

May 28, 2020

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 revised fiscal year 20/21 budget and projections as prepared by Michael Szczech and his staff under the guidance of City Administrator Sara Lillevand and as presented to the Committee on May 21, 2020.

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 potential revenue risks, projected pension costs in detail, OPEB funding, equipment replacement, and facilities maintenance. Overall, we believe the assumptions used, and the results presented, to be reasonable and consistent with past practices, which have proven to be appropriately conservative.

The Covid-19 virus and resulting pandemic are creating significant economic uncertainty around some elements of the City's revenues, such as transfer taxes, Recreation Department activities and property rentals, and expenses. The budget is appropriately conservative and reflects the Finance Director's best estimates for these items, but the situation is fluid and will require constant monitoring throughout the year.

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 its renewal in March substantially increases the stability of the City's revenue in the near future. 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 believes 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 previous 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 has taken steps in prior years to plan for and set aside additional funds to begin to address many of these underfunded liabilities. The City



continues to do an excellent job planning for and controlling future costs and it is truly remarkable to compare where we are today to where we were back in 2011.

After reviewing the current projections, however, the Committee concludes that the City lacks sufficient resources to maintain the City's infrastructure, including facilities, streets, and sidewalks for the duration of the long term projections. Therefore, the Committee encourages the Council to develop additional revenue sources to ensure adequate funding of the Facilities Maintenance Fund and other infrastructure areas. In addition, as has been discussed at the Council in the past, several of the City's facilities require replacement or significant upgrading to meet current standards and to improve efficiency. Consequently, the Council should also investigate other sources of funds, such as the issuance of bonds, to fund these necessary investments since it is not possible to fund costs of this magnitude through expense reductions.

In reviewing the City's long term projections and considering the current economic situation, the Committee reminds the Council of several things:

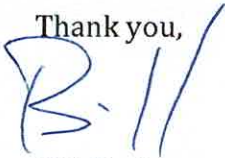
- The long term financial projections seek to maintain, over the long term, an 18% General Fund balance (which, the Committee thinks is prudent). To achieve this target, however, requires that the City eliminate or reduce transfers to the Facilities Maintenance Fund for the foreseeable future. The result is a substantial underfunding of the Facilities Maintenance Fund over the term of the projections which will severely affect repair and replacement expenditures in the later years. This underfunding is not sustainable, and attention should be given to taking steps to increase funding.
- The Committee supports the conservative approach taken in establishing the budget for transfer tax revenues given the current economic uncertainties. However, there is the potential that the anticipated decline in revenue does not occur if the economy recovers and property sales in the City continue at a normal rate. In this case, and assuming no material adverse impacts in other budget areas, the Committee recommends that the increased revenue be used to fund the Facilities Maintenance Fund, consistent with prior years.
- 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 projected CalPERS expenses have not changed substantially from the prior year. However, future pension costs may rise significantly should

CalPERS investment performance be below target due to a sustained downturn in financial markets.

- The prior funding of the PARS Fund will provide the City much needed flexibility in managing future pension cost increases. However, this flexibility may be adversely affected by stock market fluctuations to the extent there is significant decline in values during the withdrawal years.
- For several years now, the City has benefitted from a robust economic recovery and rising Bay Area housing prices. Given the uncertainty in economic conditions due to Covid-19, 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