

May 31, 2023

Ms. Mayor and City Council,

As part of our annual efforts, the Budget Advisory and Financial Planning Committee (the “Committee”) has completed its 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 proposed fiscal year 23-24 budget and projections, as prepared by Finance Director Michael Szczech and his staff under the guidance of City Administrator Rosanna Bayon Moore, and as presented to the Committee on May 9, 2023.

From the presentation, we feel that the City’s understanding of its financial position, as in previous years, is very thorough and well communicated. The Finance Director presented the projected financial results for the current fiscal year as well as projections for the upcoming budget year. The presentation included 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 well-founded and consistent with past practices.

FY22-23 Results and FY23-24 Budget

As we return to a normalized environment following the disruptions of the Covid-19 pandemic, the City has weathered its financial impacts admirably and maintains a strong financial condition. Property tax-related revenue (including parcel tax and real estate transfer tax), which makes up over two-thirds of the City’s revenue, has been bolstered by the strong real estate market during the pandemic. In addition, almost all other revenue categories have rebounded and now equal or exceed their pre-pandemic levels. The higher-than-expected revenues helped the City achieve a projected budget surplus of approximately \$3.6 million for FY22-23.

The Committee supports the proposed uses of the FY22-23 surplus, which include transfers to the Facilities Capital and Equipment Replacement Funds and retaining approximately \$1.7 million of the surplus in the General Fund to cover one-time operating expenses budgeted for FY23-24. Those one-time operating expenses include (a) temporary, part-time staff in Planning and Building, Administration and Public Works, intended to advance City priorities including clearing the backlog of building permits and digitizing records, and (b) \$1.1 million in consulting costs related to the Housing Element, approximately \$700,000 of which was budgeted and unspent in FY22-23.

The proposed budget for FY23-24 reflects the City's continued commitment to conservative budgeting and financial discipline. This approach 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 continues to fund reserves to handle potential increases in pension and retiree health care liabilities and can accommodate those costs without impacting services.

Long-term Planning

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.

In reviewing the City's long-term projections, the Committee notes the following:

- The financial projections seek to maintain, over the long term, an 18% General Fund balance, which the Committee thinks is a prudent goal.
- The Committee supports the conservative approach used to establish the budget for Transfer Tax revenues given their historic volatility. Projected Transfer Tax revenue is set at \$3.4 million for FY 23-24 and beyond, a modest increase from \$3.2 million in FY22-23. This increased budget amount could still be attained with a recessionary pace of sales and/or drop in sales prices given the 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 (MSPT). The projections assume that the MSPT continues with a standard CPI adjustment each year, and the Committee supports this approach. In addition, in the coming months and in accordance with its charge, the Committee will be

examining the need for the MSPT and recommending whether this tax should be continued, and if so, at what rate.

- The Committee notes that the long-term projections include \$150k to \$200k per year operating subsidy for the pool. While the intent of the City is to operate the pool on a revenue-neutral basis, actual operating performance is not yet known, and therefore the City has taken this conservative budgeting approach.

Over the past decade, the City has done an excellent job planning for and controlling future costs of retirement commitments and equipment replacement. Below, the Committee highlights future needs that it believes require further attention now, followed by revenue considerations to address those needs.

Infrastructure Needs

As the Council is aware, quantifying and planning for the future costs associated with the City's facilities, streets, and sidewalks – broadly, its infrastructure – have been and continue 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 an admirable job over the past several years. 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 noted last year, 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 years, 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 contrasts with 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. Despite the notable progress being made, the following infrastructure needs remain:

- **Aging Buildings.** The Facilities Capital Fund projections include estimates for major capital projects to address the necessary replacement or renovation of aging buildings and parks to meet current standards and to improve operating capacity and efficiency. Staff has done a commendable job of aggregating historical reports and assessments with the aim of updating the estimates and creating an overall master plan for implementation. However, recent increased staffing demands related to the pool project and the Housing Element have understandably adversely impacted the master plan work. Much more work remains to be done to more comprehensively detail and quantify our capital needs and to provide sufficient information

for the City Council to weigh strategic priorities. Nonetheless, based on existing information, the cost of such infrastructure needs (preliminarily estimated to be \$70 million) is well beyond the City's current funding capacity. The Committee continues to believe that further quantification, prioritization, and planning for these capital projects is of high importance given the high cost for some of these projects, as well as the long lead time to identify funding and to implement these initiatives. We applaud the Council for establishing an ad hoc subcommittee to revisit the work performed to date with the aim of advancing the policy topic with the entire governing body. We encourage staff to continue work on this important effort as additional staff capacity becomes available upon substantial completion of the pool project and the Housing Element.

- **Stormwater Management/Storm Drain Infrastructure Needs.** The Regional Water Quality Control Board regulates local jurisdictions' stormwater management and is moving to impose new requirements on cities to control stormwater runoff. Currently, cities are being required to inventory their storm drain infrastructure and project the cost of improvements to meet new standards. At present, no State funding sources are available to cover the potential costs, which are likely to be significant. While the full extent of need and cost is currently being investigated, the first three projects that have been identified and included in the Facilities Capital Fund expenditures total \$1.7 million, and address areas of known need where there has been flooding and/or failure of the storm drain infrastructure.
- **Road Conditions.** While the City has made efforts to step up its repaving activity and improve its roadways in recent years, the condition of Piedmont's roads has not improved measurably since 2017. Piedmont's overall Pavement Conditions Index (PCI) was 64 in 2017 (where a score of 50 – 69 is in the "Good" category), 67 in 2019, 65 in 2022, and 63 as measured in 2023, albeit prior to the completion of the most recent paving project. An estimated \$500,000 to \$700,000 in additional annual spending above recent levels would be required to improve the PCI to over 70 and into the "Very Good" category. The long-range projections do not include any additional annual amounts for paving beyond the dedicated street improvement funding sources (Measures BB & F, gas tax revenue and SB1) that the City has historically utilized to maintain its streets.

Regarding the adequacy of the Facilities Capital Fund, the Committee notes that achieving the target 18% General Fund balance in the long-term projections can only be achieved by eliminating transfers to the Facilities Capital Fund after the FY 23-24 budget year, and the long-term projections therefore reflect a Facilities Capital Fund that will be depleted after FY 25-26. While certain major capital projects may be funded through debt financing, like the pool, this will not be feasible

for all capital projects and the Facilities Capital Fund, as presented, is therefore inadequately capitalized for the duration of the 10-year projections. This projected underfunding is not realistic since there will undoubtedly be necessary replacement expenditures after FY 25-26. The Committee does recognize, however, that this funding shortfall may be alleviated to some degree if revenues, such as transfer taxes, come in higher than projected or if the City develops incremental or new tax sources.

Staffing Needs

The City's staffing levels, along with the City's population, have held largely steady over the past two decades. However, the provision of services is becoming increasingly complex due to a combination of factors including changing technologies and increasing requirements for local jurisdictions to address regional challenges. For example, our region's severe housing shortage and homelessness crisis have led to a significant increase in requirements imposed by the State upon cities to create capacity and plan for increased housing production, demanding staff time and resulting in significant consulting costs. Similarly, the staff report presenting the FY23-24 budget refers to the need to increase public safety dispatch staffing (which has not changed since 1978), in large part due to the need to keep pace with changing technologies. It should be noted that the long-range plans do not include any changes in the City's headcount; rather, the dispatch staffing is presented as a potential addition for Council consideration.

While funding for the initial year of new dispatch positions is available through the Citizens' Option for Public Safety (COPS) Fund, the ongoing costs of these positions is not included beyond FY23-24 in the City's long-range projections. With an annual cost of approximately \$300,000, which represents less than 1% of the City's annual budget, it is possible that this additional cost could be funded in most years through some combination of lower expenses due to employee vacancies and/or higher than projected property-related tax revenue. However, one of this Committee's basic principles is to ensure that funding is identified for known future requirements, and thus the Committee recommends that as the Council considers increasing staffing, it also consider options to increase revenue, as discussed below.

Revenue Considerations

It has become clear from discussions regarding the potential increase in the dispatch staff for police and fire, as well as those around facilities capital projects, that the City has limited ability to absorb future cost increases due to inflation, new State mandates or the need to increase staff to provide the services that the residents of the City expect. The Committee therefore encourages the Council to explore alternatives to develop additional sources of revenue or to increase the revenue generated from current taxes and fees. Specifically:

- The Committee recommends the Council examine, or direct this Committee to examine, modernization of the existing Utility User Tax (“UUT”), which is collected from residents for the use of electricity, gas, water, and telephone services. The City has not modified the structure of the UUT in decades and should now examine whether its UUT is consistent with neighboring communities and cities throughout the State. For example, modernizing the telephone portion of the UUT, which does not fully cover cellular phones or internet-based communication, to match current technology would ensure that all Piedmont taxpayers are treated alike regardless of the type of telecommunication technology they use. Such a review should examine both the services subject to the tax as well as the rate. Should a broader base of services be included, a reduced rate may be appropriate. Also, the current tax on water is set at a flat per-parcel rate; alternatives include a rate based on parcel size or water use. While the UUT generates a fraction of revenue compared to property-related taxes, it remains a meaningful revenue source for the City.
- The Committee recommends that the City take steps to ensure that current business taxes are being evenly collected across the City. Currently, both the Real Estate Rental Tax and the Business License Tax are collected on a self-reported basis. The only check on rental occupancy is via cross-reference for households that submit proof of residency to the Piedmont Unified School District via a lease agreement. However, a comparison of census data on renter-occupied housing units in Piedmont and rental tax receipts indicates that collection rates may represent 80% to 90% of total rental units. The collection rate for the Business License Tax is unknown. Efforts to improve collections and the even application of these taxes could include an education campaign, potentially coupled with an amnesty period to encourage all business owners (including residents who operate businesses out of their homes) and all property owners who rent property (including single family homes as well as ADUs) to begin paying the applicable taxes without penalty. Ideally this could be done immediately, so that any missed revenue can be captured and taken into account prior to or simultaneously with the Committee’s upcoming study to formulate a recommendation regarding the MSPT renewal.
- The Committee recommends increasing Piedmont’s Real Property Transfer Tax (Transfer Tax). The Committee also recommended an increase in the Transfer Tax in its June 2020 report, which thoroughly discussed revenue sources for facilities projects, and all the factors contributing to that recommendation continue to be true. While Transfer Tax revenue is highly volatile and must be conservatively budgeted, the surplus in good years can be captured to boost funding for infrastructure maintenance and the renovation of Piedmont’s aging buildings. Piedmont’s current Transfer Tax is assessed at the rate of \$13.00 per \$1,000 on full value of property sold

and has not been increased since 1993. The Committee's June 2020 report noted that both Berkeley and Oakland had recently voted to increase their transfer tax rates, as well as to form a tiered transfer tax system. Since June 2020, Emeryville has joined Oakland and Berkeley in creating a tiered system with an upper rate of \$25.00 per \$1,000, while Albany and San Leandro have increased their tax rates by approximately 30% and 80%, respectively. Piedmont's Transfer Tax is now among the lowest of the Alameda County cities that assess a transfer tax, as shown in Attachment A.

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 this next fiscal year but cautions that the City is likely to face challenges as it becomes necessary to address the City's increasing service needs and capital projects. 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
Andrew Flynn
Cathie Geddeis
Robert McBain
Paul Raskin
Frank Ryan
Vanessa Washington
Alice Cho (alternate)

Attachment A

Alameda County Real Property Conveyance Tax Rate by City				
City	2023		2020	
	Rate per thousand on full value (as of 1/1/2023)	Ordinance	Rate per thousand on full value (as of 1/1/2020)	Ordinance
Alameda	\$12.00	2987 AMC	\$12.00	
Albany	\$15.00	2020-09	\$11.50	Feb-60
Berkeley	\$15.00	6072-NS	\$15.00	6072-NS
	\$25.00		\$25.00	
Emeryville	\$12.00	Measure O	\$12.00	14-011
	\$15.00			
	\$25.00			
Hayward	\$8.50	92-26	\$8.50	92-26
Oakland	\$10.00	11628 CMS	\$10.00	11628 CMS
	\$15.00		\$15.00	
	\$17.50		\$17.50	
	\$25.00		\$25.00	
Piedmont	\$13.00	546 NS	\$13.00	546 NS
San Leandro	\$11.00	2020-08	\$6.00	93-09

Source: Alameda County Auditor-Controller / Clerk Recorder
Bold indicates changes since Committee's prior review in June 2020