



City of Palo Alto

City Council Staff Report

(ID # 13800)

Meeting Date: 1/10/2022

Report Type: Action Items

Title: Review and Accept the FY 2023 - FY 2032 Long Range Financial Forecast (LRFF) and FY 2023 Budget Development Guidelines

From: City Manager

Lead Department: Administrative Services

Recommended

Motion

The Finance Committee and staff recommend that the City Council accept the Fiscal Year (FY) 2023 to 2032 General Fund Long Range Financial Forecast (Attachment A) and annual Budget Development Guidelines (Attachment B) and direct staff to use this forecast as the starting point for the initiation of the FY 2023 budget process.

Executive

Summary

The FY 2023 - 2032 Long Range Financial Forecast (LRFF) was reviewed with the Finance Committee on December 7, 2021 (Attachment A) along with the annual Budget Development Guidelines (Attachment B). This report summarizes the key discussion points with the Finance Committee and includes additional information requested by the Finance Committee to provide context and/or additional data points of reference to the City Council. Per the City Council policies, this item, unanimously approved by the Finance Committee, would be a consent agenda item. However, staff and the Committee have placed this item on the City Council's action agenda for the full Council deliberation in acknowledgement of the importance for financial planning in the continued varied economic conditions due to the ongoing pandemic.

Discussion

The FY 2023 - 2032 General Fund Long Range Financial Forecast (LRFF) marks the beginning of the FY 2023 annual budget process and provides the projected General Fund financials over the next ten years based on current City Council approved service levels ("Base Case") as well as alternative financial models.

As of the timing of this LRFF, the local economy is showing positive signs of recovery, and these trends are expected to continue in the coming year. Staff is cautiously optimistic and the onset of the Omicron variant at the time of the development of this forecast continues to demonstrate the variability in the economic recovery. Economists agree, the economy and recovery activities follow closely the projections and status of the COVID-19 pandemic. This

forecast assumes that major tax revenues continue to rebound, though it does anticipate that in some instances it may take several years to recover to pre-pandemic levels.

The Base Case forecast projects a surplus of \$2.4 million in FY 2023, followed by a \$1.0 million shortfall in FY 2024, with small but increasing surpluses in FY 2025 through FY 2032. Critically important this year, as noted by the Finance Committee are two alternative scenarios that are more closely aligned with City service needs:

- Scenario A) an immediate Restoration of Service to Pre-COVID-19 Service Levels, and
- Scenario B) a Competitive Market Compensation Adjustment.

Scenario A would result in a budget shortfall of \$11.0 million in FY 2023 and continued shortfalls through 2030. Scenario B would result in a lower surplus of \$0.9 million in FY 2023 and a slightly longer period of shortfall through FY 2025. Though the alternative scenarios are modeled separately, it is the intent that elements of one or both scenarios are considered in budget development. As discussed with the Finance Committee, both staff and the committee agree that the most likely scenario is not any of the models in isolation, however likely some combination of the Base Case, Scenario A, and Scenario B will ultimately be the reality of the near-term financial future for the City's General Fund.

Additionally, a one-time funding surplus was reported in the FY 2021 Annual Comprehensive Financial Report (ACFR) ([CMR 13501](#)), which resulted in Budget Stabilization Reserve (BSR) levels that currently exceed the 18.5 percent funding target by \$4.6 million in FY 2022. In addition, this LRFF estimates that FY 2022 could end the year with a surplus of up to approximately \$10 million. These one-time funding surpluses have not been factored into the 2023-2032 forecast years. The Committee and staff acknowledged the important to recognizing the one-time versus ongoing revenues and costs. This was discussed further during the budget development guidelines which encourages matching one-time sources of funding with one-time uses of funds.

As directed by the City Council, staff will include recommendations for addition of resources and appropriation of funds as part of the FY 2022 Midyear process, scheduled in the first quarter of the new calendar year and expects to provide recommendations for these surplus funds as part of this report

Additional Information Requested by the Finance Committee

As part of the Finance Committee's review of the LRFF, a few requests were made to provide context and/or additional data points of reference. Staff has compiled these items below.

Transfer of Property Ownership: At the December 7, 2021 meeting, the Finance Committee requested additional information relating to the turnover status of properties and impact to overall Property Tax revenues. The table below is provided by the City's property tax consultant, HdL Coren & Cone, and includes a historical summary of the original assessed value versus the sales price (in millions), by ownership type. This analysis is one of many variables

used in the development of Property Tax estimates. Of the overall assessed value (AV) growth in FY 2022, approximately two (2) percent of the annual AV growth is attributed to the transfer of property ownership; this is consistent with recent years.

	Single Family Residential				Multifamily, Commercial, Industrial, Vacant				TOTALS				
Tax Year	# Sales	Orig. Value	Sale Price	% Chg	# Sales	Orig. Value	Sale Price	% Chg	# Sale	Orig. Value	Sale Price	% Chg	\$ Chg
2021	489	\$844	\$1,620	92%	48	\$221	\$337	53%	537	\$1,065	\$1,957	84%	\$892
<i>Est. Revenue Change: \$828</i>													
2020	483	\$752	\$1,511	101%	39	\$450	\$598	33%	522	\$1,202	\$2,108	75%	\$906
<i>Est. Revenue Change: \$841</i>													
2019	448	\$656	\$1,396	113%	53	\$413	\$737	78%	501	\$1,069	\$2,132	99%	\$1,063
<i>Est. Revenue Change: \$992</i>													
2018	494	\$705	\$1,662	136%	51	\$575	\$1,065	85%	545	\$1,279	\$2,727	113%	\$1,448
<i>Est. Revenue Change: \$1,363</i>													
2017	537	\$737	\$1,678	128%	45	\$177	\$402	127%	582	\$914	\$2,080	128%	\$1,166
<i>Est. Revenue Change: \$1,100</i>													

Each value indicated above (i.e., "Original Value" or "Sales Price") is the sum of the full value of all parcel transactions in millions. For example, in 2021, the original value of \$844 million increased to \$1.6 million once the new sale price was accounted for, a growth of \$776 million in assessed value or 92% change.

Inflation: At the December 7, 2021 meeting, the Finance Committee requested additional information pertaining to the impact of inflation on the organization. As a service driven organization, nearly 60 percent of General Fund costs are salaries and benefits. Salaries and benefits are increased each year in accordance with applicable Memorandum of Agreements (MOA's). In instances where no MOA is in place, the City's practice is to use a general 2.0 percent increase. This is consistent with prior Council direction in previous long range financial forecasts to use the 2.0 percent increase as a forecasting assumption, not as a commitment to future negotiations. It is a standard convention used in good times and bad, not a prediction of what will happen in the coming few years. As the general cost of living grows, staff are monitoring current contracts with neighboring jurisdictions and seeing upward trends in general wage increases, likely due in-part because of this inflationary period.

Staff has factored in the most recent California Consumer Price Index¹ in the San Francisco Bay Area for non-salary expenses in FY 2023. While this assumption assists in aligning expenses with routine increases, it does not account for new contracts. As staff address new projects or sunseting multi-year service contracts, typically a public procurement process is completed for a new contract. Through this public process, these new multi-year agreements may see growth from prior costs at higher rates due to the growing cost of business. For example, on the January 10, 2021 calendar, the City recently completed a procurement process for power washing of City facilities and sidewalks. The lowest bid was over \$200,000 above the engineers estimate of approximately \$700,000. Staff monitors these and works to offset cost increases to the extent possible, however will continue to identify any gaps as new contracts are entered.

¹ State of California Department of Industrial Relations. <https://www.dir.ca.gov/OPRL/capriceindex.htm>

Inflation is not anticipated to impact the City's current long-term debt, as these debt structures are financed at fixed rates. Should the City consider financing investments in the future, staff will review the market and adjust the cost of the financing accordingly.

STAKEHOLDER

ENGAGEMENT

The preliminary forecast for FY 2023 represents the beginning of the fiscal year 2023 budget development process. As in previous years, the City Council discussion of LRFF will provide guidance to staff in the budget development process. It is anticipated that conversations with City Council and the community will occur through public budget hearings in Spring 2022, according to the standard budget adoption process.

RESOURCE

IMPACT

Financial implications from this report and input from the City Council will be considered in the City Manager's development of the Fiscal Year 2023 budget.

ENVIRONMENTAL

IMPACT

This report is not a project for the purposes of the California Environmental Quality Act. Environmental review is not required.

Attachments:

- Attachment A: FY 2023-2032 Long Range Financial Report (LRFF), CMR 13502
- Attachment B: FY 2023 Budget Development Guidelines



City of Palo Alto

Finance Committee Staff Report

(ID # 13502)

Meeting Date: 12/7/2021

Title: Review and Recommend That Council Accept the FY 2023 - FY 2032 Long Range Financial Forecast (LRFF) and FY 2023 Budget Development Guidelines

From: City Manager

Lead Department: Administrative Services

RECOMMENDATION

Staff recommends that the Finance Committee review and recommend that the City Council accept the General Fund Long Range Financial Forecast (LRFF) for Fiscal Year 2023-2032 and the FY 2023 annual Budget Development Guiding Principles (Attachment A) and direct staff to use this forecast as the starting point for the initiation of the FY 2023 budget process.

EXECUTIVE SUMMARY

Historically, the City has presented a ten-year General Fund Long Range Financial Forecast (LRFF) in December that marks the beginning of the annual budget process. This preliminary forecast is based on the most current information available, actual revenues for FY 2021, and expected results through FY 2022. General Fund expenditures are based on current City Council approved service levels compared to projected revenues over the next year.

The Base Case Long Range General Fund forecast projects a surplus of \$2.4 million in FY 2023, followed by a \$1.0 million gap in FY 2024, with small but increasing surpluses in FY 2025 through FY 2032. This forecast maintains current service levels approved in FY 2022 and should be used for planning purposes to assist in gauging effects of major policy interventions against a likely “status quo” version of the future. The level of uncertainty in this forecast is reduced from where it was a year ago, but the City is first and foremost continuing to manage through the unpredictable nature of the pandemic and impacts on the local economy.

In addition to the Base Case Forecast, staff modeled two alternate forecast scenarios that could more closely align with the City’s service needs and financial outcome from the pandemic. The two scenarios are A) an immediate Restoration of Service to Pre-COVID-19 Service Levels, and B) a Competitive Market Compensation Adjustment. These scenarios are modeled separately for purposes of this report, but impacts from both of these scenarios could happen during the forecast period. Compared to the Base Case, both of these scenarios increase the General Fund gap over the next ten years. In Scenario A, FY 2023 changes from a surplus to a gap of \$11.0

Attachment A

million, and revenues are not anticipated to be able to fund the annual expenditures until FY 2030. In Scenario B, the surplus in FY 2023 decreases to \$0.9 million, the General Fund has a larger gap in FY 2024 of \$2.6 million, and the gap continues into FY 2025 (\$1.0 million) before returning to a surplus in FY 2026.

The difficult and significant actions that Council took to reduce services and balance the budget during the pandemic were never meant to be permanent; however, restoration of impacted services would require deliberate action. As mentioned in the preliminary FY 2022 Q1 financial status report ([CMR 13439](#)), there are several issues across the City impacting the ability to transition out of the pandemic including staff turnover, recruitment and retention, and supply chain issues that could continue into FY 2023. Development of the FY 2023 budget and planning for the subsequent years outlined in the forecast will need to be done strategically over the next several months in order to balance the increased service level needs of the community with the financial resources currently projected.

City staff will continue to review and refine these projections to establish the FY 2023 budget and use this forecast to begin internal planning for budget balancing solutions. Based on this forecast, it is anticipated that the prioritization of spending and consideration of measured restoration of services are necessary to ensure continued financial stability. More detailed guidelines or Budget Policies to inform the development of the FY 2023 budget are discussed at the end of this document (Attachment A).

Looking forward, the City continues to face several pressures from the uncertain recovery from the financial impacts of the COVID-19 pandemic, to funding and completing the 2014 Council approved Infrastructure Plan projects, and the growing costs of pension benefits and labor costs due to the current labor market and cost of living in the Bay Area. The continued policy direction from the City Council regarding proactively addressing the pension obligations, including the direction to assume a lower discount rate in calculating pension costs, is contained in the forecast model. The City continues to face critical choices in order to balance short term revenue projections based on the current economic situation and lingering impacts of COVID-19, with future financial challenges including any unforeseen program needs, any additional proactive funding contributions to pension liabilities, and evaluating service restorations to pre-pandemic levels. The review of this forecast and the planning that follows will be critical since the City is facing many requests and has identified several key programs that the community would like to fund and complete.

Included in this report and subsequent documents are the following:

- Discussion of the current financial climate of the United States to the local economy of the City of Palo Alto
- Current financial forecast including Revenue and Expense assumptions in FY 2023-2032
 - o Current financial status of the General Fund as of the FY 2022 Adopted Budget, and a brief discussion of revised FY 2022 revenue estimates by category (a more

Attachment A

detailed discussion is in the preliminary 1st Quarter Financial Status Report CMR #13439)

- FY 2023 Budget Development Policies to inform the Budget process (Attachment A)
- Alternate scenarios to the base case forecast to demonstrate financial impacts to the City from:
 - o Full restoration of services to pre-pandemic levels; reductions in FY 2021 and FY 2022 as a result of the COVID-19 Pandemic, and
 - o Modeled potential market-based compensation adjustments

BACKGROUND

Annually the Office of Management and Budget produces a ten-year General Fund Long Range Financial Forecast (LRFF). The LRFF reflects staff's best estimates on the projected revenues and expenditures over the next ten years based on the information that is currently available. It is important to note that the LRFF is a planning document and is separate and distinct from the development of the City's annual Operating and Capital Budgets. There are assumptions and parameters modeled in the LRFF, but these assumptions are revised and refined as more information becomes available through the budget development process.

The LRFF contains a comprehensive review of the costs to provide current City Council approved service levels, including current contracts, updates to salaries and benefits based on the current population of employees, and the current labor contracts in effect. Important to note in this LRFF is the ongoing budget adjustments that were approved in the FY 2022 Adopted Budget and in the FY 2022 Q1 Preliminary Financial Status Report ([CMR 13439](#)). The LRFF also reviews the status of the current economy and various economically sensitive revenues such as Sales Tax, Documentary Transfer Tax, Property Tax, and Transient Occupancy Tax to explain key trends in those areas. This Forecast allows staff and City Council to look at both the short-term and long-term financial status of current service levels in the General Fund to inform daily policy decisions and evaluate long-term goals and ongoing challenges.

Palo Alto serves a diverse community with a broad range of unique services that adds to the significant complexity of managing a balanced budget and healthy financial outlook. The demands and conflicts coupled with an economy that is recovering with some uncertainty after the COVID-19 pandemic have heightened the intensity of the financial forecasting and budget development processes. New analyses and data generation demands require deep-dives into complex problem-solving within an engaged public process across a wide range of issues. These forecast figures present staff with the challenge of prioritizing the growing needs of the City with the fiscal sustainability of these needs.

The Economy

National, state, regional and local economic indicators are mixed, while the national economy performance is strong it has cooled as summer ends. The local economy on the other hand had strong performance in the second and third (calendar) quarters of 2021 with the expectation this will continue into calendar year 2022 and beyond, albeit at a slower growth rate, as

Attachment A

progress on vaccinations allow economic activity to resume and/or expand particularly in previously shut-down sectors like restaurants, hotels, entertainment, and travel. Increased spending of household pandemic-era savings due to pent-up demand for services created by the pandemic restrictions could result in stronger economic growth as the pandemic restrictions further wane. However, increased spending on services may slow spending on durable goods which has increased and added to the strain to the supply chain. Business investments continue to be robust, particularly in information processing equipment and software. Overall housing construction remains strong, but it is expected to gradually decline since building is outpacing population growth and demand. This is expected to a lesser degree in high demand and densely populated areas like the San Francisco Bay Area. With the recent passage of the bipartisan infrastructure bill in Congress, the concern about the impact of the Federal stimulus packages ending, that contributed to the positive economic indicators over the past year, has lessened though there remains uncertainty about the infrastructure spending timing in the short-term.

As of the printing of this report, the rising vaccination rate, declining hospitalizations, and slowing of the spread of the virus in California and particularly in the Bay Area bodes well for Palo Alto's economic recovery. On a national level, areas of the country that are slower to address the pandemic might cause a slower national economic recovery in calendar year 2022. Another impediment to growth, both nationally and locally, is the labor market contraction. The pre-pandemic employment declined by about 10 million nationally, and businesses of all types are impacted by labor shortages. Employment remains down by millions over the pre-pandemic level even with the population growing over the past year. Some of this is explained by lack of childcare preventing a parent from re-entering the labor force, health concern especially those at higher risk and/or cannot be vaccinated due to a high risk of complications, and the long known and expected baby boomers' retirement trend that the pandemic is thought to have accelerated. This has created the conditions for companies to offer higher wages and/or benefits to both skilled and lower-skilled workers to attract and retain them. However, issues like the labor shortages, supply chain challenges, and rising gas and oil prices are stoking inflationary pressures which could, if unchecked, dampen economic growth. The Federal Open Market Committee (FOMC), whose actions during the pandemic kept the financial markets liquid and operating, is carefully monitoring the economy and has already taken steps to address the rising inflation, although the ability to keep this in an acceptable range is uncertain.

According to the US Bureau of Economic Analysis (BEA), the "advance" estimate of the U.S. economy's national gross domestic product (GDP) percentage change from the preceding quarter grew in the second and third (calendar) quarters by 6.7 percent and 2 percent, respectively. According to the BEA, "the increase in real GDP in the third quarter reflected increases in private inventory investment, personal consumption expenditures (PCE), state and local government spending, and nonresidential fixed investment that were partly offset by decreases in residential fixed investment, federal government spending, and exports. Imports, which are a subtraction in the calculation of GDP, increased (see below Table 1). The increase in third quarter GDP performance reflected the continued economic impact of the COVID-19

pandemic. A resurgence of COVID-19 cases resulted in new restrictions and delays in the reopening of establishments in some parts of the country. Government assistance payments in the form of forgivable loans to businesses, grants to state and local governments, and social benefits to households all decreased. The national consumer price index (CPI), as of the third calendar quarter has grown 5.3 percent and exceeds smaller increases in first and second quarters of 1.9 percent and 4.8 percent. More households could see their finances as worse if inflation erodes their nominal wage gains and shrinks their real purchasing power. The recent inflation spike has driven pandemic pessimism, but it's not clear if this will lead into reduced retail spending. The following graphs depict the GDP and consumer price index (CPI) over the past few years and CPI forecast in calendar year 2022.

Table 1: National Gross Domestic Product (GDP)

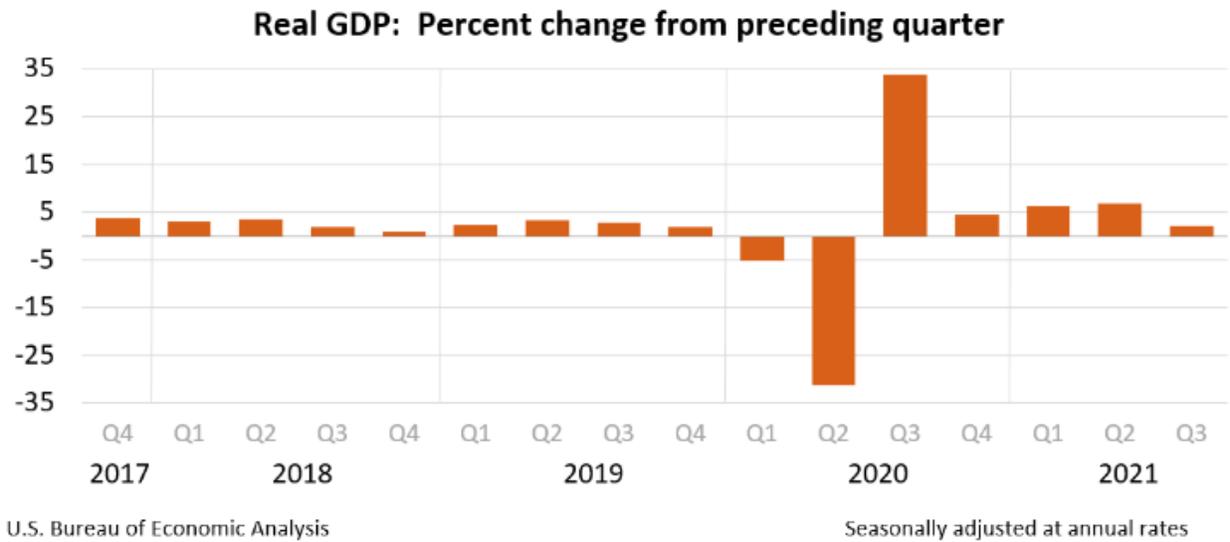
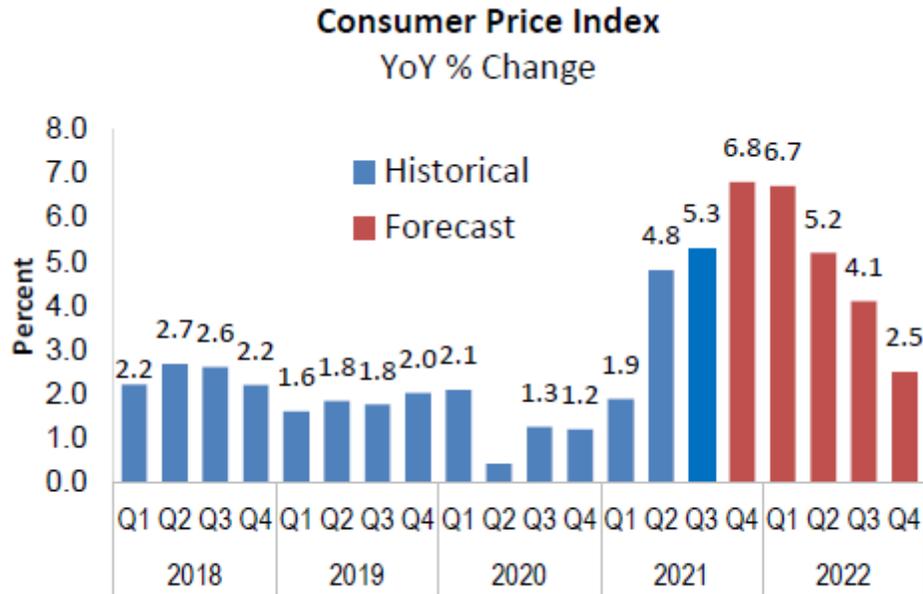


Table 2: National Consumer Price Index

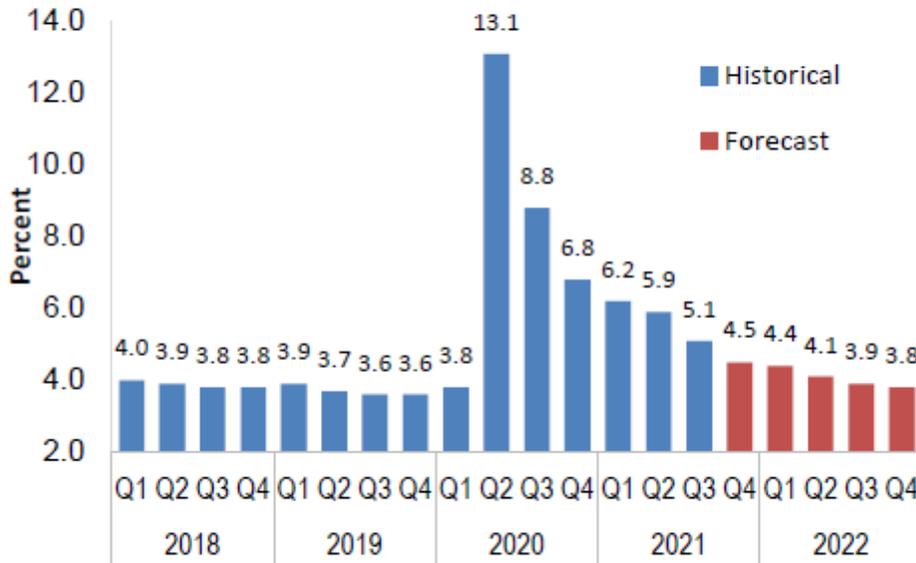


Source: US. Bureau of Labor Statistics; BOTW

The nation’s unemployment rate fell to 5.1 percent in the third quarter, compared to a record high of 13.1 percent at the height of the pandemic in the second (calendar) quarter of 2020. It is expected, by the U.S. Bureau of Labor Statistics, that the unemployment rate will decline below the pre-pandemic low of 3.5 percent. Per the State of California's Employment Development Department, the state’s unemployment rate as of September 2021 is 6.4 percent and the County of Santa Clara is 3.9 percent. Nationally, the improved unemployment rates are driven by job gains in the leisure and hospitality; trade, transportation and utilities; professional and business services; education and health services; manufacturing, and construction. As shown in Table 2, these trends are expected to continue in calendar year 2022. Historically, the Bay Area job growth has been led by the Peninsula for the past several years. The unemployment rate for the San Francisco Peninsula improved to 4.7 percent in September 2021 compared to 9.0 percent in September 2020.

Table 3: U.S. Unemployment Rate

U.S. Unemployment Rate In Percent Quarterly Average Rate



Source: US. Bureau of Labor Statistics; BOTW

DISCUSSION

Included in this section are the Base Case and revenue and expense assumptions. As with all forecasts, there is uncertainty regarding the revenue and expenditure estimates contained in this document. For example, General Fund revenues may exceed or fall below expectations based on changes in economic or non-economic conditions. Various cost elements can also vary from year to year. Adding to this complexity is the uncertain recovery from the financial impacts of the COVID-19 pandemic. This forecast assumes a gradual improvement of economic conditions and the continued easing of public health restrictions. In this forecast major tax revenues continue to rebound from prior year levels, reserves for economically sensitive revenues are phased out as modified or canceled programs return, and investments in Capital projects are restored to pre-pandemic levels. It also recognizes legislative responses to the pandemic that have boosted the City’s financial outlook in the near term, such as the Coronavirus Aid, Relief, and Economic Securities Act (CARES Act), and American Rescue Plan Act (ARPA). As one-time sources, these funds are eliminated in FY 2024.

Base Case

The following table displays the projected General Fund revenues and expenditures over ten years and the cumulative net operating margin. The operating margin reflects the variance between the projected General Fund revenues and expenditures for each year of the forecast or the annual surplus or shortfall. The net operating margin is presented on a one-time basis, as the annual surplus or shortfall for a given year, and on an incremental basis. The incremental forecast assumes that each shortfall is addressed completely with ongoing solutions in the year

Attachment A

it appears and that each surplus is completely expended with ongoing expenditures. Because it is the City’s goal to remain in balance on an ongoing basis, the incremental figure is useful to illustrate the additional surplus and/or shortfall attributed to a particular fiscal year. To the extent that a shortfall is not resolved, or a surplus is not expended on an ongoing basis, it is important to understand that the remaining budget gap or surplus will carry over to the following year.

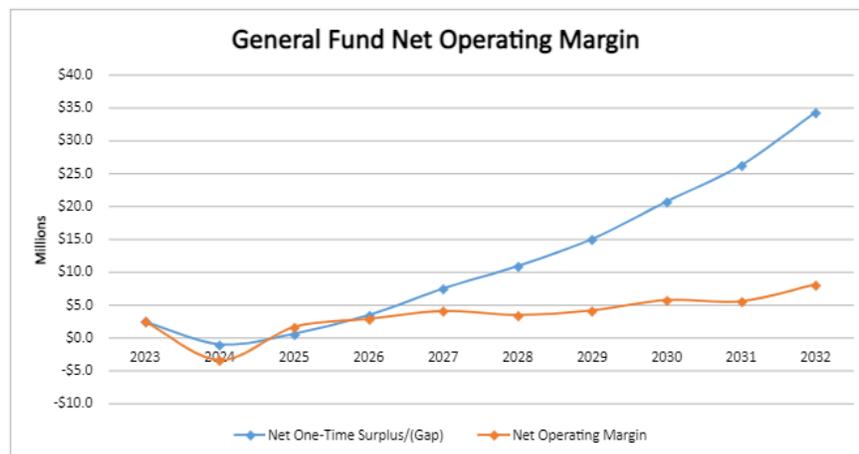
The current Base Case financial forecast projects a surplus of \$2.4 million in FY 2023, followed by a \$1.0 million shortfall in FY 2024, with small but increasing surpluses in FY 2025 through FY 2032. As outlined above, if the City spends the projected FY 2023 surplus of \$2.4 million on an ongoing basis, the available projected gap for FY 2024 will be approximately \$3.4 million. Based on these assumptions, the cumulative net operating margin, or ongoing surplus, during the forecast period is \$34.3 million.

TABLE 4: FY 2023 – 2032 Long Range Financial Forecast (Base Case)

	Actual 2021	Adopted 2022	Projected 2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	2032
Total Revenue	\$200,925	\$206,452	\$218,167	\$230,393	\$239,692	\$252,271	\$259,853	\$268,149	\$277,233	\$286,670	\$297,136	\$308,506	\$320,187
Total Expenditures	\$185,634	\$209,210	\$207,468	\$227,995	\$240,741	\$251,691	\$256,437	\$260,691	\$266,344	\$271,661	\$276,414	\$282,271	\$285,855
Net One-Time Surplus/(Gap)	\$15,291	(\$2,758)	\$10,699	\$2,398	(\$1,049)	\$581	\$3,416	\$7,458	\$10,889	\$15,009	\$20,722	\$26,235	\$34,332
Cumulative Net Operating Margin (One-Time)													\$119,990
Net Operating Margin			\$0	\$2,398	(\$3,446)	\$1,629	\$2,836	\$4,041	\$3,431	\$4,120	\$5,713	\$5,513	\$8,097
Cumulative Net Operating Margin													\$34,332

Assumes that the annual shortfalls are solved with ongoing solutions and annual surpluses are spent for ongoing expenditures.

TABLE 5: FY 2023 – 2032 Long Range Financial Forecast Net Operating Margin (Base Case)



Revenue Assumptions

On October 25, 2021, the City Council reviewed and discussed the preliminary Q1 FY 2022 financial status report ([CMR 13439](#)). This report provided a snapshot in time, with some revenues projected to exceed the FY 2022 Adopted Budget estimates that reflected a slow to moderate recovery pace as directed by the City Council ([CMR 11954](#)).

Tax revenues constitute nearly 60 percent of General Fund resources and the FY 2022 forecast projects a 10.5 percent, or \$11.6 million, increase over adopted levels that is driven by higher than anticipated receipts in Sales Tax, Property Tax, and Transient Occupancy Tax (TOT) categories. In FY 2023, the forecast projects a \$9.1 million, or 7.5 percent, tax revenue increase compared to the FY 2022 projected levels. The forecast assumes that major tax revenues continue to rebound from prior-year levels; however, overall tax revenues in FY 2022 remain below pre-pandemic levels by \$12.3 million, or 9.1 percent, and are not expected to reach pre-pandemic levels until FY 2024 in this LRFF.

The FY 2022 forecast for non-tax revenues projects a slight 0.2 percent, or \$112,000 increase over adopted levels. In FY 2023, the forecast projects a \$3.6 million, or 5.0 percent, increase compared to FY 2022 projected levels. This increase is primarily attributable to new fee-based programs in the Fire Department and the restoration of several programs and services that were modified due to public health orders, mainly in public safety and community services.

As part of the Federal stimulus support, the City is expected to receive \$13.7 million in American Rescue Plan Act (ARPA) funding that the Council, per the legislation, has designated to address the immediate financial impacts resulting from the COVID-19 pandemic, specifically the significant revenue loss. Budgetarily, and included in this forecast, is the assumed use of \$8.2 million (60 percent) appropriated in FY 2022 and \$5.5 million (40 percent) appropriated in FY 2023 to assist in smoothing the revenue loss as a result of the pandemic. As a one-time funding source, ARPA funding is eliminated in FY 2024 and beyond which contributes to the fluctuations in the surplus/operating gap in the first few years of the 10-year forecast. The changes by revenue category, as well as the current expected FY 2022 status of many of the revenue categories, are discussed in greater detail below.

TABLE 6: General Fund Revenue Forecast

Revenue & Other Sources	Actual 2021	Adopted 2022	Projected 2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	2032	CAGR 10 Years	CAGR 5 Years
Sales Taxes	29,127	28,184	30,633	32,306	33,369	34,333	35,157	36,107	37,118	38,205	39,535	41,152	43,012	2.9%	1.1%
Property Taxes	56,572	51,228	56,469	58,220	61,794	65,682	69,838	74,079	78,413	83,040	88,271	93,860	100,149	5.6%	2.4%
Transient Occupancy Tax															
General Purpose	2,796	2,528	5,398	7,684	10,862	12,938	13,361	13,768	14,294	14,887	15,612	16,398	17,255	8.4%	6.0%
Infrastructure	2,383	5,899	5,657	9,238	12,719	14,966	15,456	15,927	16,536	17,222	18,061	18,969	19,961	8.0%	5.6%
Documentary Transfer Tax	10,627	7,137	8,125	7,391	7,182	7,423	7,677	7,948	8,235	8,534	8,863	9,190	9,519	2.6%	0.7%
Utility Users Tax	14,642	14,370	14,667	14,898	15,616	16,483	17,436	18,448	19,618	20,570	21,379	22,276	23,235	4.5%	2.2%
Other Taxes and Fines	683	1,434	1,434	1,784	1,784	1,784	1,784	1,784	1,784	1,784	1,784	1,784	1,784	0.0%	0.0%
Subtotal: Taxes	116,830	110,780	122,383	131,522	143,327	153,610	160,710	168,062	175,998	184,242	193,505	203,629	214,916	5.0%	2.5%
Charges for Services	24,478	23,870	23,870	28,448	29,862	31,279	31,449	31,623	31,800	31,980	32,165	32,352	32,471	1.3%	1.1%
Permits and Licenses	7,888	8,406	8,406	9,455	9,532	9,840	10,041	10,158	10,400	10,650	10,905	11,163	10,854	1.4%	0.7%
Return on Investments	1,063	852	964	985	1,008	1,033	1,064	1,096	1,130	1,172	1,220	1,271	1,325	3.0%	1.1%
Rental Income	13,293	14,476	14,476	15,487	16,068	16,608	17,259	17,773	18,198	18,636	19,083	19,544	20,015	2.6%	1.4%
From Other Agencies	2,173	8,521	8,521	6,696	1,273	990	258	258	258	258	258	258	258	-27.8%	-27.8%
Charges to Other Funds	11,661	14,165	14,165	12,946	13,828	14,118	14,278	14,383	14,652	14,935	15,202	15,490	15,547	1.8%	1.1%
Other Revenue	2,387	2,260	2,260	2,261	2,202	2,202	2,204	2,204	2,205	2,206	2,207	2,207	2,208	-0.2%	-0.3%
Total Non-Tax Revenue	62,944	72,551	72,663	76,279	73,773	76,070	76,552	77,495	78,643	79,837	81,039	82,286	82,680	0.8%	0.2%
Operating Transfers-In	21,151	23,121	23,121	22,592	22,592	22,592	22,592	22,592	22,592	22,592	22,592	22,592	22,592	0.0%	0.0%
BSR Contribution (One-Time)															
Total Source of Funds	\$200,925	\$206,452	\$218,167	\$230,393	\$239,692	\$252,271	\$259,853	\$268,149	\$277,233	\$286,670	\$297,136	\$308,506	\$320,187		

TABLE 7: General Fund Revenue Forecast Year to Year Percentage Change

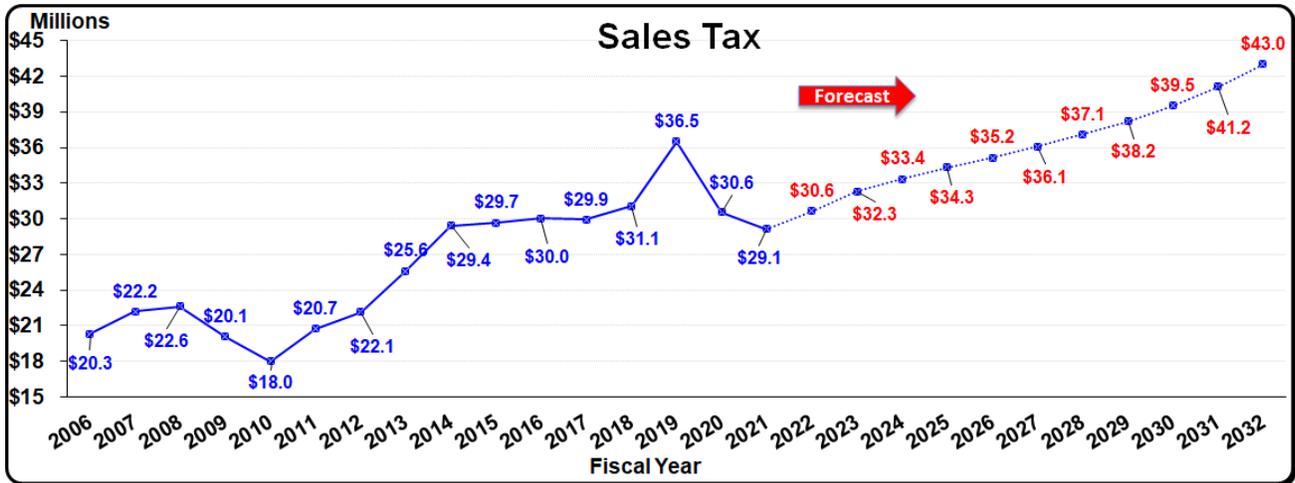
Revenue & Other Sources	Actual 2021	Adopted 2022	Projected 2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	2032
Sales Taxes		-3.2%	8.7%	5.5%	3.3%	2.9%	2.4%	2.7%	2.8%	2.9%	3.5%	4.1%	4.5%
Property Taxes		-9.4%	10.2%	3.1%	6.1%	6.3%	6.3%	6.1%	5.9%	5.9%	6.3%	6.3%	6.7%
Transient Occupancy Tax													
General Purpose		-9.6%	113.5%	42.3%	41.4%	19.1%	3.3%	3.0%	3.8%	4.2%	4.9%	5.0%	5.2%
Infrastructure		147.6%	-4.1%	63.3%	37.7%	17.7%	3.3%	3.0%	3.8%	4.1%	4.9%	5.0%	5.2%
Documentary Transfer Tax		-32.8%	13.8%	-9.0%	-2.8%	3.4%	3.4%	3.5%	3.6%	3.6%	3.9%	3.7%	3.6%
Utility Users Tax		-1.9%	2.1%	1.6%	4.8%	5.6%	5.8%	5.8%	6.3%	4.9%	3.9%	4.2%	4.3%
Other Taxes and Fines		110.1%	0.0%	24.4%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Subtotal: Taxes		-5.2%	10.5%	7.5%	9.0%	7.2%	4.6%	4.6%	4.7%	4.7%	5.0%	5.2%	5.5%
Charges for Services		-2.5%	0.0%	19.2%	5.0%	4.7%	0.5%	0.6%	0.6%	0.6%	0.6%	0.6%	0.4%
Permits and Licenses		6.6%	0.0%	12.5%	0.8%	3.2%	2.0%	1.2%	2.4%	2.4%	2.4%	2.4%	-2.8%
Return on Investments		-19.8%	13.1%	2.2%	2.3%	2.4%	3.0%	3.0%	3.1%	3.8%	4.1%	4.2%	4.3%
Rental Income		8.9%	0.0%	7.0%	3.8%	3.4%	3.9%	3.0%	2.4%	2.4%	2.4%	2.4%	2.4%
From Other Agencies		292.1%	0.0%	-21.4%	-81.0%	-22.2%	-74.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Charges to Other Funds		21.5%	0.0%	-8.6%	6.8%	2.1%	1.1%	0.7%	1.9%	1.9%	1.8%	1.9%	0.4%
Other Revenue		-5.3%	0.0%	0.0%	-2.6%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Total Non-Tax Revenue		15.3%	0.2%	5.0%	-3.3%	3.1%	0.6%	1.2%	1.5%	1.5%	1.5%	1.5%	0.5%
Operating Transfers-In		9.3%	0.0%	-2.3%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
BSR Contribution (One-Time)													
Total Source of Funds		2.8%	5.7%	5.6%	4.0%	5.2%	3.0%	3.2%	3.4%	3.4%	3.7%	3.8%	3.8%

Sales Tax

Sales tax receipts declined in FY 2020 and FY 2021 by 16.3 percent and 4.70 percent, respectively. However, the FY 2021 fourth quarter cash receipts increased by 28.2 percent over the prior year’s same quarter. The general retail, food products which includes restaurants, and transportation which includes auto sales had significant increases. This economic trend also occurred in municipalities in the San Francisco Bay Area and in California. These significant upward trends were partially offset by business-to-business sales which has been declining.

Sales Tax is anticipated to generate \$30.6 million in FY 2022, a \$2.5 million or 8.7 percent increase over the adopted level of \$28.2 million, and \$1.5 million or 5.2 percent over FY 2021 actuals of \$29.1 million. In FY 2023, this revenue is anticipated to increase to \$32.3 million, a \$1.7 million or 5.2 percent increase over FY 2022 projected levels. Revenue in this category is experiencing growth; however, remains below pre-pandemic levels of \$36.5 million in FY 2019.

TABLE 8: City of Palo Alto Sales Tax Revenues through FY 2032



Property Tax

Property tax revenue is the General Fund’s largest revenue source and represents approximately 25 percent of the total revenues. Historically, the 10-year compound annual growth rate (CAGR) was 8.2 percent with a low of –1.1 percent in FY 2011 and a high of 11.5 percent in FY 2015. During economic downturns, impacts to property tax occur a year later. As a result, the FY 2021 actual growth was 10.7 percent and FY 2022 is forecasted to be flat. In addition, fiscal years 2018, 2019, 2020, and 2021 included receipts of \$1.4 million, \$2.7 million, \$3.9 million, and \$5.5 million, respectively, for excess Educational Revenue Augmentation Fund (ERAF) distributions from the County of Santa Clara. The FY 2022 forecast includes \$4.5 million for excess ERAF. ERAF is the fund used to collect and disburse property taxes that are shifted to/from cities, the County, and special districts prior to their reallocation to K-14 school agencies. When the state shifts more local property tax than required to support schools these funds are returned and known as excess ERAF. As a result of the volatility of ERAF, it is not considered a permanent local revenue source.

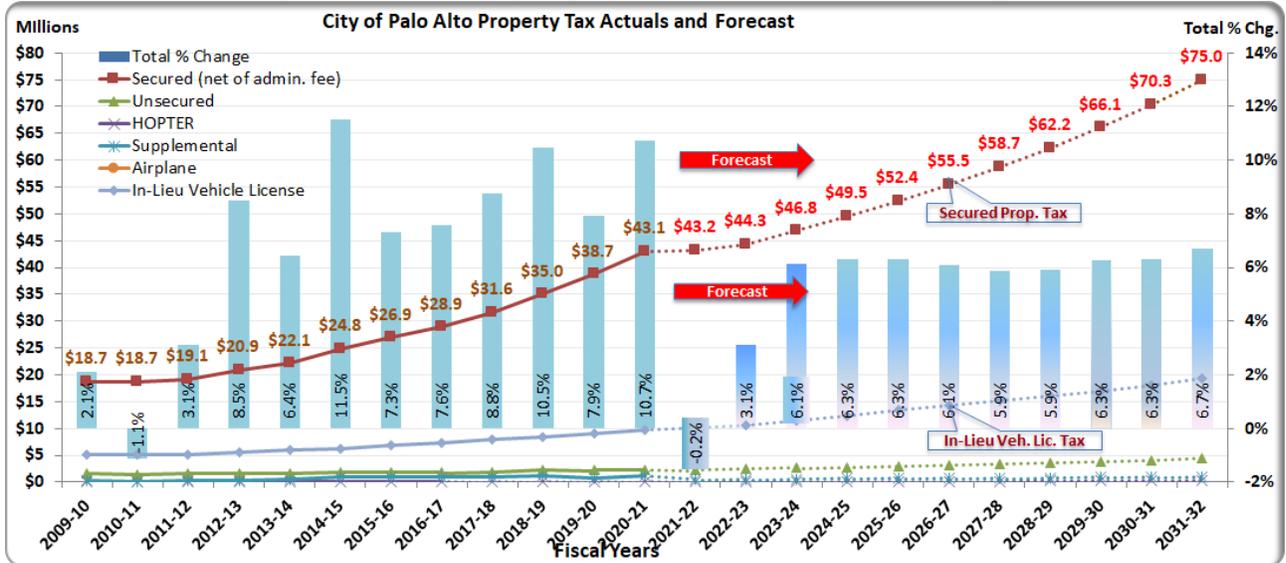
As discussed in the preliminary first quarter (Q1) FY 2022 financial status report ([CMR 13439](#)), five counties including, Santa Clara County, and the State were in a dispute over the calculation and disbursement of excess ERAF funds. The City had been reserving these funds, pending a resolution of the dispute beginning in FY 2021 and through prior near-term forecasts. The dispute between the counties and the State was settled in FY 2021 and, consistent with City Council direction, these funds have been recognized in the Budget Stabilization Reserve (BSR) and reallocated to the City’s reserve: Utilities Transfer Litigation (Equity Transfer). In FY 2022, an additional \$1.7 - \$2.0 million above budgeted levels is anticipated as a result of the favorable resolution.

In November 2021, the County of Santa Clara notified the cities that the California School Boards Association and its Education Legal Alliance filed a lawsuit against the Controller of the State of California arguing that the settlement reached with the counties is unlawful. The County estimates that 20 percent of ERAF in FY 2022 is subject to this litigation. This forecast assumes a slightly higher 25 percent or \$1.5 million reserve for potential loss starting in FY 2022

and beyond. It’s uncertain if a similar percentage is at risk for the prior two years; staff will continue to monitor the status of this dispute and report on any significant developments.

Transfer of ownership has been a significant driver of past growth; however, that growth is expected to moderate in FY 2022 due to the delayed impact of the (pandemic) recession. For example, the median sales price of single family residential in the first quarter of FY 2022 declined by 2.6 percent.

TABLE 9: City of Palo Alto Property Tax Actuals and Forecast through FY 2032



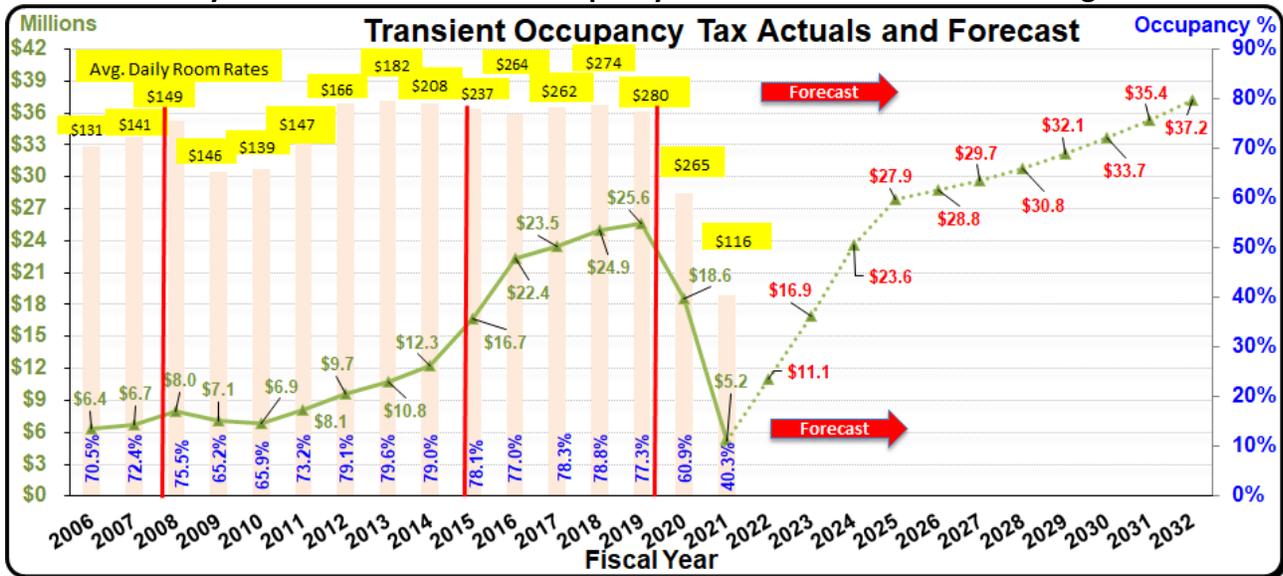
Property Tax is anticipated to generate \$56.5 million in FY 2022, a \$5.2 million or 10.2 percent increase over adopted levels of \$51.2 million and remains consistent with FY 2021 actuals of \$56.6 million. In FY 2023, this revenue is anticipated to increase to \$58.2 million, a \$1.7 million or 5.2 percent increase over FY 2022 projected levels.

Transient Occupancy Tax (TOT)

Revenue in this category is impacted by business and other leisure/non-leisure travel and has experienced significant reductions in prior years due to public health orders, travel restrictions, and diminishing business and personal travel plans resulting from the pandemic. As public health conditions improve and travel resumes, revenue in this category is anticipated to recover and possibly grow. This revenue remains low compared to pre-pandemic actuals of \$25.7 million in FY 2019; however, strong growth was realized in the FY 2021 fourth and FY 2022 first quarters. In FY 2022, receipts are expected to generate approximately \$11.1 million (57 percent below pre-pandemic levels) versus the FY 2021 actuals of \$5.2 million (80 percent below pre-pandemic levels); a 23 percent improvement. The opening of the two Marriott hotels in the prior fiscal year and the re-opening of several hotels in the first quarter of FY 2022 are positive developments that will also drive recovery for this tax revenue.

Estimated TOT receipts of \$11.1 million in FY 2022, would generate a \$2.7 million or 32.1 percent increase over adopted levels of \$8.4 million, and \$4.9 million or 113.5 percent over FY 2021 actuals of \$5.2 million. In FY 2023, this revenue is anticipated to increase to \$16.9 million, a \$5.8 million or 52.3 percent increase over FY 2022 projected levels. Year-to-date, daily average room rates increased by 37.7 percent from \$120.76 per day to \$166.24 per day while occupancy rate increased by 40.4 percent from 43.2 percent to 60.6 percent.

TABLE 10: City of Palo Alto Transient Occupancy Tax Actuals and Forecast through FY 2032

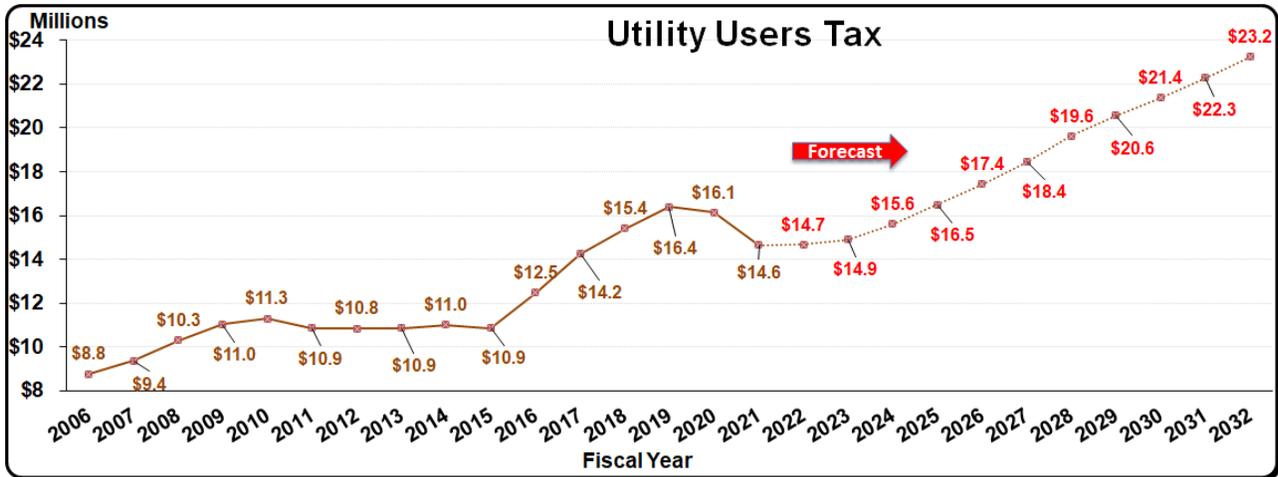


Note: Jan. 2008, TOT Rate went from 10% to 12%
 Jan. 2015, TOT Rate went from 12% to 14%
 April 2019, TOT Rate went from 14% to 15.5%

Utility User’s Tax (UUT)

The UUT is levied on electric, gas, and water consumption, as well as on telephone usage. Revenue in this category is impacted by consumption levels and has experienced reductions in prior periods due to water reduction programs and reduced workforces and business closures due to the pandemic. This revenue is showing early signs of recovery as public health orders ease and workers return to the office. UUT is anticipated to generate \$14.7 million in FY 2022, a \$0.3 million or 2.1 percent increase over adopted levels of \$14.4 million, relatively constant with FY 2021 levels. In FY 2023, this revenue is anticipated to increase to \$14.9 million, a \$0.2 million or 1.6 percent increase over FY 2022 projected levels.

TABLE 11: City of Palo Alto Utility Users Tax Actuals and Forecast through FY 2032

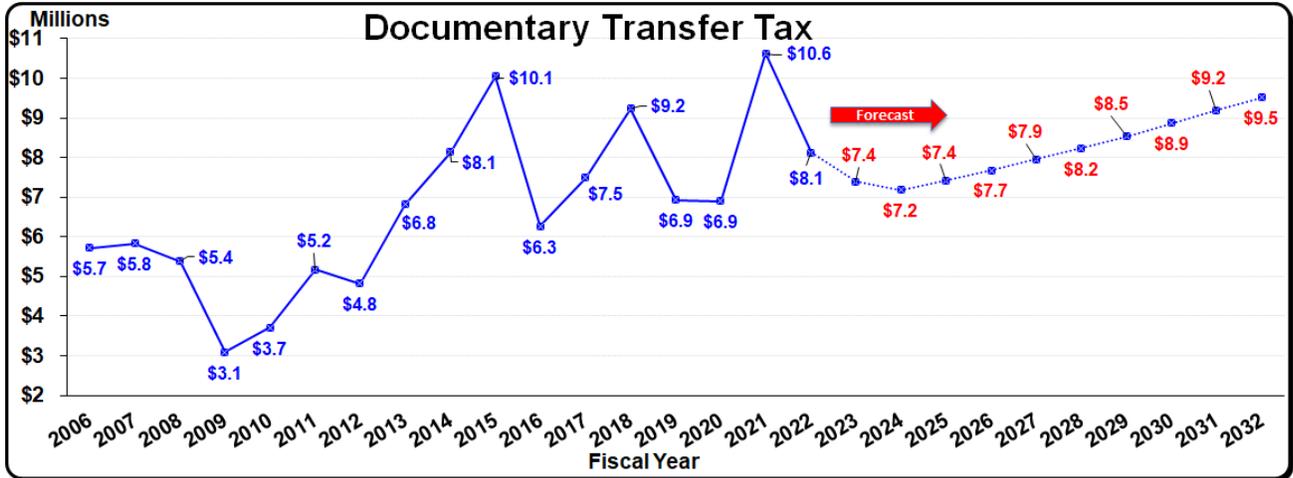


Documentary Transfer Tax (DTT)

Revenue in this category is highly volatile and dependent on sales volume and the mix of commercial and residential sales. In FY 2021, DTT experienced record receipts of \$10.6 million. This milestone was a result of six large commercial transactions and robust residential sales. During economic downturns, some investors see it as an opportunity to expand their holdings. Revenue from July through October in FY 2021 is running 4.4 percent above the same period in FY 2020. DTT is anticipated to generate \$8.1 million in FY 2022, a \$1.0 million or 13.8 percent increase over adopted levels of \$7.1 million, and \$2.5 million or 23.5 percent lower than FY 2021 actuals of \$10.6 million. In FY 2023, this revenue is anticipated to decrease to \$7.4 million, a \$0.7 million or 9.9 percent decrease over FY 2022 projected levels.

As in past years, this revenue source is challenging to forecast and can fluctuate month to month depending on real estate transactions. The number of transactions through October 2021 (283) are running higher than those through October 2020 (229) with the total value of these transactions increasing by 4.4 percent. However, though performance to date is higher than the FY 2021 peak revenue receipts, the FY 2021 DDT receipts is not expected to be repeated in FY 2022 since the major commercial sales receipts, which made up over half the DDT receipts in FY 2021, came in the latter half of the last fiscal year. Though the Palo Alto housing market remains strong, as discussed in the Property Taxes section, single family residential median sales price in Palo Alto has slightly declined, which is an expected occurrence as the recession will impact property sales activity in FY 2022.

TABLE 12: City of Palo Alto Documentary Transfer Tax Actuals and Forecast through FY 2032



Rental Income

Rental Income of \$14.5 million in FY 2022 primarily reflects rent paid to the General Fund from the City’s Enterprise Funds and the Cubberley Community Center. There is a slight increase in rental income of \$1.0 million. The increase can be attributed to a review of the changes in the California Consumer Price Index (CCPI) in the San Francisco Bay Area from the August-to-August period, and it is expected that revenues will be reviewed and revised subsequent to this forecast based on updated information, typically the December to December change in the CCPI. This also assumes rentals of City space return to pre-pandemic levels in FY 2023. Impacts from the pandemic, including reductions related to the rent forgiveness program ([CMR 12234](#)) which provides up to three months of rent forgiveness for active non-profit tenants should be resolved in FY 2022. As of November 1, 2021, the program has resulted in 12 tenant applications for \$255,000 of the \$744,000 budgeted for rent relief. A further round of applications will occur prior to the program’s sunset at the end of FY 2022. Additionally, staff are working with several tenants to resolve issues of past due rent, and the City Attorney’s Office has become involved in ongoing discussions. It is assumed this revenue source will decrease during FY 2022 until past due rent issues are resolved.

The City is also considering using the former Los Altos Treatment Plant (LATP) site for Project Homekey and a water purification site. Should this occur, the site would no longer be available for rental as a laydown yard. Please see the General Expenses section of this report for additional information regarding future plans for the former LATP site.

Charges for Services and Permits and Licenses

Revenues in the ‘Charges for Services’ and the ‘Permits and Licenses’ categories are anticipated to be \$28.4 million and \$9.5 million, respectively, in Fiscal Year 2023. These amounts are approximately \$5.6 million higher than the FY 2022 amounts, mainly due to adjustments to revenue from new Fire Department fees and adjustments to the Economically Sensitive Department Revenue Reserve, discussed below.

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Revenues in these categories were impacted by changes in FY 2023, such as increases to reflect a full year of operation for the Junior Museum and Zoo, which includes a ticketed entry fee and membership program. These budget categories also include revenues associated with two fee-based programs in the Fire Department: a first responder fee (assessed on commercial insurance companies), to cover the cost for initial response for first due engine; and an ambulance subscription fee, to secure co-pay free ambulance transport. These fees are still in development and are currently scheduled for implementation by Spring or Summer of 2022.

Additionally, revenues in these categories were impacted by a phase-out of the Economically Sensitive Department Revenue Reserve. This reserve was established to mitigate unexpected losses from services impacted by the COVID-19 pandemic, such as the suspension of parking enforcement, delays opening the Junior Museum and Zoo, and limited operations at community centers, recreational facilities, and the Children's Theatre. In total, \$5.0 million was set aside for this purpose in the prior year. This forecast assumes gradual overall improvements in the return of canceled or modified services by phasing out this reserve over three years, appropriating \$2.5 million in FY 2023, \$1.25 million in FY 2024, and \$0 in FY 2025 and beyond.

The revenue estimates in these categories are primarily driven by the cost of staff to provide services to the community; therefore, revenues are impacted by the City's personnel service costs and modeled to increase by rates consistent with general salary and benefits and CPI trends. One exception to this is for Development Services activities and related revenue. Development Services fees are fully cost-recoverable and the department has been modeled as cost-neutral in this forecast. Staff will analyze municipal fee revenue activity as part of the FY 2023 Budget development process and bring forward adjustments as appropriate.

Charges for Service - Stanford Fire and Dispatch Services

The City and Stanford have two separate agreements for the provision of fire response and emergency dispatch services. The fire response services agreement became effective in July 2018 and outlines service level terms and a new cost allocation methodology as the baseline for agreement costs. The term extends through June 2023, with renewals through 2028 unless otherwise terminated. The agreement included a new staffing deployment model for suppression and medical services, which was approved by the City Council in October 2017 and deployed in January 2018. This forecast aligns with the new staffing model and, in accordance with the agreement, adjustments to revenue from Stanford have been aligned with the year-over-year changes to the operating expenses in the Fire Department for FY 2022. Similarly, changes to the revenue received for dispatching services have been aligned with the FY 2022 adjustments to the operating expenses in the Technical Services Division of the Police Department where the costs to provide these services are budgeted. Adjustments include applicable costs for the Public Safety Communications Manager position approved as part of FY 2022 preliminary first quarter adjustments. For fire revenue, additional adjustments may be applicable if a new labor agreement with IAFF is negotiated. Salary and benefits cost increases are assumed using the CCPI in the San Francisco Bay Area from the August-to-August period of 3.7% for the base year and 2.5% for out years.

Charges to Other Funds

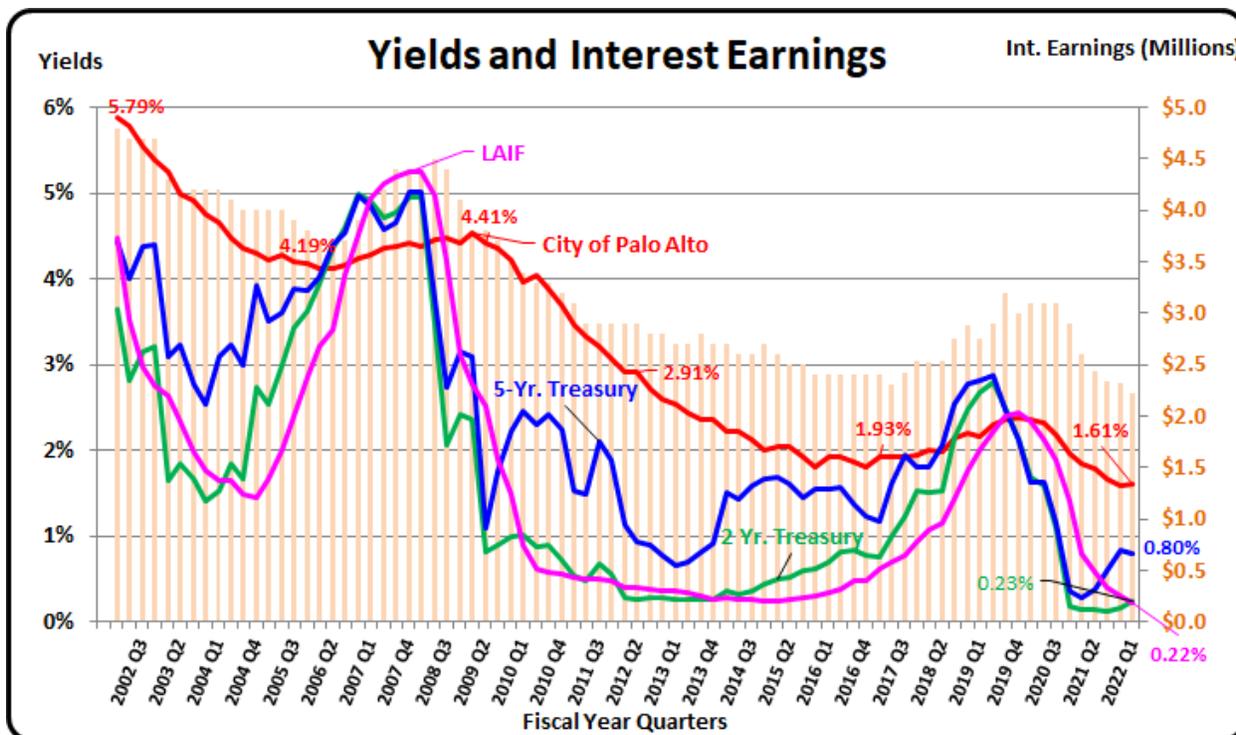
The main source of revenues in this category is General Fund administrative cost allocation plan charges to the Enterprise and Internal Service Funds. Internal support departments such as Administrative Services, Human Resources, and Council Appointed Offices provide services to Enterprise and Internal Service Funds. The costs for these services are recovered through the administrative cost allocation plan charges. The FY 2023 estimate for Charges to Other Funds of \$13.0 million reflects a slight decrease of 8.45 percent from the FY 2022 Adopted amount of \$14.2 million; this is primarily attributed to fully adjusting the costs associated with the allocated charges in the Internal Support Departments to the adjustments made as part of the FY 2022 Budget as well as a technical adjustment to better align the cost plan methodology with the system calculations.

Return on Investment

The return-on-investment category reflects the interest earnings on the City's investment portfolio. This category is a combination of past investments, new investments at current market rates, and available investable cash which fluctuates seasonally and annually. Staff had anticipated the decline in interest rates would occur sooner and at a faster rate than it has occurred, so the City experienced a higher than anticipated return on investments in FY 2021. In addition, prudent investments further resulted in higher investment yields and earnings.

The average portfolio rate of return for the first quarter of FY 2022 was 1.61 percent, and a 1.58 percent average yield as of the fourth quarter of FY 2021. The revised General Fund FY 2022 interest earning estimate of \$0.95 million is \$0.10 million higher than the Adopted Budget of \$0.85 million. In FY 2023, the forecast reflects a relatively level interest rate environment with slight increases through the ten-year period.

TABLE 13: Palo Alto Historical Investment Portfolio Yield and Citywide Interest Earnings



Operating Transfers-in

Operating Transfers-in materialize as expenses in other funds throughout the City and as a revenue in the General Fund. This budget category includes repayment of a previous loan from the General Fund to the Airport Fund, funding for police patrol in the downtown area, and the equity transfer from the Electric and Gas funds. Overall, the Operating Transfers-in are estimated to be \$22.6 million, a \$0.5 million decrease from the FY 2022 level of \$23.1 million due to the removal of a one-time transfer of funding for animal services in FY 2022.

In accordance with a methodology approved by the City Council in June 2009, the equity transfer is calculated by applying a rate of return on the capital asset base of the Electric and Gas funds. This rate of return is based on PG&E's rate of return on equity as approved by the California Public Utilities Commission (CPUC). The transfer amount is calculated based on the Utility Department's projections from the Electric and Gas Five Year Financial Forecasts, as approved by the City Council in spring 2021 (CMR [12240](#)). For more detail on the ordinance adopting the 2009 transfer methodology, see CMR 280:09, Budget Adoption Ordinance for Fiscal Years 2009 and 2010; and CMR 260:09, Finance Committee Report explaining proposed changes to equity transfer methodology.

This estimate also considers the trial court's decision in Green v. City of Palo Alto (Santa Clara Superior Court Case No. 16CV300760), a class action lawsuit which challenges the City's gas and electric rates under Proposition 26, one of many such cases following a 2015 decision involving the City of Redding. In Green, the trial court judge found the City's electric rates valid, but that the City's gas rates were taxes requiring voter approval under California's Proposition 26,

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because they were set at a level sufficient to fund an annual transfer to the City’s general fund. The results of this lawsuit will have important implications for Palo Alto, as well as for other municipal utilities and cities in California. In September 2021, the Council therefore authorized an appeal to seek guidance from the Court of Appeal on these novel legal questions. The City is also exploring a ballot measure to seek voter approval or modification of the City’s general fund transfer so City voters can have the final word on how they want to finance City services, and at what level. Because the appeal is pending, the exact exposure to the City’s General Fund cannot be estimated at this time. However, the City believes it is prudent to set aside funding to cover the \$12.6 million remedy related to gas rates that the Superior Court identified in Phase II, plus interest, as well as the estimated future reduction in the gas equity transfer, should the current Santa Clara County Superior Court decision be upheld. While the process for calculating the equity transfer from the Electric and Gas Funds has not changed, the funding is now being held in a Litigation Reserve. This action continues the City’s proactive actions to address known liabilities with the best information available at the time and sets these funds aside pending final resolution of this dispute.

Expense Assumptions

As part of developing the FY 2023-2032 Forecast expenditure budget, the General Fund expense categories have been adjusted by removing FY 2022 Adopted Budget one-time expenses and updating major cost elements such as salary and benefits costs. The table below displays the expense forecast and when compared to the FY 2022 estimated expenditures, growth of 9.9 percent is expected in FY 2023.

TABLE 14: General Fund Expense Forecast and Year to Year Percentage Change

Expenditures & Other Uses	Actual	Adopted	Projected										CAGR 10 Years	CAGR 5 Years	
	2021	2022	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031			2032
Salary	67,284	69,304	66,304	72,531	74,791	76,699	78,718	80,554	82,274	83,986	85,698	87,411	89,125	2.5%	1.1%
Benefits	58,509	62,245	63,745	66,247	68,738	71,045	71,867	72,088	73,581	74,650	76,004	77,392	76,430	2.1%	0.8%
Subtotal: Salary & Benefits	125,793	131,549	130,049	138,778	143,529	147,744	150,584	152,641	155,855	158,636	161,701	164,803	165,554	2.3%	1.0%
Contract Services	17,807	30,200	30,200	29,088	29,756	30,417	28,107	28,631	29,185	29,710	30,284	30,796	31,378	0.4%	-0.2%
Supplies & Material	2,234	2,980	2,980	3,085	3,160	3,234	3,308	3,382	3,456	3,530	3,604	3,678	3,752	2.3%	0.9%
General Expense	6,585	7,938	7,938	8,481	8,548	8,631	8,684	8,752	8,821	8,904	7,959	8,026	8,093	0.2%	0.3%
Rents & Leases	1,709	1,298	1,298	1,332	1,367	1,404	1,442	1,481	1,522	1,563	1,605	1,649	1,693	2.7%	1.1%
Facilities & Equipment	464	427	427	443	454	465	476	487	498	509	520	531	542	2.4%	1.0%
Allocated Charges	17,423	20,117	20,117	22,445	23,105	23,729	24,275	24,818	25,417	26,040	26,630	27,250	27,780	3.3%	1.0%
Total Non Sal/Ben Before Transfers	46,221	62,960	62,960	64,875	66,391	67,880	66,292	67,551	68,899	70,255	70,602	71,929	73,238	1.5%	0.4%
Operating Transfers-Out	4,326	4,296	4,296	4,431	4,462	4,493	4,529	4,561	4,598	4,636	4,669	4,707	4,746	1.0%	0.3%
Transfer to Infrastructure - Base	6,911	4,506	4,506	10,673	13,640	16,607	19,575	20,010	20,456	20,912	21,381	21,863	22,356	17.4%	6.5%
Transfer to Infrastructure - TOT	2,383	5,899	5,657	9,238	12,719	14,966	15,456	15,927	16,536	17,222	18,061	18,969	19,961	13.0%	5.6%
Total Use of Funds	185,634	209,210	207,468	227,995	240,741	251,691	256,437	260,691	266,344	271,661	276,414	282,271	285,855	3.2%	1.3%

Expenditures & Other Uses	Actual	Adopted	Projected										
	2021	2022	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	2032
Salary	3.0%	-4.3%	9.4%	3.1%	2.6%	2.6%	2.3%	2.1%	2.1%	2.0%	2.0%	2.0%	2.0%
Benefits	6.4%	2.4%	3.9%	3.8%	3.4%	1.2%	0.3%	2.1%	1.5%	1.8%	1.8%	-1.2%	-1.2%
Subtotal: Salary & Benefits	-0.2%	-0.2%	6.7%	3.4%	2.9%	1.9%	1.4%	2.1%	1.8%	1.9%	1.9%	0.5%	0.5%
Contract Services	69.6%	0.0%	-3.7%	2.3%	2.2%	-7.6%	1.9%	1.9%	1.8%	1.9%	1.7%	1.9%	1.9%
Supplies & Material	33.4%	0.0%	3.5%	2.4%	2.3%	2.3%	2.2%	2.2%	2.1%	2.1%	2.1%	2.0%	2.0%
General Expense	20.6%	0.0%	6.8%	0.8%	1.0%	0.6%	0.8%	0.8%	0.9%	-10.6%	0.8%	0.8%	0.8%
Rents & Leases	-24.1%	0.0%	2.7%	2.7%	2.7%	2.7%	2.7%	2.7%	2.7%	2.7%	2.7%	2.7%	2.7%
Facilities & Equipment	-8.0%	0.0%	3.7%	2.5%	2.4%	2.4%	2.3%	2.3%	2.3%	2.2%	2.2%	2.1%	2.1%
Allocated Charges	15.5%	0.0%	11.6%	2.9%	2.7%	2.3%	2.2%	2.2%	2.4%	2.4%	2.3%	2.3%	1.9%
Total Non Sal/Ben Before Transfers	3.1%	3.1%	3.0%	2.3%	2.2%	-2.3%	1.9%	2.0%	2.0%	0.5%	1.9%	1.8%	1.8%
Operating Transfers-Out	-0.7%	0.0%	3.1%	0.7%	0.7%	0.8%	0.7%	0.8%	0.8%	0.7%	0.8%	0.8%	0.8%
Transfer to Infrastructure - Base	-34.8%	0.0%	136.8%	27.8%	21.8%	17.9%	2.2%	2.2%	2.2%	2.2%	2.3%	2.3%	2.3%
Transfer to Infrastructure - TOT	147.6%	-4.1%	63.3%	37.7%	17.7%	3.3%	3.0%	3.8%	4.1%	4.9%	5.0%	5.2%	5.2%
Total Use of Funds	12.7%	-0.8%	9.9%	5.6%	4.5%	1.9%	1.7%	2.2%	2.0%	1.7%	2.1%	1.3%	1.3%

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FY 2022 Preliminary First Quarter Adjustments

On October 25, 2021 the City Council received preliminary information on the City's financial condition as of the first quarter (Q1) of FY 2022. That report indicated a gradual improvement in the local economic outlook, similar to national trends. During that meeting, Council also approved several budgetary and staffing adjustments to realign resources with priorities identified by the City Council after the FY 2022 Adopted Budget (CMR 13439). Ongoing adjustments from FY 2022 Q1 are part of this forecast, including the addition of economic development coordination and management staffing (1.00 FTE Assistant to the City Manager) housing support operations program staffing (1.00 FTE Assistant to the City Manager), Development Center front desk staffing (1.00 FTE Administrative Associate III), and the restoration of the Public Safety Communications Manager (1.00 FTE). The City Council also expressed interest in staff bringing forward an additional action in FY 2022 to add a Code Enforcement Officer (1.00 FTE, approximately \$170,000 including staffing and vehicle costs) to support enforcement of the ban on gas powered leaf blowers and address the backlog of code enforcement requests. Various one-time adjustments were also approved, which are detailed in CMR 13439. These one-time adjustments are contemplated in this forecast in that they impact the FY 2023 estimated beginning balance of the Budget Stabilization Reserve (BSR).

In addition to these actions, Council also approved the acceptance and appropriation of a Staffing for Adequate Fire Emergency Response (SAFER) Grant to reimburse the City for an additional 5.0 FTE Firefighter positions for three years ([CMR 13643](#)). These positions have been assumed in this forecast along with the ongoing costs associated with the positions once the grant funding ends in FY 2025.

Salary and Benefits

The table above depicts the estimated General Fund salaries and benefits costs. Consistent with prior years, the FY 2023 salaries and benefits costs represent approximately 60 percent of the General Fund budget expenditures.

Salary and Benefits are projected to increase \$7.2 million or 5.2 percent from the prior year, from \$131.5 million to \$138.8 million. Discussed in the following sections, this is primarily attributable to increases in salaries (\$3.2 million or 4.7 percent) and pension costs (\$2.7 million or 7.8 percent).

Salary

Consistent with the City's salary budget methodology for recent budgets, positions are budgeted at the actual rate of pay of employees including benefit selections as of Fall 2021. Then, by position, salary costs are updated in accordance with applicable Memorandum of Agreements (MOA's) between the City and its labor groups and the Management and Professional Personnel and Council Appointees Compensation Plan(s). It is important to note that as of this forecast, all bargaining groups are at the end of their agreement terms. The forecast assumes step increases for employees in applicable positions, including SEIU, IAFF, and PAPOA, and merit increases for Management and Professional employees. A general wage

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adjustment of 2.0 percent is included for all employees and all years of the forecast since no MOA’s are in effect. This is consistent with prior Council direction in previous long range financial forecasts to use the 2.0 percent increase as a forecasting assumption, not as a commitment to future negotiations.

Benefits

Pension: Pensions are budgeted based on CalPERS determined rates as of the June 30, 2020 valuation ([CMR 13440](#)) for the City’s Miscellaneous and Safety plans. CalPERS determines the City’s total contributions for a given Fiscal Year as the sum of two factors: Normal Cost (NC) and Unfunded Accrued Liability (UAL). Together the NC and the UAL expressed as a percentage of payroll is the ‘blended rate’ and is used to represent total costs in the discussion below.

The *Normal Cost (NC)* is expressed as a percentage of payroll and is paid as part of the payroll reporting process of active employees. Commonly referred to as the ‘pay-go’ cost, the NC is variable and increases or decreases directly with the salary levels of the City. It represents the necessary funding for the City to pay for employees presuming that CalPERS meets the current set of assumptions.

In a year that CalPERS does not meet assumptions, due to plan changes, assumption changes, method changes, or plan experience (including investment gains/losses), there is an increase or decrease to the *Unfunded Accrued Liability (UAL)*. Commonly referred to as the ‘catch-up’ cost, the UAL is expressed as a dollar amount and is calculated over an amortized period with defined annual payments, similar to a mortgage. The contributions for UAL are billed as a flat dollar amount as opposed to a percentage of payroll due to potential funding issues that could arise from a declining payroll or number of active members in the plan. However, CalPERS provides an estimated percentage of payroll for UAL to allow a consistent comparison of total costs.

In the miscellaneous plan, total costs are projected to increase from the current 41.8 percent in FY 2022 to 42.9 percent in FY 2023. In the safety plan, total costs are projected to increase from the current 69.6 percent in FY 2022 to 71.1 percent in FY 2023. These rates do not consider the employee pick-up of the employer share; that pick-up materializes as savings in the City’s pension costs. Consistent with applicable MOAs, the FY 2023 forecast presumes that the miscellaneous plan will pick up 1 to 2 percent of the employer pension cost and that safety plan members will pick up 3 to 4 percent.

TABLE 15: CalPERS’ Projected FY 2022-2032 Blended Retirement Rates

(percentage of payroll)

	FY 2022	FY 2023	FY 2024	FY 2025	FY 2026	FY 2027	FY 2028	FY 2029	FY 20230	FY 2031	FY 2032
Miscellaneous	41.8	42.9	43.5	44.1	41.5	37.6	37.2	36.7	36.3	36.0	32.6
Safety	69.6	71.1	72.9	74.0	74.0	73.8	73.1	71.3	70.4	69.5	66.0

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The City has taken several proactive steps to address rising pension costs and long-term liabilities, including cost-sharing in labor agreements, establishing an irrevocable Section 115 Pension Trust (“Pension Trust”), and adopting a Pension Funding Policy. In January 2017 the City council authorized the establishment of a Pension Trust Fund with the Public Agency Retirement Service (PARS) ([CMR 7553](#)). Contributions were initially made to the Pension Trust on an ad-hoc basis, using one-time savings or excess revenues. In October 2018, the City Council directed staff to include in budget assumptions the NC for pension benefits at an equivalent of 6.2 percent discount rate and a transfer of the additional (“supplemental”) funding beyond CalPERS actuarial determined contribution levels to the Pension Trust Fund ([CMR 9740](#)). Additional one-time contributions continue to be made each year if excess revenues or unspent savings are available, subject to City Council approval. This practice was reinforced in the development of a Pension Funding Policy, adopted by the City Council in November 2020 ([CMR 11722](#)). As part of policy goals, the City seeks to reach a 90 percent funded status by FY 2036. This policy is subject to modification at City Council discretion and requires that staff report the status of the funding goal every three years. Staff anticipates returning in Fall 2022 with this analysis. In this forecast, an approximate \$5.2 million (\$3.1 million in the General Fund) in supplemental contributions is assumed in FY 2023, relatively constant to prior year contribution levels. Through FY 2022, a total of \$40.2 million in principal contributions will have been made to the Pension Trust.

In the General Fund, it is anticipated the City will spend a total of \$37.3 million on total pension costs in FY 2023, including both CalPERS contributions and supplemental Pension Trust Fund contributions. This is approximately \$2.7 million higher than the prior year costs of \$34.6 million, or a 7.8 percent increase. These expenses represent approximately 16 to 17 percent of the General Fund’s total expenses.

Healthcare: Consistent with the most recent labor agreements between the City and its bargaining units in the General Fund, the City’s contribution amounts towards medical costs for employees are based on a flat rate contribution from the City, with the employee contributing towards the remaining medical plan premium. Like salaries, healthcare costs are updated in accordance with applicable Memorandum of Agreements (MOA) between the City and its labor groups and the Management and Professional Personnel and Council Appointees Compensation Plan(s).

Retiree Healthcare/Other Post-Employment Benefits (OPEB): Retiree Medical is based on the most recent actuarial study prepared by Bartel Associates, which is completed every two years. The most recent study was completed in May 2021 to inform the development of the FY 2023 and FY 2024 operating budgets. Consistent with City Council direction ([CMR 11284](#)), this forecast continues the practice to budget the cost for retiree healthcare at a more conservative 6.25 percent discount rate and transmit the amount above the required payment as an additional discretionary payment (“prefunding”) to the California Employers’ Retiree Benefit Trust (CERBT) Fund. In FY 2022, this additional contribution is approximately \$2.2 million (\$1.4 million General Fund). The City continues to budget for the full payment of the Actuarial

Determined Contribution (ADC) for retiree healthcare. CalPERS blends active employees with pre-Medicare retirees and charges the same medical premium, even though younger employees on average consume less healthcare. The higher premium to younger employees thereby subsidizes older employees and retirees who, on average, have higher claims and premiums. This implied subsidy effectively lowers the funding necessary to meet the ADC. The FY 2023 Budget estimates \$9.3 million for ADC, an approximate \$500,000 or 5.7 percent increase from FY 2022 levels of \$8.8 million.

TABLE 16: Retiree Medical General Fund Contributions (Millions)

FY 2023	FY 2024	FY 2025	FY 2026	FY 2027	FY 2028	FY 2029	FY 2030	FY 2031	FY 2032
\$9.3	\$9.5	\$9.8	\$10.1	\$10.1	\$10.9	\$11.2	\$11.5	\$11.9	\$12.3

Workers' Compensation: The budget appropriation for workers' compensation includes an estimate for claims incurred and reserves for current filings at an 85 percent confidence level, based on actuarial studies completed by Bickmore. In FY 2021, claims expenditures decreased slightly by \$340,000 or 5.3 percent from \$6.4 million to \$6.1 million from the prior year. Actuarial estimates completed in August 2020 informed FY 2022 budget levels of \$5.9 million (\$3.9 million in the General Fund). More recent actuary estimates completed in August 2021 project higher than expected levels for FY 2022 at \$6.3 million (\$4.2 million in the General Fund). Staff will continue to monitor expenditures in the fund and bring forward adjustments as necessary. Estimates for FY 2023 are \$6.6 million (\$4.4 million in the General Fund), representing a \$0.8 million increase (\$0.5 million in the General Fund) or 12.8 percent increase over the Adopted FY 2022 Budget of \$5.9 million (\$3.9 million in the General Fund). Estimates for workers' compensation increase in the forecast at rates consistent with general CPI increases.

Contract Services

This forecast assumes contract services of \$29.1 million in FY 2023, a 3.7 percent decrease from the FY 2022 Adopted budget of \$30.2 million. This decrease is driven primarily by the removal of one-time costs adopted in FY 2022 including funding to address continued COVID-19 recovery efforts across the City. These decreases are partially offset by service contract increases as well as a 3.7 percent CPI cost increase in FY 2023 based on a review of the changes in the California Consumer Price Index (CCPI) in the San Francisco Bay Area from the August to August period. It is expected that the estimated CPI increases will be substituted with further department base budget requests as part of the FY 2023 budget process.

Contract Services - Committed Additions

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The Committed Additions included in this forecast account for anticipated operating and maintenance (O&M) costs in the General Fund for capital projects anticipated to come online in within the ten-year forecast period. A preliminary total estimate of \$0.1 million for costs associated with the Boulware Park Improvements (PE-17500) and Library Automated Materials Handling (LB-21000) projects that are anticipated to come online in FY 2023. Additional cost increases are included throughout the ten-year forecast, primarily due to estimated operating impacts from the Public Safety Building (PE-15001), Fire Station 4 (PE-18004), Dog Park Installations (PG-18001), and Park Restroom Installations (PG-19000).

TABLE 17: FY 2023 – FY 2032 Committed Additions (Millions)

<u>FY 2023</u>	<u>FY 2024</u>	<u>FY 2025</u>	<u>FY 2026</u>	<u>FY 2027</u>	<u>FY 2028</u>	<u>FY 2029</u>	<u>FY 2030</u>	<u>FY 2031</u>	<u>FY 2032</u>
<u>\$0.1</u>	<u>\$0.5</u>	<u>\$0.6</u>	<u>\$0.6</u>	<u>\$0.6</u>	<u>\$0.7</u>	<u>\$0.7</u>	<u>\$0.7</u>	<u>\$0.7</u>	<u>\$0.8</u>

Supplies and Materials

The FY 2022 Adopted Budget for the General Fund included \$3.0 million for Supplies and Materials, which is anticipated to increase slightly by a 3.7 percent CPI cost increase in FY 2023 to \$3.1 million based on a review of the changes in the California Consumer Price Index (CCPI) in the San Francisco Bay Area from the August to August period. It is expected that the estimated CPI increases will be substituted with department base budget requests as part of the FY 2023 budget process.

General Expense

This category includes costs for travel and meetings, telephone and non-city utilities, contingency accounts, bank card service charges, and subsidies and grants provided through the Human Services Resource Allocation Program (HSRAP). The FY 2022 Adopted Budget of \$7.9 million is expected to increase to \$8.5 million in FY 2023, primarily due to a \$1.0 million increase for Project Homekey (discussed further below) and a 3.7 percent CPI cost increase based on a review of the changes in the California Consumer Price Index (CCPI) in the San Francisco Bay Area from the August to August period. These increases are partially offset by a \$0.8 million decrease for the removal of the Budget Uncertainty Reserve in FY 2023. It is expected that the estimated CPI increases will be substituted with department base budget requests as part of the FY 2023 budget process.

General Expense – Project Homekey: On September 27, 2021 the City Council directed staff to apply for Project Homekey funding in conjunction with LifeMoves to build an emergency shelter at the former Los Altos Treatment Plant (LATP) site (CMR 13595). This project will rapidly deploy modular housing to provide interim housing opportunities for homeless individuals and families in the City of Palo Alto. Project Homekey is a program, funded by the State of California Department of Housing and Community Development, intended to provide grant funding and facilitate a partnership with the State to quickly acquire, rehabilitate, or master lease a variety of housing types. Once developed, these projects provide interim or permanent housing options for persons experiencing homelessness and who are also at risk of health concerns. The

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site would be operated for at least fifteen years as interim housing per the program's durational requirement. This project would utilize a combination of funding sources including the Project Homekey Program for capital expenses and donations, grant funds, and City support for ongoing operations expenses. This LRFF includes the City's committed investment of \$7.0 million in operating expenses (\$1.0 million annually starting in FY 2023 through FY 2029), with actual timing of the funding still to be determined. Some operating funding support is expected from Project Homekey as well as the County of Santa Clara. Any remaining gaps in funding will need to be closed by fundraising, operating cost containment strategies, and/or grant funds.

General Expense - Cubberley Lease: In FY 2015, the City and Palo Alto Unified School District (PAUSD) agreed to a five-year extension of the Cubberley lease from January 2015 to December 2019. In October 2019, the City Council directed staff to negotiate with PAUSD to extend the lease agreement an additional five years, through December 2024 ([CMR 10730](#)). A new Cubberley lease was approved by the City Council in June 2020 ([CMR 11460](#)) for a smaller portion of the Cubberley site with a correspondingly lower base rent payment([CMR 11386](#)). As part of the original lease agreement, the City Council approved creation of the Cubberley Infrastructure Improvements Fund. The new lease continues the \$1.9 million transfer to the Cubberley Property Infrastructure Fund, which is classified as an Operating Transfer-Out and discussed in further detail below. With the Cubberley Infrastructure funds set aside, the monthly base rent for the Cubberley premises is \$228,000 throughout the term or \$2.7 million annually. The monthly base rent may be reduced by \$14,000 per month if the JMZ Building is returned to PAUSD and \$6,000 per month if the S Building is returned. The Community Services Department is currently in negotiations with PAUSD to expand the Cubberley premises by renting additional space from the M Building. Separately, the City leases extended child daycare site from PAUSD on a two-year lease from July 2020 to June 2022. The combined monthly rent for the child daycare sites amounts to \$59,000 plus \$4,000 for utilities (\$756,000 annually for rent and utilities).

Rents and Leases

The Rents and Leases expense category for FY 2023 is estimated to increase from the prior-year level by approximately 3 percent based previously negotiated lease increases and remain at \$1.0 million. This category includes the lease agreement for Development Services staff at locations outside City Hall (285 Hamilton and 526 Bryant) as well as lease with Stanford for El Camino Park. A new lease agreement was executed in December 2020 for the Development Services office location at 526 Bryant Street, limiting the space to the basement level ([CMR 11426](#)). In June 2021, the City entered into a seventh amendment for the Development Services office lease at 285 Hamilton Avenue to extend the term from February 2022 to January 2025 ([CMR 12334](#)). As expenses for rent for Development Services are adjusted, a corresponding revenue adjustment will be made to ensure Development Services maintains cost recovery levels.

Facilities and Equipment

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The Facilities and Equipment expense category is expected to increase from the FY 2022 Adopted level of \$427,000 to \$443,000 by a 3.7 percent CPI cost increase in FY 2023 based on a review of the changes in the California Consumer Price Index (CCPI) in the San Francisco Bay Area from the August-to-August period. This budget category includes subscription payments for equipment like public safety radios as well as other non-capital equipment.

Allocated Charges

Allocated Charges represent expense allocations by the City's Enterprise and Internal Service Funds for services and products they provide to General Fund departments. The FY 2022 Adopted Budget for the General Fund included \$20.1 million for these expenses, including utilities usage, general liability insurance, technology costs, vehicle equipment maintenance and replacement costs and other charges. The FY 2023 allocated charges in the Forecast update the revenues and expenses for these various allocations based on the information available at the time of the Forecast development. FY 2023 is anticipated to experience an increase of 11.6 percent to a total of \$22.4 million. This change is primarily due to a general CPI cost increase of 3.7 percent across most allocated charges; however, several of these charges have increased more significantly due to anticipated cost increases for Liability Insurance and Technology services. In addition, the two-year reduction of vehicle replacement charges approved by Council as part of the FY 2021 Adopted Budget has been restored as of FY 2023, increasing that charge by \$1.4 million.

Operating Transfers Out

Operating Transfers Out include transfers from the General Fund to Debt Service Funds, the Technology Fund, and various other funds but excludes transfers to the Capital Improvement Fund, which are detailed in the following Transfer to Infrastructure section. The FY 2022 Adopted Budget included Operating Transfers Out of \$4.3 million. In FY 2023, Operating Transfers Out are anticipated to increase to \$4.4 million as a result of standard annual cost escalators of transfers between the General Fund and the Electric and Technology funds.

Transfer to Infrastructure

During the development of the FY 2022 budget, uncertainties from COVID-19 were anticipated to significantly decrease TOT revenues, which represents a significant portion of the General Fund transfer to the Capital Improvement Fund. The anticipated impact was reflected in the FY 2022 Adopted General Fund transfer to the Capital Improvement Fund, which was \$8.5 million and comprised of a \$2.6 million base transfer including interest earnings and \$5.9 million from TOT revenue generated through an additional voter-approved 3.5 percentage point TOT increase. Incremental TOT increases from the voter-approved rate increase and new hotels are dedicated to the Capital Improvement Fund to support the 2014 Council Infrastructure Plan, consistent with City Council direction. As the local economy continues to recover from the COVID-19 pandemic, this forecast estimates transfers from TOT revenues in FY 2023 are currently projected to increase to \$9.2 million and the base transfer to increase to \$10.7 million for a total \$19.9 million transfer to the Capital Improvement Fund. This forecast continues the goal established as part of the 2022-2026 CIP to restore the base portion of this transfer to pre-pandemic levels by FY 2026. This budget category also includes the separate \$1.9 million transfer to the Cubberley Property Infrastructure Fund, described earlier in this document.

Budget Stabilization Reserve

The City's Budget Stabilization Reserve (BSR) serves as the primary General Fund reserve. By policy, the BSR is maintained in the range of 15 to 20 percent of General Fund operating expenditures, with a target of 18.5 percent. Any reduction to the reserve below 15 percent requires City Council approval. At the discretion of the City Manager, any BSR balance above 18.5 percent may be transferred to the Infrastructure Reserve (IR), which was established to provide funding for maintenance and rehabilitation of the City's capital assets. The BSR is used to fund unanticipated one-time costs as opposed to ongoing or recurring operating expenditures. The City's intent is to fund ongoing programs and services with ongoing dollars. Maintaining the BSR at 18.5 percent also provides flexibility for the City to deal with unforeseen issues that may arise. Furthermore, establishing, and following, sound fiscal reserve policies has been a strong factor in the City being rated AAA by rating agencies.

Based on information reported in the FY 2021 Annual Comprehensive Financial Report (ACFR) [CMR 13501](#), the City's current BSR balance is \$43.3 million, approximately \$4.6 million above the 18.5 percent target. In addition to the additional funding from FY 2021, this report estimates that FY 2022 could end the year with a surplus of \$10.7 million, based on the current trends of a number of major tax revenue categories, compared to the FY 2022 Adopted Budget. This one-time funding surplus compared to the FY 2022 budget has not been factored into the 2023-2032 LRFF assumptions. Use of this funding is discussed further in the Conclusion section of this memorandum.

Assumptions NOT Included in Forecast

It should be noted that this forecast does not include several potential impacts to the FY 2023-2032 LRFF that are outlined below. This is not intended to be a comprehensive list nor in any priority order.

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Project Homekey: On September 27, 2021, the City Council directed staff to apply for Project Homekey funding in conjunction with LifeMoves to build an emergency shelter at the former Los Altos Treatment Plant (LATP) site (CMR 13595). This project will rapidly deploy modular housing to provide interim housing opportunities for homeless individuals and families in the City of Palo Alto. As discussed previously, this LRFF includes the City's committed investment of \$7.0 million in operating expenses (\$1.0 million annually starting in FY 2023 through FY 2029); however, with the actual timing of the funding still to be determined, and commitments from other local partners negotiated, City costs for this project could fluctuate up or down throughout the ten year period.

November 2022 Ballot Initiatives: In 2019, the City Council approved the Fiscal Sustainability Workplan (CMR 10267), which included the exploration of a revenue generating ballot measure. Work on this initiative was suspended in March 2020 as part of the City's pandemic response. Resumption of this effort was outlined in the Community and Economic Recovery Workplan and 2021 Council Priorities and on June 15, 2021, the Finance Committee (CMR 12299) recommended that the City Council approve the Ballot Measure Workplan. On August 16, 2021, the City Council (CMR 12381) approved the workplan for a revenue generating November 2022 ballot measure that was recommended by the Finance Committee and staff. The Ballot Measure Workplan contains three major components: analysis, polling, and outreach. Full implementation of this workplan will require significant resources, including internal staffing and consultant expertise as well as extensive stakeholder engagement.

Sustainability and Climate Action Plan (S/CAP): In early 2020, the City launched an update of the [Sustainability and Climate Action Plan](#) (S/CAP) Framework to determine the goals and key actions needed to meet its sustainability goals, including the goal of reducing green house gas (GHG) emissions to 80 percent below 1990 levels by 2030 (the "80 x 30" goal). In April 2021 ([CMR 12009](#)), Council reviewed the S/CAP Update Report, provided feedback on policy tools, directed the Mayor to form an S/CAP Ad Hoc Committee, directed staff to pursue near-term actions in parallel to the S/CAP Update, and directed staff further develop various elements of the S/CAP. The S/CAP Ad Hoc Committee launched in August 2021 and the City is currently in the process of finalizing the proposed S/CAP Goals and Key Actions as well as the Three-Year Work Plan, which was created at the direction of the April Council motion. The final S/CAP Report and Three-Year Work Plan will be brought to Council for acceptance in Spring 2022 and CEQA review will commence once the S/CAP Goals and Key Actions are finalized. As the S/CAP Work Plan and final report are still in development, cost projections are not yet contemplated in the forecast. Implementation is anticipated to require significant resources, including internal staffing and consultant expertise as well as stakeholder engagement.

Service reductions not restored to pre-pandemic levels: The base case LRFF assumes that the significant reductions taken in the FY 2021 and FY 2022 Adopted Budgets continue throughout the forecast period, unless otherwise restored by subsequent City Council actions, including those taken in FY 2022 Adopted and FY 2022 Q1. A summary of Q1 adjustments is included in this report in the section entitled FY 2022 Preliminary First Quarter Adjustments. Full

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restoration of remaining reductions is modeled in Alternative Scenario A. The following is a high-level summary of the reductions in FY 2021 in response to the initial economic impacts of COVID-19, as originally stated in the FY 2022-2031 LRFF ([CMR 11954](#)). For a detailed listing of adjustments, including FY 2021 and FY 2022 reductions and restorations and other FY 2022 actions, see relevant CMRs including the FY 2021 Budget Adoption ([CMR 11330](#)), FY 2022 Budget Adoption ([CMR 12307](#)), FY 2022 Q1 ([CMR 13439](#)), and listing of other [budgetary amendments](#).

Community & Library Services: FY 2021 reductions included \$0.3 million in program revenues and \$4.9 million in expenses in the General Fund, including 16.1 full-time and 21.02 part-time staffing reductions (finalized in FY 2022). These actions reduced library hours at all branches, keeping smaller libraries (Children's, Downtown, and College Terrace) open three days a week and full-service branches (Mitchell Park and Rinconada) open six days per week. This includes greater cost-recovery through changes in service delivery, charges for services, and/or limiting operating hours for facilities such as the new Junior Museum and Zoo (JMZ), community centers, open space preserves, the Children's Theatre, and the Art Center. These actions also reduced or eliminated programming such as special events, art exhibits, human services activities, and teen programs.

Planning, Transportation, and Infrastructure: FY 2021 reductions included \$2.1 million in program revenues and \$6.1 million in expense in the General Fund, including 8.25 full-time and 1.44 part-time staffing reductions (finalized in FY 2022). Included were actions to reduce administration, code enforcement, front counter support, and inspection services. Understanding that this could delay services to the development community, the building inspection and plan review team was reorganized to minimize the impacts to lead times for inspections, progress on the Energy Reach Code, and the ability to meet next day inspections. The Crosstown and Embarcadero shuttle programs were eliminated, and the delivery of this service redesigned to reduce costs. Additionally, funding for tree trimming and vehicle replacement was reduced for one year and rate changes in various utility enterprise funds were suspended.

Public Safety: FY 2021 adjustments included an increase of \$1.55 million in program revenues and a reduction of \$7.3 million in expenses in the General Fund, including 33.27 full-time and 2.28 part-time staffing reductions (finalized in FY 2022). These actions included suspensions of specialized police units such as the traffic enforcement and investigation units to maintain minimal police patrol services and shift the priority of police services to urgent calls, lowering capacity to respond to nonurgent calls. Additional changes included limited officer training, promotional testing, uniform purchases and eliminated or changed to full cost recovery non-essential programming such as school resource officers. Curtailed dispatch, communication, and emergency preparedness services, as well as emergency incident response and training and work to

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adopt fees to increase revenue for first responder and ambulance subscription were also included in the actions.

Internal Services & Council Appointed Officers: FY 2021 reductions included \$2.9 million in operating expenses in the General Fund, including 5.9 full-time and 0.96 part time staffing reductions (finalized in FY 2022). Internal Services departments include the Information Technology, Human Resources, and Administrative Services Departments as well as the Council and appointed officers (City Manager, City Attorney, City Auditor and City Clerk). Reductions in these areas align with the changes in services, increasing timeframes for assistance and review in areas such as recruitments, procurements, performance reporting, and risk management. Technology solutions will be constrained to only essential contracts and systems and support equipment needs as majority of our workforce continues to work from home. The City Council, Innovation and Special Events, and Human Recourses contingency accounts were eliminated in FY 2021 on a one-time basis.

Significant code and ordinance updates: Updates to several significant programs, codes, and ordinances such as the Seismic Inventory ordinance and program, Historic Building survey and ordinance, and a zoning code update are expected to be necessary in the near future. Depending on future Council direction and the results of program and survey updates, implementation is anticipated to require significant resources, including internal staffing and consultant expertise.

Labor negotiations: As of the timing of this report, there are no agreements in effect for FY 2023 and beyond. The City's current agreements with safety units are set to expire on June 30, 2022. These safety units are the Palo Alto Peace Officers Association (PAPOA), the International Association of Fire Fighters (IAFF), Fire Chiefs Association (FCA), and Palo Alto Police Management Association (PAPMA). Additionally, the City's agreement with the Management and Professional group is set to expire June 30, 2022. Agreements with the Service Employees International Union (SEIU) extends through December 2021 and new labor agreements are anticipated with the Utilities Management and Professional Association (UMPAPA) whose contract expired June 30, 2020.

CalPERS Pension Updates: As of the timing of this report, the CalPERS board completed their Asset Liability Management (ALM) process which reviews capital market assumptions and strategic asset allocation and sets the discount rate for future periods. This comprehensive review is completed every four years. Most significantly, this study resulted in actions that reduce the discount rate from 7.0 to 6.8 percent, add 5 percent leverage to the asset allocation mix, and increase the normal cost paid by Public Employee's Pension Reform Act (PEPRA) employees. Most PEPRA employees will see median increases ranging from 1.2% in miscellaneous plans to 1.5% in safety plans in their total normal cost. These changes, as well as preliminary 21.3 percent returns for the period ending June 30, 2021, will materialize in City finances beginning in FY 2024. Overall, CalPERS expects that many plans will see required

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employer contributions that are comparable to or slightly lower than previously determined contribution requirements. Additional information can be found in the CalPERS news release issued on November 15, 2021: <https://www.calpers.ca.gov/page/newsroom/calpers-news>.

Capital Infrastructure Plan: As referenced earlier, the June 2014 Council approved Infrastructure Plan of \$125.8 million in projects was based on construction and design costs with data from 2012. As construction costs have increased and the City is required to pay prevailing wages, the Infrastructure Plan's funding status has shifted. The FY 2022 Adopted Capital Budget anticipated that these projects would cost \$259.8 million. Staff is working to maintain these projects within the current budget; however, project costs can fluctuate based on market conditions at the time of construction award.

Grade Separation: The grade separation project consists of the four at-grade crossings along the Caltrain corridor in the City of Palo Alto located at Palo Alto Avenue, Churchill Drive, Meadow Avenue, and Charleston Road. The City is working on conceptual alternative plans for the selection of the preferred alternative at Churchill Avenue, Meadow Drive, and Charleston Avenue crossings. On April 26, 2021, the City Council eliminated two South Palo Alto Tunnel Alternatives from consideration after receiving the final report and recommendations from the Expanded Community Advisory Panel (XCAP) ([CMR 12185](#)). Staff is currently in process to provide a detailed review of the alternatives in consideration and seeking Council direction for additional studies to further narrow alternatives in consideration for selection of a preferred alternative.

In FY 2022, staff plans to conduct additional studies as directed by the Council and work with the Rail Committee for the selection of preferred alternative(s). Once preferred alternatives are selected, the next phase will include preparing preliminary engineering and environmental documents, which is anticipated in FY 2023 for the three crossings. The Valley Transportation Authority (VTA) 2016 Measure B Caltrain Grade Separation funding will be available to the City for funding the next phases of the project including preliminary engineering and environmental review, right-of-way, design, and construction.

The 2016 Measure B program tax revenue amounts to a total of \$700 million in 2017 dollars for all at-grade crossings in Santa Clara County. The City anticipates allocation of 50% of said funding. Grade Separation 2016 Measure B funding requires matching local funds as a result, additional funding sources will need to be identified to perform this work in upcoming years (FY 2023 – FY 2032). The full funding needed to complete the grade crossings project is unknown at this time. However, it is expected, that funding necessary to complete this work will exceed funding currently identified for this project. Therefore, additional resources will need to be explored to plan and fund these grade separations.

Parks Master Plan: The Parks Master Plan was finalized in 2017; however, when approved it identified a need to develop a funding strategy and this is still in process. As such, this forecast does not yet contemplate the necessary investments to fully execute this plan.

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Racial Equity Work: The Race & Equity Framework and action plan was approved in June 2020 ([CMR 11441](#)) and remaining funding of \$0.5 million has been reappropriated to be available in FY 2022. Staff is in the process of procuring consultants to assist with the City's diversity, equity, and inclusion efforts in engaging staff, the City Council, and Boards/Commissions. After this initial work, further recommendations are forthcoming and will likely require additional funding either for more consultant assistance and/or an ongoing in-house Equity Officer position (which was discussed during the 2020 Ad Hoc Committee meetings). These recommendations are anticipated to be brought forward as part of the FY 2023 or FY 2024 budget process.

Palo Alto Animal Shelter operations and rebuild

In early 2019, the City entered into a public private partnership with Pets In Need (PIN) to support the operation of the City's animal shelter. Part of PIN's operating proposal included robust fundraising to demolish the current shelter and build a state-of-the-art animal shelter for the City. The City anticipated that the cost of the rebuilding would be shared between the City and PIN; however, in November 2021 PIN announced a decision to end the operating agreement with the City in FY 2022. Due to the recent nature of this decision, this forecast does not contemplate alternative operating plans nor the necessary investments to execute the rebuild.

City owned assets operated by non-profit organizations: This Forecast does not include any additional capital or operating investments for the Avenidas Senior Center, the Ventura Child Care Center, nor the Sea Scout Building. As costs around potential capital or operating investments for these assets solidify, staff will return to City Council to address them as appropriate. In FY 2022 the City Council directed a funding strategy for the Roth Building Rehabilitation Project, which consisted of utilizing \$4.0 million from a variety of funding sources including the Stanford University Medical Center (SUMC) fund community and infrastructure funds, parks impact fees, and community center impact fees ([CMR 12307](#)). This funding strategy is included in the LRFF; however, if costs for rehabilitating the Roth building increase, additional sources of funding would need to be identified.

Cubberley Community Center Concept Plan: The City and PAUSD completed a co-design process for a Cubberley Community Center Concept Plan in 2019; however, costs to implement that concept plan in excess of the dedicated Cubberley infrastructure funding included in the existing agreement between the PAUSD and the City are not assumed in this Forecast. The Concept Plan may require revision before implementation as operational changes have occurred since its completion including execution of a new lease between the City and PAUSD for the school district owned portion of Cubberley, which commenced on July 1, 2020, and reduced the amount of building space leased to the City.

Loans for special projects: From time to time the City's General Fund will assist other City operations with modest cash flow loans to bridge fiscal years. For example, the City provided over \$3 million in loans to the Airport Fund as it works to secure significant grant funding from

the Federal Aviation Administration (FAA) for capital improvement costs. As of FY 2020, the Airport Fund began paying back the loan to the General Fund. Additions and other initiatives funded in other funds may need financial support from the General Fund to ensure they are fully implemented. Additional loans from the General Fund are not assumed in this forecast.

Legislative Updates: Various actions at the state and federal level that could impact the City of Palo Alto have not been incorporated into this forecast due to the changing context and uncertainty of the quantitative impacts of potential legislative changes. This includes the Cadillac Healthcare Tax at the federal level, property tax changes at a state level, and state-level efforts focused on the provision of affordable housing. As uncertainty regarding the potential impact of various legislative initiatives is clarified, appropriate adjustments will be identified and brought forward as part of future budget development cycles.

Tax revenue alignment with updated Comprehensive Plan: The 2030 Comprehensive Plan was adopted in FY 2018, including the potential fiscal impact of various land use scenarios. The fiscal impact of this plan and various land use scenarios are not factored into this forecast.

FY 2023 Budget Development Guidelines

As discussed earlier in this document, this preliminary forecast represents the initial steps of the FY 2023 budget development process. In the FY 2019 – FY 2028 Long Range Financial Forecast presented in December 2018, staff included budget development guidelines based on the trends that were identified and the anticipated fiscal condition of the City. Due to the clear overlap of projecting the City’s fiscal condition and the need to shape service level expectations, staff recommends that the inclusion of Budget Development Guidelines be incorporated into the discussions at the beginning of an annual budget process.

As the City and the County continue to move through recovery from COVID-19, the local economy and major tax revenue categories are showing signs of rebounding. City operations, which were adapted to best support and serve the community during County Public Health Orders and State Public Health restrictions, are returning to in person delivery where possible. However, as mentioned in the preliminary FY 2022 Q1 financial status report ([CMR 13439](#)), there are several issues across the City impacting the ability to transition out of the pandemic that could continue into FY 2023:

- Staff turnover across City departments is slowing the ability to restore programs and services impacted by the pandemic, coupled with the addition of new projects and priorities identified by the Council subsequent to the 2021 priority setting and FY 2022 Budget Adoption.
- Challenges with recruiting and hiring, due to the number of vacancies and the services restored in the FY 2022 Budget, are also contributing to slower service restoration.
- Supply chain issues related to manufacturing and construction are impacting various programs across the City, including replacement of City fleet vehicles, and acquiring materials for construction projects.

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This year, the FY 2023 Budget Development Guidelines, which are detailed in Attachment A, are meant to reflect the anticipated fiscal condition of the City and to provide high-level budgetary direction to the organization. These guidelines will shape and inform the annual financial planning and the allocation of resources across the organization, especially in the General Fund. Further, strategic work is underway focused on a Community and Economic Recovery Strategy. Key to the City Council's and staff's fiscal and recovery planning is the important work underway to understand the fiscal implications of a revenue generating ballot measure for the November 2022 election. This also includes the potential for City actions to affect economic recovery and associated impacts on City revenues. This, in turn, affects the level and nature of services the City can deliver to the community.

When the Fiscal Sustainability Workplan ([CMR 10267](#)) was approved by the City Council on April 22, 2019 drafting a budget development policy was listed as part of the "Newly proposed or potential activities proposed to be completed". The inclusion of Budget Development Guidelines in with this forecast represents staff's recommended method of addressing this referral. Pairing Budget Development Guidelines with the forecast at the beginning of the budget process links the anticipated fiscal condition of the organization with the necessary context regarding service delivery prioritization and resource allocation that will be further explored through the process. This also ensures that the City is able to proactively address anticipated changes in its fiscal condition through the budget process.

Conclusion

The financial impacts of the COVID-19 pandemic and health orders significantly restrained consumer spending, resulting in a weakened job market, and uncertainty; however, positive trends in major tax revenue categories that began in Q4 of FY 2021 and continue into Q1 of FY 2022 indicate that the economy is slowly recovering. This preliminary forecast provides context to begin discussions on how to approach restoring services back to pre-pandemic levels while keeping in mind the budget constraints still facing the City in the first couple years of the forecast.

The forecast does not assume restoration of the service changes experienced in FY 2021 and FY 2022, and as seen in Alternative Scenario A below, incoming resources are not enough to sustain full restorations in FY 2023 and beyond. Alternative Scenario B, examines a competitive market adjustment for labor, and demonstrates that this adjustment would cause a longer gap as compared to the base case forecast. As mentioned previously, there is one-time funding of \$4.6 million from savings in FY 2021 and there is an anticipated surplus of up to approximately \$10 million in FY 2022. This figure is above the preliminary estimate provided to the Council in the Preliminary FY 2022 Q1 Financial Status report in October 2021 of additional revenues of \$5 million - \$6 million and is primarily driven by updated Sales Tax figures. When combined, these one-time surplus funds from FY 2021 and projected in FY 2022 have not been factored into the 2023-2032 LRFF assumptions. The City Council provided staff direction as part of the Preliminary FY 2022 Q1 Financial Status report to bring forward recommended allocation of these surplus funds as part of the FY 2022 Mid-Year Budget Review, which staff anticipates bringing for Council review in the first quarter of the new calendar year.

With regard to the \$4.6 million, since it is savings from FY 2021 and above the 18.5 percent BSR target, by City Council approved current policy, the funding would be allocated 50% to be transferred to the Section 115 Pension Trust and 50% transferred to the Capital Improvement Fund for infrastructure investment. Given the additional financial variables, additional options for allocation may include: increase funding in the Utility Transfer Litigation Reserve, restoration of services and/or investment in high priority projects, or left in the BSR to be discussed as part of the FY 2023 budget. Final recommended actions will be brought forward as part of the FY 2022 Mid-Year Budget Review as noted previously.

Alternative Scenarios for Consideration

Alternative Forecast Scenario A: Restoration of Service to Pre-COVID-19 Service Levels

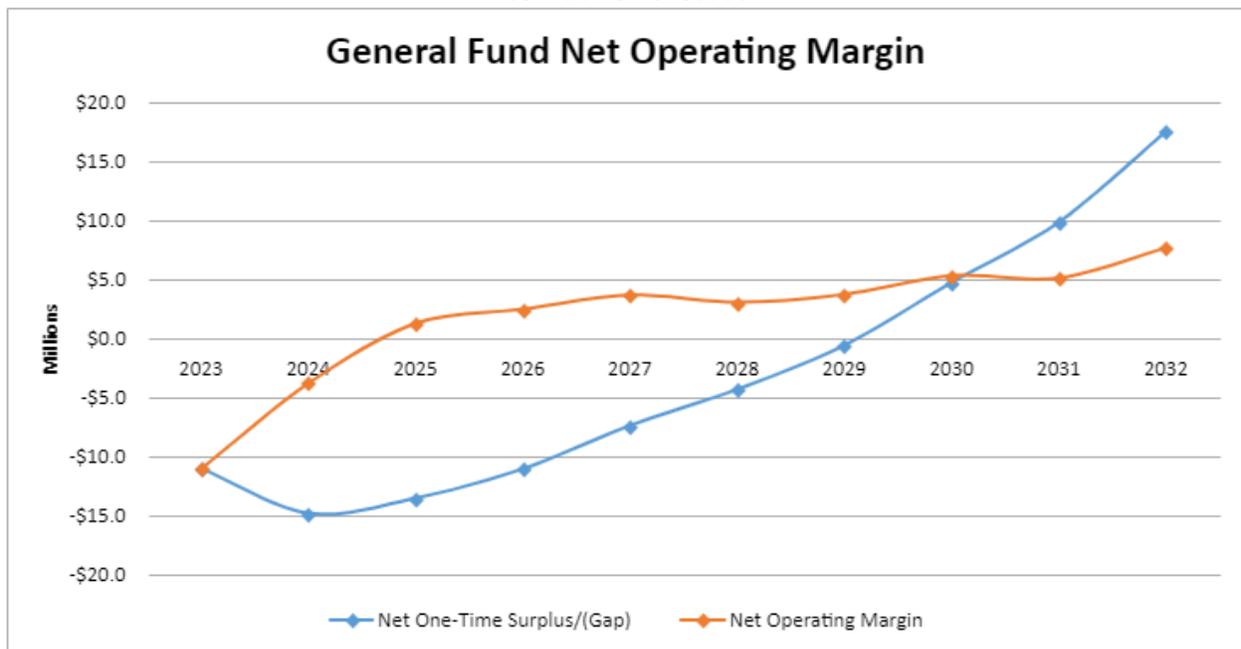
As discussed in the Assumption NOT Included in Forecast section above, the base case forecast does not include restoration of services that were impacted as a result of the COVID-19 pandemic, other than specific actions taken by Council in the preliminary FY 2022 Q1 financial status report ([CMR 13439](#)). Those items have been outlined in the FY 2022 Preliminary First Quarter Adjustments section of this memorandum. This alternative forecast models the impact of restoring City Services to the pre-pandemic levels in FY 2023. The summary table for this alternative forecast and the Net Operating Margin graph for this alternative forecast are below. Additional discussion for this alternative follows these figures.

**TABLE 18: FY 2023 – FY 2032 Long Range Financial Forecast
Alternative Forecast A**

	Actual 2021	Adopted 2022	Projected 2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	2032
Total Revenue	\$200,925	\$206,452	\$218,167	\$230,393	\$239,692	\$252,271	\$259,853	\$268,149	\$277,233	\$286,670	\$297,136	\$308,506	\$320,187
Total Expenditures	\$185,634	\$209,210	\$207,468	\$241,427	\$254,509	\$265,803	\$270,902	\$275,517	\$281,541	\$287,238	\$292,380	\$298,637	\$302,630
Net One-Time Surplus/(Gap)	\$15,291	(\$2,758)	\$10,699	(\$11,034)	(\$14,817)	(\$13,531)	(\$11,048)	(\$7,369)	(\$4,308)	(\$568)	\$4,756	\$9,869	\$17,557
Cumulative Net Operating Margin (One-Time)													(\$30,493)
Net Operating Margin			\$0	(\$11,034)	(\$3,782)	\$1,285	\$2,483	\$3,680	\$3,061	\$3,741	\$5,323	\$5,113	\$7,688
Cumulative Net Operating Margin													\$17,557

Assumes that the annual shortfalls are solved with ongoing solutions and annual surpluses are spent for ongoing expenditures.

**TABLE 19: FY 2021 –2030 Long Range Financial Forecast Net Operating Margin
Alternative Forecast A**



Compared to the Base Case, the General Fund would have a large gap of approximately \$11.0 million in the first year of the forecast. This gap would shrink gradually until 2030, which would be the first-year revenues would be at a level to support the expenses. Although an immediate restoration of all services to pre-pandemic levels is not feasible as evidenced by this scenario, as mentioned previously in this report, thoughtful and measured restoration of high priority services that can be sustained by the recovering revenue will be brought forward for Council consideration as part of the FY 2022 Mid-Year Review as well as the FY 2023 Budget process.

Alternative Forecast B: Compensation Change Model, Near-term Adjustments

Consistent with City Council direction and past practice, the Base Case assumes a two percent general wage adjustment in the years beyond the terms of existing MOAs. This rate is used as a forecasting assumption and not a commitment for future negotiations. As of the timing of this

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forecast, there are no MOAs in effect. Therefore, the entirety of the forecast assumes a 2.0 percent wage increase.

This alternative scenario models the impact of a one-time adjustment in FY 2023 to increase compensation by an additional 2.0 percent above the two percent assumed in the Base Case to better align the workforce to be competitive in the market (4.0 percent total). As with other alternative models in the LRFF, this model is for forecasting purposes and is not a commitment to future labor negotiations.

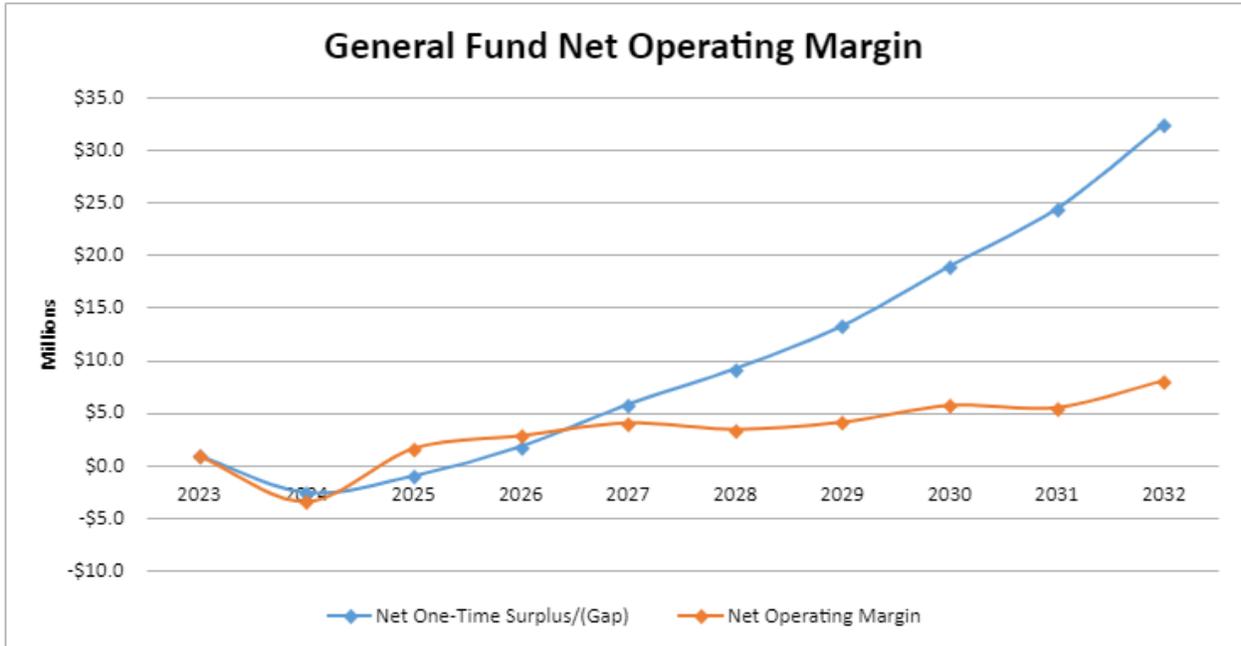
Similar to trends at the local and national level, the City is experiencing challenges in staffing a high level of vacancies due to labor shortages and an uptick in resignations that are contributing to a highly competitive labor market. As a service-driven organization, with approximately 60 percent of resources allocated to staff, the City is particularly vulnerable to the current workforce challenges. In this competitive environment, employees have more choices, and many are re-evaluating their career decisions with new perspectives. Recognition of the difficult work and continued dedication is important, and City management is working on flexible work arrangements (where feasible), advancing a positive work environment, and supporting other programs that express appreciation and reinforce Palo Alto's reputation as an employer of choice.

**TABLE 20: FY 2023 – FY 2032 Long Range Financial Forecast
Alternative Forecast B**

	Actual 2021	Adopted 2022	Projected 2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	2032
Total Revenue	\$200,925	\$206,452	\$218,167	\$230,393	\$239,692	\$252,271	\$259,853	\$268,149	\$277,233	\$286,670	\$297,136	\$308,506	\$320,187
			5.7%	5.6%	4.0%	5.2%	3.0%	3.2%	3.4%	3.4%	3.7%	3.8%	3.8%
Total Expenditures	\$185,634	\$209,210	\$207,468	\$229,538	\$242,315	\$253,296	\$258,074	\$262,361	\$268,047	\$273,398	\$278,186	\$284,079	\$287,699
			-0.8%	10.6%	5.6%	4.5%	1.9%	1.7%	2.2%	2.0%	1.8%	2.1%	1.3%
Net One-Time Surplus/(Gap)	\$15,291	(\$2,758)	\$10,699	\$855	(\$2,622)	(\$1,025)	\$1,779	\$5,788	\$9,186	\$13,272	\$18,950	\$24,427	\$32,488
Cumulative Net Operating Margin (One-Time)													\$103,098
Net Operating Margin			\$0	\$855	(\$3,477)	\$1,598	\$2,804	\$4,009	\$3,398	\$4,086	\$5,678	\$5,477	\$8,061
Cumulative Net Operating Margin													\$32,488

Assumes that the annual shortfalls are solved with ongoing solutions and annual surpluses are spent for ongoing expenditures.

**TABLE 21: FY 2023 – 2032 Long Range Financial Forecast Net Operating Margin
Alternative Forecast B**



In FY 2023, the one-time increase of two percent adds approximately \$2.8 million citywide (\$1.5 million in the General Fund). Minor increases for a general 2.0 percent adjustment are forecasted in the out years. In this scenario, the initial surplus in FY 2023 is lessened compared to the Base Case and wider gaps between revenues and expenses occur in the out years of the forecast. The Base Case projected that by FY 2025, the City would begin to have a positive surplus; this alternative forecast extends the operating gap to FY 2026.

STAKEHOLDER ENGAGEMENT

The preliminary forecast for FY 2023 represents the beginning of the fiscal year 2023 budget development process. Information provided in this report will be discussed with the City Council after Finance Committee and those conversations will provide direction to staff in the budget development process. It is anticipated that conversations with City Council and the community will occur through public budget hearings in Spring 2022, according to the standard budget adoption process.

RESOURCE IMPACT

Financial implications from this report and input from the Finance Committee will be considered in the City Manager’s development of the Fiscal Year 2023 budget.

ENVIRONMENTAL IMPACT

This report is not a project for the purposes of the California Environmental Quality Act. Environmental review is not required.

Attachments:

- Attachment A - FY 2023 Budget Development Guidelines

FY 2023 Budget Development Guidelines

- 1) Develop a structurally balanced budget that brings ongoing revenues and expenses into alignment. Develop a plan for any structural imbalance to ensure that the City maintains fiscal sustainability over the short, medium, and long-term.
- 2) Allocate one-time resources for one-time needs rather than committing one-time resources to ongoing services. Examine appropriate uses of revenue surpluses that exceed forecasted levels such as planning for recession needs, restoration needs, and strategic investments.
- 3) Ensure appropriate resource allocation for City Council’s identified priorities.
- 4) Focus on business process redesign to enhance quality, flexibility, and cost-effectiveness of service delivery (include examining opportunities to streamline, simplify, reorganize, and reallocate resources to avoid duplication of effort).
- 5) Explore alternative service delivery models (such as partnerships with non-profits or other public/private sector groups) to minimize overlap, maximize cost share, and effectively use resources.
- 6) Continue to thoroughly analyze non-personnel/equipment/other costs, such as contract services, for cost savings opportunities or realignment with current needs.
- 7) Explore the expansion of existing revenue sources or the addition of new revenue sources, including the alignment of existing charges for services and the opportunity to establish new fees, when appropriate.
- 8) Continue to analyze and prioritize resource augmentations, seeking to offset augmentations with reductions elsewhere for net-zero impacts to the budget whenever possible; however, ensuring when resource augmentations are added, it is in alignment with one-time and ongoing forecasted sources.
- 9) Continue to prioritize proactively funding long term liabilities including but not limited to debt obligations, pension obligations, and capital infrastructure in accordance with City policies as approved by Council.

FY 2023 Budget Development Guidelines

- 1) Develop a structurally balanced budget that brings ongoing revenues and expenses into alignment. Develop a plan for any structural imbalance to ensure that the City maintains fiscal sustainability over the short, medium, and long-term.
- 2) Allocate one-time resources for one-time needs rather than committing one-time resources to ongoing services. Examine appropriate uses of revenue surpluses that exceed forecasted levels such as planning for recession needs, restoration needs, and strategic investments.
- 3) Ensure appropriate resource allocation for City Council's identified priorities.
- 4) Focus on business process redesign to enhance quality, flexibility, and cost-effectiveness of service delivery (include examining opportunities to streamline, simplify, reorganize, and reallocate resources to avoid duplication of effort).
- 5) Explore alternative service delivery models (such as partnerships with non-profits or other public/private sector groups) to minimize overlap, maximize cost share, and effectively use resources.
- 6) Continue to thoroughly analyze non-personnel/equipment/other costs, such as contract services, for cost savings opportunities or realignment with current needs.
- 7) Explore the expansion of existing revenue sources or the addition of new revenue sources, including the alignment of existing charges for services and the opportunity to establish new fees, when appropriate.
- 8) Continue to analyze and prioritize resource augmentations, seeking to offset augmentations with reductions elsewhere for net-zero impacts to the budget whenever possible; however, ensuring when resource augmentations are added, it is in alignment with one-time and ongoing forecasted sources.
- 9) Continue to prioritize proactively funding long term liabilities including but not limited to debt obligations, pension obligations, and capital infrastructure in accordance with City policies as approved by Council.