should consider creating and funding a new position of an independent internal auditor with the authority to investigate and report on City operations.
- R3. By December 31, 2023, require the Finance Advisory Commission to issue quarterly financial reports on the City's financial condition and require that the reports be discussed at City Council meetings.
- R4. By December 31, 2023, develop a schedule to install and maintain comprehensive records management systems for all City operations by June 30, 2025.
- R5. By October 1, 2023, begin strategic planning to increase the City's sales tax.
- R6. By December 31, 2023, initiate a comprehensive inventory and review of the City's entire portfolio of properties to identify opportunities for more cost-effective use of each holding. The assessment, including recommendations and timelines for implementation, should be completed no later than May 1, 2024.
- R7. By December 31, 2023, implement a plan to address the operational and financial condition of the MVMCC, including an evaluation of options for rent increases.

## REQUIRED RESPONSES

The following responses are required, pursuant to Penal Code sections 933 and 933.05:

From the following governing body within 90 days:

- The City of Novato (F1-F10, R1-R7)

Note: At the time this report was prepared information was available at the websites listed.

Reports issued by the Civil Grand Jury do not identify individuals interviewed. Penal Code Section 929 requires that reports of the Grand Jury not contain the name of any person or facts leading to the identity of any person who provides information to the Civil Grand Jury. The California State Legislature has stated that it intends the provisions of Penal Code Section 929 prohibiting disclosure of witness identities to encourage full candor in testimony in Grand Jury investigations by protecting the privacy and confidentiality of those who participate in any Civil Grand Jury investigation.



## **APPENDIX A**

### **A History of Fiscal Warnings**

Below are quotes extracted from City Manager comments in the adopted City budgets for the past 12 years. Of note, the term “structural deficit” was used as early as 2011. The approved budget documents may be found on the Novato website.<sup>43</sup>

2011-12: “... the City faces significant financial challenges as the underlying structural problem continues to worsen.”

2012-13: “Our financial forecasts project ongoing structural deficits in the coming years.”

2013-14: “... determine a plan to find long term fiscal sustainability.”

2014-15: “... after years of budget cuts, belt tightening, layoffs, furloughs, and economic malaise, the City Council adopted a Fiscal Sustainability Plan in February 2014 to chart a sustainable path for Novato’s future.”

2015-16: “[This is] the budget year in which we’ve committed to achieving new ongoing revenue by November 2015.”

2016-17: “... an acknowledgement that the ¼ cent Measure C tax is less than the adopted Fiscal Sustainability Plan’s assumption.”

2017-18: “The City’s Fiscal Sustainability Plan has committed to approximately \$1 million in annual funding required to properly maintain city buildings and infrastructure, and this proposed budget reflects that contribution. Unfortunately, based on current revenues, this investment from the General Fund is not sustainable in the long run.”

2018-19 and 2019-20: “The increased demand for services coupled with mandatory operational increase will require our organization to begin developing strategies for revenue generation and new fiscal sustainability policies and strategies over the next three to five years that allow the Council to develop fiscal policies to address future cost increases and demand for more services.”

2020-21 and 2021-22: “Even prior to the pandemic, the City Council was working toward ensuring future fiscal sustainability, including identifying ways to generate revenue to support critical services.”

2022-23: “FY 2022/23 represents the third consecutive year a deficit has been projected.”

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<sup>43</sup> [www.novato.org/government/finance/city-budget](http://www.novato.org/government/finance/city-budget), Accessed on 4/25/23.

## **APPENDIX B**

### **Financial Advisory Commission (Commission)**

#### **North Bay Children's Center Loan**

In October 2022, the North Bay Children's Center requested a loan from the City for improvements on the Center's Novato campus: \$2 million principal, plus \$55,000 for processing costs. The proposed interest was 2.5 percent, payable over 30 years. This loan would be funded through the Novato Public Finance Authority (NPFA), originating through the Hamilton Trust as a lease/leaseback.

Commission members provided feedback to staff and the City Council, advising of their concerns with the details of the loan. Some of the concerns members noted:

- This would set precedent for other non-profits to request funding.
- There are no criteria to identify who can/should qualify for funds.
- There is concern regarding the financial viability of the organization and the ability to pay and it is not clear where the balance of the project funding will come from.
- The terms of the loan (30-year term/loan rate) are not consistent with other construction loans and many construction projects fail.
- The terms of the loan are much more favorable than would be received through a commercial bank. Funding should only be disbursed as project milestones are completed.
- North Bay Children's Center is debt free; they should be leveraging for a loan instead.

On October 20, 2022 the Commission of seven voted unanimously to recommend that the City Council reject the Hamilton Trust Loan Proposal.<sup>44</sup> However, on October 25, 2022, the Novato City Council voted 3-2 to enter into the loan agreement with the North Bay Children's Center.<sup>45</sup>

#### **Homeward Bound Veterans Project Loan**

One month later the Commission evaluated a bridge loan for the Homeward Bound Veterans Project, a 30-month loan to cover Phase I construction costs of a 24-unit, veterans housing apartment complex. Upon completion and certificate of occupancy, Homeward Bound would receive money from the State Veterans Housing and Homeless Prevention Program (VHHP), which will be paid to the City as reimbursement of the loan. The projected completion of this

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<sup>44</sup> [www.novato.org/home/showpublisheddocument/35127/638047168631030000](http://www.novato.org/home/showpublisheddocument/35127/638047168631030000). Accessed on 4/20/23.

<sup>45</sup> [novato.granicus.com/DocumentViewer.php?file=novato\\_2b6df3b448a6a08915d0611c39e18d6d.pdf](http://novato.granicus.com/DocumentViewer.php?file=novato_2b6df3b448a6a08915d0611c39e18d6d.pdf), Accessed on 4/20/23.

phase of construction was October 2024. The loan is scheduled to fund in June 2025, with the terms of the loan extending to September of 2025. Homeward Bound was requesting a loan amount of \$3,000,000 at an interest rate of 2.5 percent. The money for this loan will be funded from the City's Emergency Disaster Relief Fund; these monies are currently being held in the Local Agency Investment Fund (LAIF). LAIF's rate at this point is about 1.7 percent and it is unknown if it will exceed the 2.5 percent rate of return for this loan in the next 30-month period.

Commission members noted their concerns with the City issuing loans. As a future agenda item, Commission members suggested that Staff add the discussion of the City's policies and procedures surrounding loan proposals and use of Hamilton Trust for loans.

On November 17, 2022 the Commission voted unanimously to recommend that the City Council reject the Homeward Bound Veterans Project Bridge Loan.<sup>46</sup> However, on December 6, 2022 the Novato City Council voted 3-2 to enter into the loan agreement with the Homeward Bound Veterans Project.<sup>47</sup>

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<sup>46</sup> [www.novato.org/home/showpublisheddocument/35328/638097302454530000](http://www.novato.org/home/showpublisheddocument/35328/638097302454530000), Accessed on 4/20/23.

<sup>47</sup> [novato.granicus.com/DocumentViewer.php?file=novato\\_156822645aee0ef9700f93324b5951cb.pdf](http://novato.granicus.com/DocumentViewer.php?file=novato_156822645aee0ef9700f93324b5951cb.pdf), Accessed on 4/20/23.