

May 29, 2019

Mr. Mayor and City Council,

As part of our annual efforts, the Budget Advisory and Financial Planning Committee (the "Committee") has completed a brief review of the most recent projections as prepared by Michael Szczech and his staff under the guidance of Paul Benoit.

The City's understanding of its financial position is better than it has ever been. The presentation from Finance Director Szczech was very thorough - dealing with projected pension costs in detail, OPEB funding, equipment replacement, and a more complete look at facilities maintenance. Overall, we believe the assumptions used, and the results presented, to be reasonable and consistent with past practices, which has proven to be appropriately conservative. As in prior years, the projections show that the long-term financial health of the City is dependent on the Municipal Services Parcel Tax ("MSPT") and the Committee recommends continuing the MSPT for the next fiscal year at the current rate and applying the normal annual CPI adjustment amount.

As you know, the Committee feels the objective of long term financial planning for the City is to take steps to ensure that current services are being paid for in the current year, to the extent possible, and that funds for known future requirements (retirement commitments and facilities/road maintenance) are set aside on a current basis. Although it has been recent practice, due to revenue limitations and not fully quantified liabilities, to underfund certain longer term liabilities such as pension costs, Other Post Employment Benefits ("OPEB") and the Facilities Maintenance Fund, the City is taking steps to plan for and set aside additional funds to begin to address many of these underfunded liabilities. These steps were detailed in last year's letter and the City continues to do an excellent job planning for and controlling future costs. It is truly remarkable to compare where we are today to where we were back in 2011.

As positive as the situation looks, the Committee reminds the Council of several things:

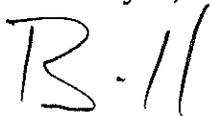
- The long term financial projections seek to maintain an 18% General Fund balance (which the Committee thinks is prudent) but adjusts (reduces) transfers to the Facilities Maintenance Fund as needed to maintain that General Fund balance. The result is inadequate funding of

the Facilities Maintenance Fund over the term which severely affects repair and replacement expenditures in the later years. This underfunding is not sustainable, and attention should be given to taking steps to increase funding.

- Although much progress has been made, there is still work to do on a long-term facilities maintenance plan (including streets, sidewalks, and parks), and until the associated long-term costs are better understood, the City will be challenged in prioritizing facility capital repair/ replacement projects. We continue to believe this to be a very high priority. The City will always have more needs and wants than funds and an agreed upon capital plan will allow the Council to prioritize its needs and better utilize its scarce resources.
- The prior funding of the PARS Fund will provide the City much needed flexibility in managing future pension cost increases, however, there is more risk to the stock market and a significant decline in values during the withdrawal years will adversely affect this flexibility.
- The current economic recovery – especially as it impacts Bay Area housing prices – is quite extended, and it is important to continue with conservative property tax and transfer tax assumptions.

The Committee appreciates the opportunity to serve the City and is especially appreciative of the work of the Finance Director in providing such a complete and thorough long term financial plan. Please let us know if you have any questions or would like any additional analysis.

Thank you,



Bill Hosler

Chair of the Budget Advisory and Financial Planning Committee