May 26, 2022

Ms. Mayor and City Council,

As part of our annual efforts, the Budget Advisory and Financial Planning Committee (the "Committee") has completed its brief review of financial projections in the city budget and whether they provide for the long-term financial future of the City. The Committee reviewed the most recent revised fiscal year 22-23 budget and projections, as prepared by Finance Director Michael Szczech and his staff under the guidance of City Administrator Sara Lillevand, and as presented to the Committee on May 10, 2022.

The City's understanding of its financial position, as in previous years, is very thorough. The presentation from the Finance Director addressed all material revenue sources and expense categories, and discussed potential revenue risks, projected pension costs in detail, Other Post-Employment Benefits (OPEB) funding, equipment replacement, facilities maintenance and capital projects. Overall, we believe the assumptions used, and the results presented, to be reasonable and consistent with past practices.

As we emerge from the Covid-19 pandemic, the City has weathered its financial impacts admirably and maintains a strong financial condition. Property tax related revenue, which makes up over three-quarters of the City's revenue, has been bolstered by the strong real estate market during the pandemic. In addition, recreation and facility rental revenues have rebounded to nearly pre-pandemic levels. The higher than expected revenues helped the City achieve a projected budget surplus for FY21-22.

The proposed budget for FY22-23 reflects the City's continued commitment to conservative budgeting and financial discipline. This approach – employed for over a decade –ensures that the City can continue to provide high quality public services, replace aging equipment, and address infrastructure repairs, while retaining a strong general fund. Further, the City has established reserves to handle potential increases in pension and retiree health care liabilities and can accommodate those costs without impacting services.

As the Council is aware, quantifying and planning for the future costs associated with the City's facilities, streets, and sidewalks – broadly, its infrastructure – has been and continues to be a focus of this Committee. This Committee has urged the City to continue to comprehensively quantify and understand these needs, and City staff has responded with a commendable job. While work remains to be done, this budget and long range plan continues to be a step in the right direction, both in terms of quantifying such costs, and allocating funding. As the Finance Director's budget report notes, the Facilities Maintenance Fund is now separated into two funds: one focused on regular repairs and maintenance (Facilities Maintenance Fund), and the other for major capital projects and improvements (Facilities Capital Fund). Due primarily to the increased transfer tax revenue in the current and prior year, and the growth in assessed property values, the City is now able to fund its facilities maintenance costs over the term of the projections. This is in contrast to prior years, in which contributions to the Facilities Maintenance Fund were generally not budgeted, and transfers would only be made to that Fund if and when budget surpluses were achieved.

The new Facilities Capital Fund projections include estimates for major capital projects to address the necessary replacement or renovation of aging buildings to meet current standards and to improve operating capacity and efficiency. Although the timing of these projects is uncertain, and more work remains to be done to more comprehensively detail capital needs, it is clear that the cost of such infrastructure needs is beyond the City's current funding capacity. The Committee continues to believe that further quantification and planning for these capital projects is a very high priority given the high cost for some of these projects as well as the long lead time to fund and implement these initiatives.

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 (including infrastructure needs) are set aside on a current basis. In short, current citizens should pay for the current costs of running the City and not defer those costs to future citizens. Over the past decade, the City has done an excellent job planning for and controlling future costs of retirement commitments and equipment replacement, and the Committee recommends that the same level of attention should now be given to quantifying and planning for the future costs associated with the City's infrastructure.

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

- The financial projections seek to maintain, over the long term, an 18% General Fund balance (which, the Committee thinks is prudent). Achieving this target in the long term projections, however, requires that the City eliminate transfers to the Facilities Capital Fund after the FY 22-23 budget year and the long term projections indicate the Facilities Capital Fund will be depleted during FY 25-26. While certain major capital projects may be funded through debt financing, similar to the pool, this will not be feasible for all capital projects and the Facilities Capital Fund is therefore inadequately capitalized for the duration of the 10-year projections. This underfunding is not sustainable since it will severely affect necessary replacement expenditures beginning in the next several years.

- The Committee supports the conservative approach used to establish the budget for transfer tax revenues given their historic volatility. The Committee also supports the modest increase in projected transfer tax revenue, from the $2.8 million consistently used in the recent past, to $3.2 million in FY23 and to $3.4 million beyond. This increased budget amount could still be attained with a recessionary pace of sales and/or drop in sales prices given substantial gains in Piedmont home values over the past decade. The Committee recommends that to the extent actual transfer tax revenue exceeds the conservative estimate, such funds be used to fund the Facilities Capital Fund.
- Pension expenses are projected to increase substantially over the next decade, as has been anticipated. While these increased expenses are fully met in the long range projections (due to the City's active management and prior funding of the of the Public Agency Retirement Services Fund), the extreme volatility of the financial markets still presents risks to the extent that investment returns fail to achieve expected returns in the long run.
- As in prior years, the projections continue to show that the long term financial health of the City is dependent on property-related taxes, especially the continuation of the Municipal Services Parcel Tax. The projections assume that the MSPT continues with a standard CPI adjustment each year, and the Committee supports this approach.
- The City continues to benefit from a robust economic recovery and rising Bay Area housing prices. Given the uncertainty as to how long such favorable economic conditions will persist, 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. The Committee believes the City is well-positioned to address the years to come. Please let us know if you have any questions or would like any additional analysis.

Thank you,

Budget Advisory and Financial Planning Committee

Deborah Leland, Chair	Paul Raskin
Andrew Flynn	Frank Ryan
Cathie Geddeis	Vanessa Washington
Robert McBain	Alice Cho (alternate)