CITY OF PALO ALTO
CITY COUNCIL
Special Meeting
Monday, January 22, 2024
Council Chambers & Hybrid
5:30 PM

Agenda Item

12. Review and Accept the FY 2025 - FY 2034 Long Range Financial Forecast (LRFF) and FY 2025 Budget Development Guidelines as Recommended by the Finance Committee, CEQA Status – Not a Project *Presentation*

CITY OF PALO ALTO

City Council
Staff Report

From: City Manager
Report Type: ACTION ITEMS
Lead Department: Administrative Services

Meeting Date: January 22, 2024
Report #:2311-2226

TITLE
Review and Accept the FY 2025 - FY 2034 Long Range Financial Forecast (LRFF) and FY 2025 Budget Development Guidelines as Recommended by the Finance Committee, CEQA Status – Not a Project

RECOMMENDATION
The Finance Committee and Staff recommend the City Council accept the General Fund Long Range Financial Forecast (LRFF) for Fiscal Year 2025-2034 (Attachment I) and the FY 2025 annual Budget Development Guidelines (Attachment II) and direct staff to use this forecast as the starting point for the initiation of the FY 2025 budget process.

EXECUTIVE SUMMARY
The FY 2025 - 2034 Long Range Financial Forecast (LRFF) was reviewed with the Finance Committee on December 5, 2023 (Attachment I) along with the annual Budget Development Guidelines (Attachment II) and were unanimously approved by the Committee. *Base Case Long Range General Fund forecast* projects a shortfall of $6.0 million in FY 2025, followed by shortfalls ranging from $5.4 million in FY 2026 down to $0.5 million in FY 2029. These amounts are consistent with previous projections used as part of the two-year budget balancing strategy when adopting the FY 2024 Budget and a reserve was adopted by Council to provide funding for the FY 2025 projected gap. 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 City Council policy, items that are unanimously approved by the Finance Committee are placed as a consent agenda item for the City Council. Though this report was approved unanimously, staff and the Committee have placed this item on the City Council's action agenda for deliberation of the full Council in acknowledgement of the importance for financial planning in the continued varied economic conditions.

BACKGROUND/ANALYSIS

The LRFF is a preliminary ten-year forecast based on the most current information available, actual revenues for FY 2023, and projected results through FY 2024 at the point in time of release (December 2023). General Fund expenditures are based on current City Council approved service levels (Base Case) compared to projected revenues over the next ten years. 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. The Committee and staff recommend use of the Base Case for the FY 2025 Budget planning.

- *Base Case Long Range General Fund forecast* projects a shortfall of $6.0 million in FY 2025, followed by shortfalls ranging from $5.4 million in FY 2026 down to $0.5 million in FY 2029. FY 2030 has a surplus of $6.6 million which continues to grow through FY 2034. This forecast maintains current service levels approved in FY 2024 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. These amounts are consistent with previous projections used as part of the two-year budget balancing strategy when adopting the FY 2024 Budget.

- *Alternate forecast scenario that reflects a 1% loss in economically sensitive revenue*. Compared to the Base Case, this scenario reduces revenues by $2.1 million in FY 2025 and maintains and increases the projected shortfalls over the next ten years, ranging from $8.1 million in FY 2025 to $3.0 million in FY 2029. FY 2030 begins a surplus of $3.9 million which continues to grow through FY 2034.

- *Alternate forecast that reflects a 1% compensation adjustment (1%) in FY 2026*. Compared to the Base Case, this scenario increases expenses by $1.2 million in FY 2026 and maintains and increases projected shortfalls over the next ten years, ranging from $6.7 million in FY 2026 to $1.9 million in FY 2029. FY 2030 begins a surplus of $5.2 million which continues to grow through FY 2034.

These alternate forecasts were done separately to show the impacts of each scenario in isolation; however, aspects of both alternate forecasts may occur in conjunction in the future.

The economy continues to demonstrate resiliency to a formal recession and this forecast reflects a continued level of stagnation offset by inflation. Risks remain due to world conflicts and potential local economy impacts. Several persistent issues across the City are improving but continue to impact the ability to provide fully authorized service levels. These include staff turnover, recruitment and retention, and supply chain issues and inflation that continue to increase costs across all aspects of the City. All of these factors lead to heightened intensity of financial forecasting and the budget development process. These forecast figures present staff with the challenge of prioritizing the growing needs of the City with the fiscal sustainability of these needs.

Consistent with the projections in the FY 2024 Adopted Budget, this LRFF reflects deficits in the near term with revenues falling below expenses. As previously recommended, the shortfall in FY 2025 will be addressed by the Uncertainty Reserve that was proactively set aside during the prior year for this purpose. Also, this LRFF assumes support from both local ballot Measures K (Business Tax) and L (Gas Utility Fund Equity Transfer) that were approved by the voters in November 2022.

Based on this forecast, ensuring ongoing financial stability will require continued prioritization of spending and utilization of one-time surplus funding or the Uncertainty Reserve to address short-term deficits in the next few years. More detailed guidelines and policies to inform the development of the FY 2025 budget are discussed in Attachment II.

As directed by the City Council, staff will include recommendations for addition of key resources and appropriation of funds as part of the FY 2024 Midyear process, including a review of objectives deferred in the development of the FY 2024 Adopted Budget. The Mid-Year Review report is scheduled for Council review in February 2024.

Finance Committee Review

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

<u>Vacancy Analysis</u>

The current vacancy rate is approximately 13.5% in the General Fund, excluding public safety. This preliminary vacancy rate is point in time and does not consider actions currently in progress for recruitments, promotions, and other staffing shifts. To better align with the status of vacancies, this forecast increases the vacancy estimate from previously assumed rate of 3% to 5% in all years. This results in additional savings of approximately $2 million annually, or a projected $5 million in total vacancy savings each year. This additional funding fully forecasts the vacancy savings the City has seen in recent years of $1.7 million as shown in Table 1.

Table 1 provides a historical summary of budget to actuals variance in the Salary and Benefits category for General Fund departments. The budget includes the budgeted vacancy factor assumption, therefore this savings is what has been achieved beyond planned levels. The table includes the annual vacancy rate and the percentage difference from budgeted funding levels. As shown below, the vacancy savings from the previous year have varied from -$1.7 million to +$1.7 million over the last five years from the budgeted vacancy assumption, reflecting a variance of less than 1.5% as compared to the budgeted.

TABLE 1: Historical General Fund Vacancy Savings ($'s in Millions)

	2019	2020**	2021**	2022	2023
Total General Fund Vacancy Savings	$1.3M	$1.3M	-$1.7M	$1.6M	$1.7M
Annual Vacancy Rate	12%	12%	15%	12%	13%
General Fund Adjusted Budget*	$123.3M	$134.7M	124.1M	$134.3M	$148.4M
Variance to Budget	1.1%	1.0%	-1.4%	1.2%	1.2%

* The annual budget reflects s*alaries and benefits net of the forecaste*d *vacancy factor each year*.
** FY 2020 and FY 2021 are anomaly years as they were significantly impacted by adjustments made due to the COVID-19 pandemic where a number of factors are impacting these rates including but not limited to a hiring freeze as well as eventual position reductions citywide.

Economic Recovery Advisory Report

During the LRFF review, the Finance Committee raised questions regarding the processes to develop LRFF assumptions and variability in actual results. As a follow up to this discussion, this report includes references to an audit completed by the Office of the City Auditor (OCA) in April 2022 to review the City's long-term financial planning models and inputs (CMR 13915[1]). The OCA results indicated that the City's was able to forecast revenues at no more than a 9% difference from original estimates over a five-year period, from FY 2016 to FY 2020. Further, the results indicated that the City has a robust process for forecasting and uses reliable information for assumptions. Overall, the OCA determined that the City's long-term financial planning models and inputs align with the OCA's considerations and best practices.

Historical Grant Funding and Funding from Other Agencies

From FY 2019 through FY 2023, various federal, state, local, and other agencies allocated funds for programs and initiatives across the General Fund and the Capital Improvement Fund. The City's practice is to recommend allocation of these funds after formal agreements are in place with the granting agency or jurisdiction. In addition, since these funds are designated for specific needs, staff strives to use these funding sources first in order to maximize resources.

Operating - General Fund

	2019	2020	2021	2022	2023
Funding by Fiscal Year (in Millions)	$0.8	$0.8	$1.1	$8.8	$12.1

Notable funding includes but is not limited to, the Federal Transportation Agency (FTA) contributed to transportation-related projects along with the Santa Clara County Measure B

[1] City Council, April 11, 2022; Staff Report # 13915, https://portal.laserfiche.com/Portal/DocView.aspx?id=59425&repo=r-704298fc&searchid=4fe0b40a-9941-44aa-8e0d-6479fb037f48

Transportation Improvement Program, and Stanford University supporting the PA Link program, Federal Health and Human Services (HHS) funding was appropriated for mental health services, COVID-19 relief through CARES and American Rescue Plan Act (ARPA) funds, fire fighter staffing funding via Staffing for Adequate Fire and Emergency Response (SAFER), and investments in safety equipment through the Santa Clara County Office of Emergency Services (SCC OES).

Capital Improvement Fund

External revenues supporting capital improvement projects fall into three broad categories: local/regional grants (including Measure B), state grants, and federal grants. The table below summarizes the amounts, sources, and uses of these revenues by fiscal year from FY 2019-FY 2023. The amounts in each fiscal year, which total $50.5 million, do not include reappropriations.

	2019	2020	2021	2022	2023
Funding by Fiscal Year (in Millions)	$12.4	$4.3	$12.6	$4.0	$17.0

Turning to currently budgeted revenues in the Capital Improvement Fund, the table below shows how Measure K, the City of Palo Alto's business tax, and Measure B, a Santa Clara sales tax that benefits transportation projects, are currently planned to be allocated across capital improvement projects based on the 2024-2028 Capital Improvement Plan (CIP). These allocations may change during the FY 2025 budget and 2025-2029 CIP development cycle.

	2024	2025	2026	2027	2028
Measure K - City of Palo Alto Business Tax	**$0.75**	**$1.5**	**$3.0**	**$3.0**	**$3.0**
PL-24000 - Meadow Dr./ Charleston Rd. Rail Grade Separation and Safety Improvements	$0.43	$0.75	$2.0	$2.0	$2.0
PL-24001 - Churchill Avenue Rail Grade Separation and Safety Improvements	$0.32	$0.75	$1.0	$1.0	$1.0
Measure B - Santa Clara County Sales Tax	**$10.5**	**$7.8**	**$27.3**	**$27.3**	**$20.3**
PL-05030 - Traffic Signal and Intelligent Transportation Systems	$0.6	$0.3	$0.3	$0.3	$0.3
PL-12000 - Transportation and Parking Improvements	$0.5	-	-	-	-
PL-17001 - Railroad Grade Separation and Safety Improvements	$1.9	$1.0	$2.0	$2.0	$1.0
PL-24000 - Meadow Dr./Charleston Rd. Rail Grade Separation and Safety Improvements	$4.5	$4.5	$15.0	$15.0	$15.0
PL-24001 - Churchill Avenue Rail Grade Separation and Safety Improvements	$3.0	$2.0	$10.0	$10.0	$4.0

Human Services Resource Allocation Process (HSRAP)

As part of the LRFF, staff provided additional details to facilitate the City Council's review of a referral to consider pegging HSRAP budget allocations to a benchmark, such as a percentage of General Fund budgeted expenditures. Staff confirmed that funding levels in prior years were not tied to a percentage of the General Fund budgeted expenditures. As part of the LRFF review, the Finance Committee elected to continue the discussion on this referral in February 2024 with any recommended changes forwarded to the City Council for consideration as part of the FY 2025 budget process. The status of the referral has been updated from 'complete' to 'in progress', as indicated in the status update completed on December 5, 2023 (CMR 2307-1794[2]).

FISCAL/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 2025 budget. Upcoming milestones related to the City's fiscal standing and the FY 2025 Budget Process include:

- February (Council) – FY 2024 Mid-Year Budget Review and Second Quarter Financial Report
- March/April (Finance Committee and Utilities Advisory Commission or UAC) – Five Year Utility Financial Plans and FY 2025 Utility Rate Recommendations
- May (Council) – FY 2025 Proposed Operating and Capital Budgets Published
- May (Finance Committee) – FY 2025 Proposed Budget Hearings, including Utility Rates, Municipal Fees, and Five-Year Capital Improvement Plan
- June (Finance Committee) – FY 2024 Third Quarter Financial Report
- June (Council) – Adoption of the FY 2025 Operating and Capital Budgets, Utility Rates, and Municipal Fees.

STAKEHOLDER ENGAGEMENT

The preliminary forecast for FY 2025 represents the beginning of the fiscal year 2025 budget development process. As in previous years, City Council discussion of the 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 2024, according to the standard budget adoption process.

ENVIRONMENTAL REVIEW

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

[2] Finance Committee, December 5, 2023; Staff Report # 2307-1794, https://portal.laserfiche.com/Portal/DocView.aspx?id=69142&repo=r-704298fc&searchid=b316cc0f-f843-4290-8390-b2abbc3f61d4

ATTACHMENTS
Attachment A: FY 2025-2034 Long Range Financial Report (LRFF), CMR 2307-1773
Attachment B: FY 2025 Budget Development Guidelines
Attachment C: Additional Information as Requested by Finance Committee

APPROVED BY:
Kiely Nose, Assistant City Manager

CITY OF PALO ALTO

Finance Committee Staff Report

From: City Manager
Report Type: ACTION ITEMS
Lead Department: Administrative Services

Meeting Date: December 5, 2023
Report #:2307-1773

TITLE

Review and Recommend the City Council Accept the FY 2025- 2034 Long Range Financial Forecast and FY 2025 Annual Budget Development Guidelines

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 2025-2034 and the FY 2025 annual Budget Development Guidelines (Attachment A) and direct staff to use this forecast as the starting point for the initiation of the FY 2025 budget process.

EXECUTIVE SUMMARY

Annually, the City presents 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 2023, and projected results through FY 2024 at the point in time of release. 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 $6.0 million shortfall in FY 2025, followed by shortfalls ranging from $5.4 million in FY 2026 down to $0.5 million in FY 2029. FY 2030 has a surplus of $6.6 million which continues to grow through FY 2034. This forecast maintains current service levels approved in FY 2024 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. These amounts are consistent with previous projections used as part of the two-year budget balancing strategy when adopting the FY 2024 Budget.
>
> Staff modeled an **alternate forecast scenario that reflects a 1% loss in economically sensitive revenue** and the impact on the General Fund over the forecast period. Compared to the Base Case, this scenario reduces revenues by $2.1 million in FY 2025 and maintains and increases the projected shortfalls over the next ten years, ranging from

$8.1 million in FY 2025 to $3.0 million in FY 2029. FY 2030 begins a surplus of $3.9 million which continues to grow through FY 2034.

Staff modeled an **alternate forecast that reflects a one-time compensation adjustment (1%) in FY 2026** and the impacts on the General Fund over the forecast period. Compared to the Base Case, this scenario increases expenses by $1.2 million in FY 2026 and maintains and increases projected shortfalls over the next ten years, ranging from $6.7 million in FY 2026 to $1.9 million in FY 2029. FY 2030 begins a surplus of $5.2 million which continues to grow through FY 2034.

These alternate forecasts were done separately to show the impacts of each scenario in isolation; however, aspects of both alternate forecasts may occur in conjunction in the future.

The economy continues to demonstrate resiliency to a formal recession and this forecast reflects a continued level of stagnation offset by inflation. Risks remain due to world conflicts and potential local economy impacts. At the national level, economic growth through the third quarter of calendar year 2023, was led by robust consumer (retail) spending despite a persistently high inflation rate and high borrowing costs with interest rates at their highest level in 22 years. Monetary policy tightening actions by the US Federal Reserve continue to achieve a “soft landing” whereby there’s a slowdown in economic growth that avoids recession for the purpose of stopping the economy from overheating and continuing to experience higher inflation. Economic uncertainty continues; however, the current outlook projects a weak economy in 2024 followed by a return to trend growth rates by 2025. Other risks that will continue to be monitored are a future protracted (U.S.) government shutdown, geopolitical events, and election resulting in changing national economic policies in 2025. All of these factors lead to heightened intensity of financial forecasting and the budget development process. These forecast figures present staff with the challenge of prioritizing the growing needs of the City with the fiscal sustainability of these needs.

Consistent with the projections in the FY 2024 Adopted Budget, this LRFF reflects deficits in the near term with revenues falling below expenses. As previously recommended, the shortfall in FY 2025 will be addressed by the Uncertainty reserve, that was proactively set aside during the prior year for this purpose. Also, this LRFF assumes support from both local ballot Measures K (Business Tax) and L (Gas Utility Fund Equity Transfer) that were approved by the voters in November 2022. As discussed later in this report, funding from the Gas Equity Transfer will be incrementally increased to the voter approved 18% of gas revenue by FY 2027 to support general fund activities, and Business Tax funding has been programmed towards three Council approved priorities for investments in public safety, transportation and train crossing safety, and affordable housing and unhoused support.

Several persistent issues across the City are improving but continue to impact the ability to provide fully authorized service levels. These include staff turnover, recruitment and retention, and supply chain issues and inflation that continue to increase costs across all aspects of the City.

Development of the FY 2025 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. With these variables, ongoing revenues are unable to keep pace with expenses in the short term. The LRFF is a tool to model financial forecasting assuming resources and services are operating at authorized levels. City staff will continue to review and refine these projections to establish the FY 2025 budget and use this forecast to begin internal planning for budget balancing solutions. Individual fiscal years will vary from this forecast such as higher vacancy rates in staffing or changes in revenue estimates. These circumstances, specific to a given year, typically represent one-time resources that are factored into the annual budget planning process. More detailed guidelines or Budget Policies to inform the development of the FY 2025 budget are discussed at the end of this document (Attachment A).

Included in this report and subsequent documents are the following:

- The Economy: discussion of the current financial climate of the United States to the local economy of the City of Palo Alto (details can be found in Attachment B)
- Summary Long Range Financial Forecast including Revenue and Expense assumptions in FY 2025-2034 (details can be found in Attachments C and D)
    - Financial status of the General Fund as of the FY 2024 Adopted Budget
    - Brief discussion of FY 2023 surplus funding
    - Updated FY 2024 revenue assumptions based on current projections
- FY 2025 Budget Development Guidelines to inform the Budget process (Attachment A)
- Alternate scenarios to the base case forecast to demonstrate financial impacts to the City from:
    - Impacts from a moderate recession
    - Impacts from a citywide 1% increase of salaries and benefits
- Response to the Human Services Resource Allocation Process (HSRAP) Funding Referral from the FY 2024 Adopted Budget process (Attachment E)

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. 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.

The Economy
Nationally, as of October 2023, the consumer price index (CPI) which measures changes in the prices paid by consumers for a basket of goods and services, was 3.2%. This is lower than the 7.7% CPI from a year ago, but still indicates increasing costs. The unemployment rate, as of October 2023, is 3.9% which is up from 3.4% at the beginning of the 2023 calendar year and may indicate an economic slowdown in the coming quarters. Despite these factors, economic growth through the third quarter of calendar year 2023, was led by robust consumer (retail) spending, and the gross domestic product (GDP), a measure of all goods and services produced in the economy, increased at an annualized rate of 4.9%. The UCLA Anderson outlook is "The oft-predicted but never seen 'recession next quarter' has now faded in the face of expansionary fiscal policy, a new national industrial policy, and a consumer who is happy to continue spending." This outlook projects a weak economy in 2024 followed by a return to trend growth rates by 2025. This weaker outlook translates into 1% to 2% GDP growth for the remainder of 2023 with the expectation this will gradually increase to a 2% to 3% growth through 2024.

The local economy continues to show strong performance in the first half of calendar year 2023. The UCLA Anderson outlook for California does not forecast a recession based on the state's strong employment and economic growth, although real personal income is forecasted to remain flat in 2023 and grow between 1% to 2% through 2025. California's unemployment rate, similar to the national trend, has risen in calendar year 2023 and is expected to be in the mid to high 4% through 2025. Additional details on economic statistics such as Gross Domestic Product (GDP), unemployment, and Consumer Price Index (CPI) can be found in **Attachment B** in greater length.

ANALYSIS
Palo Alto serves a diverse community with a broad range of unique services that adds to the complexity of managing a balanced budget and healthy fiscal outlook. This annual General Fund Long Range Financial Forecast is being developed at a time of perceived economic stagnation and geo-political unrest. The economy is currently not trending into recessionary period that has been predicted for the past several quarters; however, continued economic uncertainty heightens the intensity of financial forecasting and the budget development process. The rigor previously demonstrated by the Council and staff to tackle the challenges of the pandemic continues as staff works to prioritize the growing needs of the City with the fiscal sustainability of these needs.

The FY 2025-2034 'Base Case' revenue and expense assumptions include updates on the status of the general fund as of the FY 2024 Adopted Budget, the FY 2023 fiscal year end, and current FY 2024 projected assumptions. As with all forecasts, there is uncertainty regarding the revenue and expenditure estimates contained in this document. Instead of a recession, this forecast assumes economic stagnation at the beginning of the ten-year period, in line with current projections from UCLA Anderson. Major tax revenues have rebounded from impacts of the Covid-19 pandemic and projected to be at or above pre-pandemic levels through the ten-year forecast. Expenses are programmed to maintain service levels based on Council approval. As a result, some limited term programs are not extended through the entire ten-year forecast, but discussed in this report to indicate that continuing the programs would require additional resources. Investments in Capital projects are consistent with the 2024-2028 Capital Improvement Plan with continued focus on completing the Council approved 2014 Infrastructure Plan projects as well as maintaining and upkeeping the City's current facilities and infrastructure. The Uncertainty Reserve that was established as part of the FY 2023 Mid-Year Review was used to balance the FY 2024 Adopted Budget, but as planned and approved by Council, still has funding available to solve the projected shortfall in FY 2025. A strategic plan will be needed to solve the estimated shortfalls in the subsequent years of the forecast.

<u>Base Case</u>

Table 1 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 it appears and that each surplus is completely expended with ongoing expenditures. It is the City's goal to remain in balance on an ongoing basis, so the incremental figure is useful to illustrate the additional surplus and/or shortfall attributed to a particular fiscal year. To the extent a shortfall is not resolved, or a surplus is not expended on an ongoing basis, it is important to understand that the remaining budget shortfall or surplus will remain and be pushed to the following year.

The Base Case financial forecast projects a shortfall of $6.0 million in FY 2025, followed by shortfalls ranging from $5.4 million in FY 2026 down to $0.5 million in FY 2029. FY 2030 has a surplus of $6.6 million which continues to grow through FY 2034. Based on these assumptions, the cumulative net operating margin, or ongoing surplus, during the forecast period is a surplus of $36.5 million.

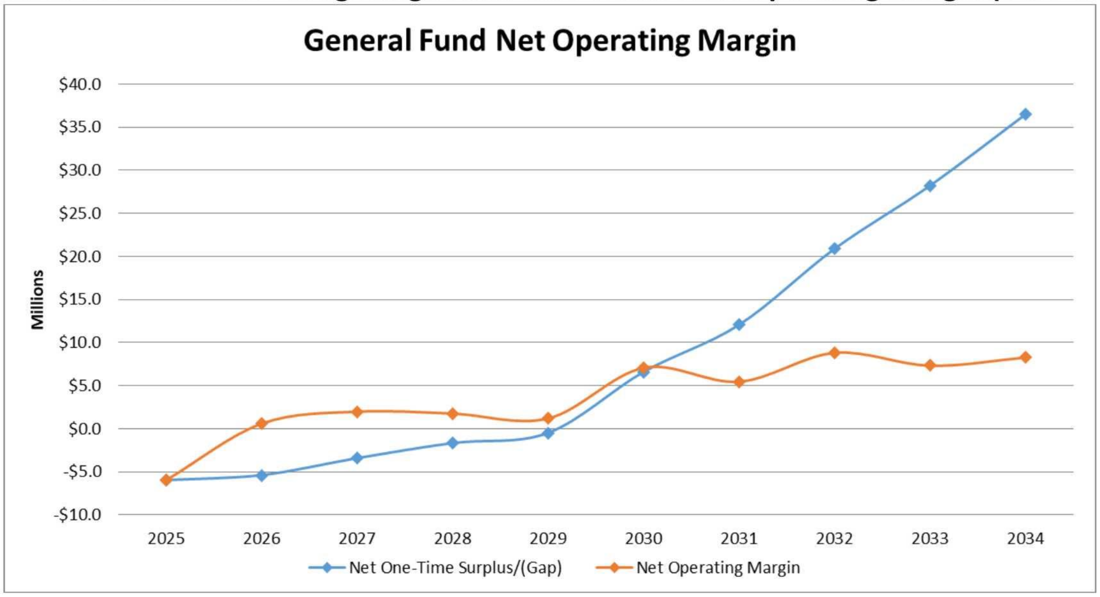
TABLE 1: FY 2025 – 2034 Long Range Financial Forecast (Base Case)

BASE CASE

	Actual 2023	Adopted 2024	Projected 2024	2025	2026	2027	2028	2029	2030	2031	2032	2033	2034
Total Revenue	$254,799	$261,141	$264,281	275,889	$289,060	$301,025	$312,564	$325,208	$339,684	$353,085	$365,820	$379,944	$394,026
BSR Contribution (One-Time)	-	$3,440	$3,440	-	-	-	-	-	-	-	-	-	-
Reappropriated Funds (One-Tim	-	$15,000	$15,000	-	-	-	-	-	-	-	-	-	-
Total Source of Funds	$254,799	$279,581	$282,722	$275,889	$289,060	$301,025	$312,564	$325,208	$339,684	$353,085	$365,820	$379,944	$394,026
Year over Year increase (revenue only)				*5.6%*	*4.8%*	*4.1%*	*3.8%*	*4.0%*	*4.5%*	*3.9%*	*3.6%*	*3.9%*	*3.7%*
Total Expenditures	$243,695	$279,581	$279,282	$281,887	$294,473	$304,465	$314,253	$325,708	$333,099	$341,030	$344,933	$351,721	$357,516
Total Use of Funds	$243,695	$279,581	$279,282	$281,887	$294,473	$304,465	$314,253	$325,708	$333,099	$341,030	$344,933	$351,721	$357,516
Year over Year increase				*0.8%*	*4.5%*	*3.4%*	*3.2%*	*3.6%*	*2.3%*	*2.4%*	*1.1%*	*2.0%*	*1.6%*
Net One-Time Surplus/(Gap)	$11,104	($0)	$3,440	($5,998)	($5,414)	($3,440)	($1,689)	($500)	$6,585	$12,055	$20,887	$28,223	$36,511
Cumulative Net Operating Margin (One-Time)													$87,220
Net Operating Margin				($5,998)	$585	$1,974	$1,751	$1,189	$7,085	$5,470	$8,832	$7,336	$8,288
Cumulative Net Operating Margin													$36,511

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

TABLE 2: FY 2025 – 2034 Long Range Financial Forecast Net Operating Margin (Base Case)



Revenue Assumptions

The FY 2023 Annual Comprehensive Financial Report (ACFR), scheduled for review by the Finance Committee on November 28, 2023, reported higher annual earnings for General Fund revenues as compared to the prior year; most major tax revenues experienced growth back to pre-pandemic levels due to the improved local economy, high price trends, and inflation (CMR 2308-1857[1]). This increased major tax revenue trend has continued through the first quarter (Q1) of FY 2024 with several categories tracking higher than the FY 2024 Adopted Budget levels. In FY 2024, staff estimates an overall increase in total revenues of $3.1 million from the Adopted $279.6 million to $282.7 million. Further discussion of changes to specific categories can be found in Attachment C, but increases are anticipated in Sales Tax, Property Tax, and Utility Users Tax and slightly offset by decreases in Transient Occupancy Tax and Documentary Transfer Tax. If these additional revenues continue to materialize in FY 2024, Staff anticipates returning to Council as part of the as part of the FY 2024 Mid-Year Budget Review to recommend using this funding to increase the uncertainty reserve to help mitigate impacts from a recession as well as smooth the near-term shortfalls seen in the first few years of this LRFF.

A summary of revenue assumptions are discussed here, extensive information regarding each revenue category can be found in **Attachment C**.

- Tax revenues constitute approximately 60% of General Fund resources. In FY 2025, the forecast projects a $7.8 million or 5.0% increase from FY 2024 projected levels ($156.8

[1] Finance Committee, November 28, 2023, CMR 2308-1857:
https://cityofpaloalto.primegov.com/portal/viewer?id=9637&type=3

million to $164.6 million). This increase is primarily attributed to higher anticipated receipts for Sales Tax, Property Tax, and Transient Occupancy Tax (TOT) categories.

- *Sales Taxes* is anticipated to increase $1.9 million or 5.1% from FY 2024 ($37.7 million to $39.6 million). Revenue in this category continue to experience growth as consumer spending continues despite high inflation and perceptions of a looming recession.
- *Property Taxes* make up the largest source of the General Fund's revenue, approximately 25%. In FY 2025, this revenue is anticipated to increase $3.3 million or 5.1% from FY 2024 ($64.6 million to $67.9 million). Robust residential and commercial property sales are anticipated to continue to grow this source annually.
- *Transient Occupancy Taxes* are impacted by business and other leisure/non-leisure travel and experienced significant reductions in the past few years due to a number of factors resulting from the pandemic. However, this revenue was able to return to pre-pandemic levels in FY 2023. In FY 2025, this revenue is anticipated to increase $1.2 million or 4.6% from FY 2024 ($25.5 million to $26.7 million).

- The forecast for non-tax revenues projects a $1.6 million or 3.2% increase in FY 2025 from FY 2024 adopted levels. This increase is primarily attributable to the alignment of revenue estimates for the Stanford agreement to provide Fire and Dispatch services, and increased rental revenue from other funds and departments that use General Fund maintained City facilities. These increases are partially offset by decreases in limited term revenue through the Staffing for Adequate Fire and Emergency Response (SAFER) Grant Program and decreased reimbursement revenue from other funds for administrative services.

The changes by revenue category can be seen in Tables 3 and 4 below. Major tax revenue trends are shown in Table 5 and discussed in greater detail in **Attachment C**.

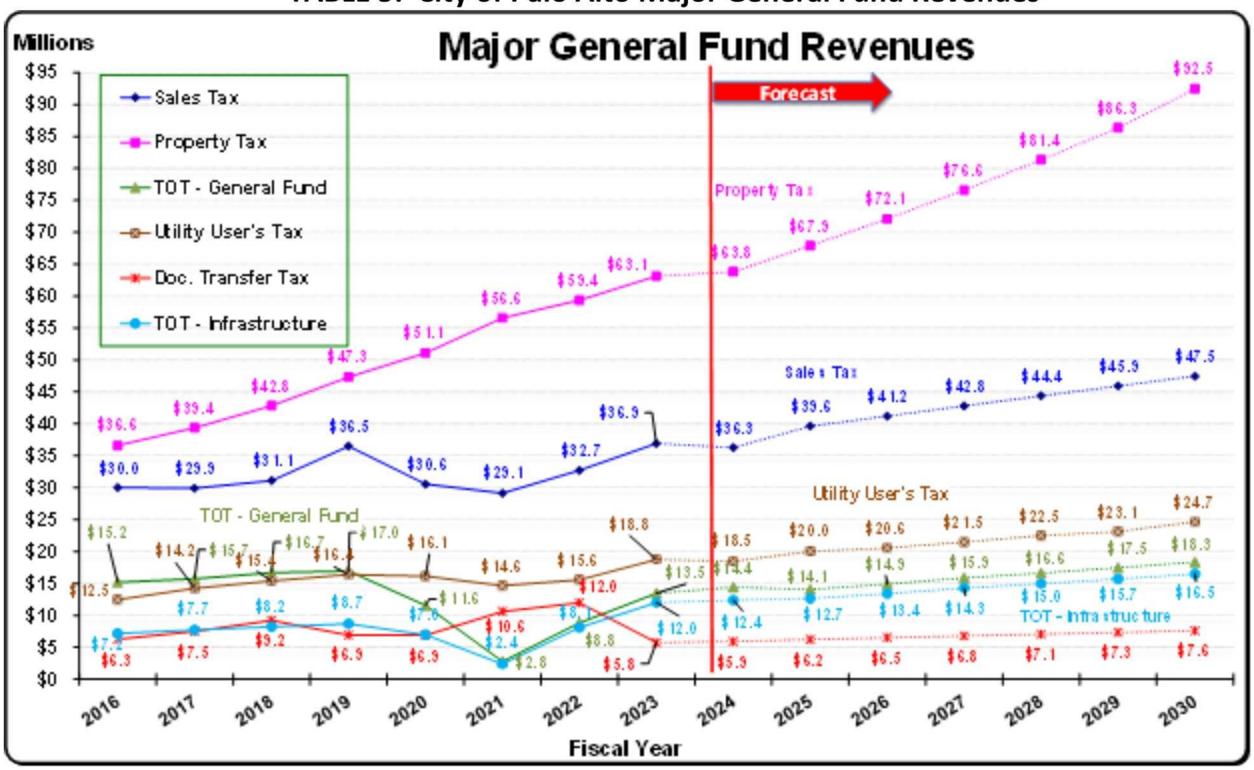
TABLE 3: General Fund Revenue Forecast

Revenue & Other Sources	Actual 2023	Adopted 2024	Projected 2024	2025	2026	2027	2028	2029	2030	2031	2032	2033	2034	CAGR 10 Years	CAGR 5 Years
Sales Taxes	36,926	36,272	37,737	39,647	41,204	42,798	44,382	45,935	47,451	49,149	50,707	52,851	55,123	3.4%	1.5%
Property Taxes	63,129	63,785	64,578	67,877	72,093	76,599	81,358	86,345	92,466	97,963	103,129	108,924	115,219	5.4%	2.4%
Transient Occupancy Tax															
General Purpose	13,471	14,437	13,450	14,072	14,913	15,882	16,647	17,468	18,336	19,259	20,266	21,330	22,450	4.8%	2.2%
Infrastructure	12,014	12,397	12,098	12,658	13,413	14,285	14,974	15,712	16,493	17,322	18,228	19,185	20,193	4.8%	2.2%
Documentary Transfer Tax	5,751	5,920	5,808	6,241	6,517	6,799	7,065	7,335	7,615	7,896	8,179	8,469	8,769	3.5%	1.6%
Utility Users Tax	18,763	18,457	19,674	20,047	20,573	21,488	22,502	23,122	24,653	25,487	26,361	27,267	28,206	3.5%	1.4%
Other Taxes and Fines	630	3,417	3,417	4,061	5,599	5,591	4,898	4,904	4,910	4,916	4,922	4,929	4,935	2.0%	1.9%
Subtotal: Taxes	150,684	154,684	156,762	164,604	174,313	183,442	191,826	200,822	211,924	221,992	231,792	242,955	254,895	4.5%	2.0%
Charges for Services	34,501	34,560	34,560	36,901	37,660	38,091	38,615	39,232	39,668	40,176	40,255	40,538	40,680	1.0%	0.6%
Permits and Licenses	7,994	10,722	10,722	11,457	11,514	11,776	12,153	12,523	12,690	12,846	12,860	12,960	12,721	1.1%	0.9%
Return on Investments	2,529	1,846	2,909	3,008	3,099	3,193	3,290	3,414	3,553	3,702	3,860	4,022	4,191	3.4%	1.3%
Rental Income	14,384	15,931	15,931	16,857	17,703	18,426	19,073	19,746	20,444	21,169	21,923	22,706	23,508	3.4%	1.6%
From Other Agencies	7,392	1,591	1,591	1,308	576	576	576	576	576	576	576	576	576	-7.9%	-7.9%
Charges to Other Funds	13,227	15,496	15,496	13,168	13,664	14,168	14,706	15,230	15,783	16,358	16,943	17,558	18,177	3.3%	1.5%
Other Revenue	2,133	2,378	2,378	2,457	2,195	2,200	2,206	2,211	2,217	2,223	2,231	2,237	2,244	-0.9%	-1.0%
Total Non-Tax Revenue	82,161	82,525	83,588	85,156	86,411	88,430	90,620	92,932	94,931	97,051	98,648	100,597	102,097	1.8%	0.9%
Operating Transfers-In	21,954	23,932	23,932	26,130	28,336	29,153	30,118	31,454	32,829	34,042	35,380	36,392	37,034	3.5%	1.9%
BSR Contribution (One-Time)		3,440	3,440												
Reappropriated Funds (One-Time)		15,000	15,000												
Total Source of Funds	$254,799	$279,581	$282,721	$275,889	$289,060	$301,025	$312,564	$325,208	$339,684	$353,085	$365,820	$379,944	$394,026		

TABLE 4: General Fund Revenue Forecast Year to Year Percentage Change

Revenue & Other Sources	Actual 2023	Adopted 2024	Projected 2024	2025	2026	2027	2028	2029	2030	2031	2032	2033	2034
Sales Taxes		-1.8%	4.0%	5.1%	3.9%	3.9%	3.7%	3.5%	3.3%	3.6%	3.2%	4.2%	4.3%
Property Taxes		1.0%	1.2%	5.1%	6.2%	6.3%	6.2%	6.1%	7.1%	5.9%	5.3%	5.6%	5.8%
Transient Occupancy Tax													
General Purpose		7.2%	-6.8%	4.6%	6.0%	6.5%	4.8%	4.9%	5.0%	5.0%	5.2%	5.3%	5.2%
Infrastructure		3.2%	-2.4%	4.6%	6.0%	6.5%	4.8%	4.9%	5.0%	5.0%	5.2%	5.3%	5.2%
Documentary Transfer Tax		2.9%	-1.9%	7.5%	4.4%	4.3%	3.9%	3.8%	3.8%	3.7%	3.6%	3.6%	3.5%
Utility Users Tax		-1.6%	6.6%	1.9%	2.6%	4.4%	4.7%	2.8%	6.6%	3.4%	3.4%	3.4%	3.4%
Other Taxes and Fines		442.4%	0.0%	18.9%	37.9%	-0.1%	-12.4%	0.1%	0.1%	0.1%	0.1%	0.1%	0.1%
Subtotal: Taxes		2.7%	1.3%	5.0%	5.9%	5.2%	4.6%	4.7%	5.5%	4.8%	4.4%	4.8%	4.9%
Charges for Services		0.2%	0.0%	6.8%	2.1%	1.1%	1.4%	1.6%	1.1%	1.3%	0.2%	0.7%	0.4%
Permits and Licenses		34.1%	0.0%	6.8%	0.5%	2.3%	3.2%	3.0%	1.3%	1.2%	0.1%	0.8%	-1.8%
Return on Investments		-27.0%	57.6%	3.4%	3.0%	3.0%	3.1%	3.8%	4.0%	4.2%	4.2%	4.2%	4.2%
Rental Income		10.8%	0.0%	5.8%	5.0%	4.1%	3.5%	3.5%	3.5%	3.5%	3.6%	3.6%	3.5%
From Other Agencies		-78.5%	0.0%	-17.8%	-56.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Charges to Other Funds		17.2%	0.0%	-15.0%	3.8%	3.7%	3.8%	3.6%	3.6%	3.6%	3.6%	3.6%	3.5%
Other Revenue		11.5%	0.0%	3.3%	-10.6%	0.2%	0.3%	0.2%	0.3%	0.3%	0.3%	0.3%	0.3%
Total Non-Tax Revenue		0.4%	1.3%	1.9%	1.5%	2.3%	2.5%	2.6%	2.2%	2.2%	1.6%	2.0%	1.5%
Operating Transfers-In		9.0%	0.0%	9.2%	8.4%	2.9%	3.3%	4.4%	4.4%	3.7%	3.9%	2.9%	1.8%
Total Source of Funds		9.7%	1.1%	-2.4%	4.8%	4.1%	3.8%	4.0%	4.5%	3.9%	3.6%	3.9%	3.7%

TABLE 5: City of Palo Alto Major General Fund Revenues



Expense Assumptions

As part of developing the FY 2025-2034 Forecast expenditure budget, the General Fund expense categories have been adjusted by removing FY 2024 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 2024 Adopted Budget, growth of 0.9% is expected in FY 2025. The small overall annual growth is due to the elimination of large one-time reserves in FY 2023 that offset the increase in expenses in other categories such as Salary and Benefits, Allocated Charges, and Transfers to Other Funds.

A summary of expense assumptions is discussed here, extensive information regarding each expense category can be found in **Attachment D**.

- *Salary and Benefits* are projected to increase $7.1 million or 4.3% from the FY 2024 ($166.9 million to $174.0 million). This is primarily attributable to increases in salaries ($2.9 million or 3.1%) and pension costs ($4.5 million or 10.2%).
    - A general wage adjustment of 2% is included for all employees starting in either January 2025 or July 2025 for all years of the forecast once negotiated contracts sunset.
    - A reserve is included for potential changes to future labor costs including, changes in vacancy rates, labor and benefit rate variability, and inflation assumptions.
- Long Term contributions to pension and other post-employment benefits reflect increases over the prior year and capital investments are being phased through the first three to five years of the forecast:
    - *Pension 115 Trust contributions* are calculated using a lower 5.3% discount rate for normal cost as compared to CalPERS 6.8%. Through FY 2024, it is expected that $67.6 million ($44.6 million in the General Fund) in supplemental principal contributions will be made to the Pension Trust. Staff expects to reach sufficient balances in the Pension Trust to begin paying down CalPERS unfunded liabilities in the next 1-2 years, consistent with the Retiree Benefit Funding Policy. The FY 2025 budget estimates $13.8 million ($8.3 million in the General Fund) in supplemental contributions, a $0.5 million or 4.1% increase from FY 2024 Adopted levels of $13.2 million.
    - *California Employers' Retiree Benefit Trust (CERBT) Fund contributions for Retiree medical* costs are calculated using a lower 5.75% discount rate as compared to a 6.25% assumption. Through FY 2024, it is expected that $11.1 million in supplemental principal contributions will be made to the CERBT Trust. The FY 2025 Budget estimates $16.9 million ($10.8 million in the General Fund) for ADC, an approximate $0.5 million or 2.9% increase from FY 2024 levels of $16.4 million.
    - *Capital Infrastructure transfers* reflect the goal established as part of the 2022-2026 Capital Improvement Plan (CIP) to restore the base portion of this transfer to pre-pandemic levels by FY 2026. The local economy has recovered from the COVID-19 pandemic, and estimated transfers from TOT revenues in FY 2025 are currently projected to increase to $12.3 million and the base transfer to increase to $12.4 million for a total $24.7 million transfer to the Capital Improvement Fund.

- Inflationary assumptions in this long range reflect the record inflation being seen at present with an assumption that the interest rate adjustments by the Federal Reserve will eventually level off inflationary increases. A 4% annual inflation is assumed throughout the ten-year forecast to estimate cost increases for non-salary services and equipment.
- Expenses are programmed to maintain service levels based on Council approval. As a result, some limited term programs are not extended through the entire ten-year forecast, but discussed later in this report to indicate that continuing the programs would require additional resources. A couple examples of these programs are the Psychiatric Emergency Response Team (PERT), and the PA Link on demand transit service. Both programs have partial funding in the LRFF but would need additional resources to continue them through the entire ten-year period. This LRFF also includes the City's committed investment of $7.0 million in operating expenses for the partnership with LifeMoves and *Project Homekey* site services ($1.0 million starting in FY 2025 and is programmed through FY 2031). The timing of the funding was shifted as a result of $2.0 million from FY 2023 and FY 2024 being approved by the Council to be used to fund expenses related to the Homekey Facilities capital project (PE-24005).

TABLE 6: General Fund Expense Forecast and Year to Year Percentage Change

Expenditures & Other Uses	Actual 2023	Adopted 2024	Projected 2024	2025	2026	2027	2028	2029	2030	2031	2032	2033	2034	CAGR 10 Years	CAGR 5 Years
Salary	78,760	91,260	91,260	94,132	99,678	105,014	109,166	113,005	115,318	117,936	119,874	121,814	124,136	3.1%	1.8%
Benefits	67,956	75,601	75,601	79,866	81,393	82,287	84,961	88,687	89,984	90,992	89,837	89,955	88,786	1.6%	1.1%
Subtotal: Salary & Benefits	146,717	166,861	166,861	173,998	181,071	187,301	194,127	201,692	205,302	208,928	209,711	211,769	212,922	2.5%	1.5%
Contract Services	24,214	28,753	28,753	29,335	29,951	31,158	31,557	32,736	33,760	35,150	36,253	37,737	38,976	3.1%	1.1%
Supplies & Material	3,048	3,332	3,332	3,458	3,596	3,740	3,890	4,046	4,208	4,376	4,551	4,733	4,922	4.0%	1.6%
General Expense	7,515	19,092	19,092	9,824	9,815	9,838	9,863	10,094	10,308	10,545	9,793	10,060	10,317	-6.0%	0.3%
Rents & Leases	163	1,368	1,368	1,405	1,443	1,482	1,522	1,564	1,606	1,649	1,694	1,741	1,789	2.7%	1.1%
Facilities & Equipment	446	799	799	458	476	495	515	536	557	579	602	626	651	-2.0%	1.6%
Allocated Charges	22,564	25,796	25,796	27,652	28,603	29,595	30,683	31,638	32,597	33,612	34,615	35,778	37,002	3.7%	1.4%
Total Non Sal/Ben Before Transfers	57,949	79,139	79,139	72,131	73,883	76,307	78,030	80,613	83,035	85,911	87,507	90,673	93,656	1.7%	1.1%
Operating Transfers-Out	12,342	5,043	5,043	6,494	6,531	6,562	6,599	6,637	6,670	6,708	6,746	6,757	6,795	3.0%	0.2%
Transfer to Infrastructure - Base	14,673	16,140	16,140	16,607	19,575	20,009	20,523	21,053	21,599	22,161	22,740	23,336	23,950	4.0%	2.4%
Transfer to Infrastructure - TOT	12,014	12,397	12,098	12,658	13,413	14,285	14,974	15,712	16,493	17,322	18,228	19,185	20,193	5.0%	2.2%
Total Use of Funds	243,695	279,581	279,282	281,887	294,473	304,465	314,253	325,708	333,099	341,030	344,933	351,721	357,516	2.5%	1.5%

Expenditures & Other Uses	Actual 2023	Adopted 2024	Projected 2024	2025	2026	2027	2028	2029	2030	2031	2032	2033	2034
Salary		15.9%	0.0%	3.1%	5.9%	5.4%	4.0%	3.5%	2.0%	2.3%	1.6%	1.6%	1.9%
Benefits		11.2%	0.0%	5.6%	1.9%	1.1%	3.2%	4.4%	1.5%	1.1%	-1.3%	0.1%	-1.3%
Subtotal: Salary & Benefits		13.7%	0.0%	4.3%	4.1%	3.4%	3.6%	3.9%	1.8%	1.8%	0.4%	1.0%	0.5%
Contract Services		18.7%	0.0%	2.0%	2.1%	4.0%	1.3%	3.7%	3.1%	4.1%	3.1%	4.1%	3.3%
Supplies & Material		9.3%	0.0%	3.8%	4.0%	4.0%	4.0%	4.0%	4.0%	4.0%	4.0%	4.0%	4.0%
General Expense		154.1%	0.0%	-48.5%	-0.1%	0.2%	0.3%	2.3%	2.1%	2.3%	-7.1%	2.7%	2.6%
Rents & Leases		740.6%	0.0%	2.7%	2.7%	2.7%	2.7%	2.7%	2.7%	2.7%	2.7%	2.8%	2.8%
Facilities & Equipment		79.0%	0.0%	-42.7%	3.9%	4.0%	4.0%	4.1%	3.9%	4.0%	4.0%	4.0%	4.0%
Allocated Charges		14.3%	0.0%	7.2%	3.4%	3.5%	3.7%	3.1%	3.0%	3.1%	3.0%	3.4%	3.4%
Total Non Sal/Ben Before Transfers		36.6%	0.0%	-8.9%	2.4%	3.3%	2.3%	3.3%	3.0%	3.5%	1.9%	3.6%	3.3%
Operating Transfers-Out		-59.1%	0.0%	28.8%	0.6%	0.5%	0.6%	0.6%	0.5%	0.6%	0.6%	0.1%	0.6%
Transfer to Infrastructure - Base		10.0%	0.0%	2.9%	17.9%	2.2%	2.6%	2.6%	2.6%	2.6%	2.6%	2.6%	2.6%
Transfer to Infrastructure - TOT		3.2%	-2.4%	4.6%	6.0%	6.5%	4.8%	4.9%	5.0%	5.0%	5.2%	5.3%	5.2%
Total Use of Funds		14.7%	-0.1%	0.9%	4.5%	3.4%	3.2%	3.6%	2.3%	2.4%	1.1%	2.0%	1.6%

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% of General Fund operating expenditures, with a target of 18.5%. As part of the FY 2024 Adopted Budget, the Council approved keeping the BSR at the 20% level to mitigate risks associated with economic uncertainty. Maintaining the BSR at this higher level through FY 2025 is a policy decision to be determined as part of the development of the FY 2025 budget. Any reduction to the reserve below 15% requires City Council approval.

The BSR is used to fund unanticipated one-time costs as opposed to ongoing or recurring operating expenditures; ongoing revenue or expense trends are updated as part of the annual budget process to adjust ongoing needs. The City's intent is to fund ongoing programs and services with ongoing dollars. Maintaining the BSR at 18.5% or higher 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 2023 Annual Comprehensive Financial Report (ACFR) CMR 2308-1857[2], the City's current BSR balance is $57.2 million, approximately $3.3 million above the 20% target of $53.9 million for FY 2024. Staff anticipates returning to Council in February 2024 with the FY 2024 Mid-Year Review and recommendations in alignment with the allocation below for the appropriation of BSR funds above the 20% level. These actions will leave the BSR at $53.7 million or $0.2 million below the 20% Council recommended level.

TABLE 7: Budget Stabilization Reserve (BSR) Summary (in millions)

General Fund BSR Balance, June 30, 2023	**$61.5**
FY 2024 Approved Adjustments to the BSR Balance	*($4.3)*
Subtotal: BSR Balance, After Approved Adjustments	**$57.2**
FY 2024 RECOMMENDED Adjustments to the BSR Balance (to be considered in FY 2024 Mid-Year Budget Review, 115 Trust and Infrastructure Reserve contribution)	($3.5)
Current Projected FY 2024 BSR Level, (June 30, 2024)	**$53.7**

As mentioned previously, the increased major tax revenue trend has continued through the first quarter (Q1) of FY 2024 with several categories tracking higher than the FY 2024 Adopted Budget levels. In FY 2024, staff estimates an overall increase in total revenues of $3.1 million from the Adopted $279.6 million to $282.7 million. Further discussion of changes to specific categories can be found in Attachment C, but increases are anticipated in Sales Tax, Property Tax, and Utility Users Tax and slightly offset by decreases in Transient Occupancy Tax and Documentary Transfer Tax. If these additional revenues continue to materialize in FY 2024, Staff will return to Council as part of the FY 2024 Mid-Year Budget Review to recommend adjustments to the FY 2024 budget to recognize this one-time revenue to increase the uncertainty reserve to continue to bridge the near-term shortfalls seen in the first few years of this LRFF.

In addition to the BSR, funding of approximately $10.1 million remains in an Uncertainty Reserve that was established as part of the FY 2023 Mid-Year Review to fund the two-year budget strategy for FY 2024 and FY 2025. The $10.1 million was assumed to be used to fund items deferred from

[2] Finance Committee, November 28, 2023, CMR 2308-1857: https://cityofpaloalto.primegov.com/portal/viewer?id=9637&type=3

the FY 2024 Adopted Budget as part of the FY 2024 Mid-Year Review ($1.1 million) and any potential shortfalls in FY 2025 ($9.0 million). These funds are one-time in nature so once they are spent, they are not available for ongoing needs.

Assumptions NOT Included in Forecast

It should be noted that this forecast does not include several potential impacts to the FY 2025-2034 LRFF that are outlined below. These items are known projects or areas of investment that are priorities but have not been fully developed in terms of costs and timelines. This is not intended to be a comprehensive list nor in any priority order.

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 greenhouse gas (GHG) emissions to 80 percent below 1990 levels by 2030 (the "80x30" goal). Investments have been made across various City funds related to S/CAP including: a new Grid Modernization for Electrification capital project (EL-24000), realignment of staff to manage infrastructure improvement projects; scaling existing successful energy efficiency programs; performing and analyzing research in alternative energy sources, sustainable water supplies, carbon sequestration options; and increasing incentives for voluntary electrification programs. The S/CAP Three-Year Work Plan Report was approved by Council in Spring 2023; however, continued implementation will require significant resources, including internal staffing and consultant expertise.

Labor negotiations: As of the timing of this report, all labor agreements for full-time employees are scheduled to expire by June 2025 except for the Service Employees International Union (SEIU) agreement, which expires January 2025. Consistent with Council direction in previous LRFF's, a general 2% assumption is included for all employees starting in either January or July 2025 for all years of the forecast since negotiated wage rates are not yet available for that time; this is not as a commitment to future negotiations and is for forecasting purposes. Additionally, this forecast includes a level of reserve for potential changes in employee compensation in future agreements for competitive wages and other terms of employment. Actual funding needs may differ, depending on outcomes of future labor negotiations. Additional information on salary and benefit assumptions and reserves for future agreements is included in Attachment D.

Capital Infrastructure 2014 Plan: The 2014 Council approved Infrastructure Plan of $125.8 million in project costs was based on construction and design costs with data from 2012. The Infrastructure Plan's funding status has shifted, as construction costs have increased and the City is required to pay prevailing wages. The FY 2024 Adopted Capital Budget anticipated that these projects would cost $270.7 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 four at-grade crossings along the Caltrain corridor in the City of Palo Alto located at Palo Alto Avenue, Churchill Avenue, Meadow Drive, and Charleston Road. As part of the FY 2024 Capital budget, the Council approved two capital projects to separate them, specifying the funding sources and costs associated with Churchill Avenue (PL-24001) and Meadow Drive and Charleston Road (PL-24000) which are being designed together. Currently, the Rail Committee is reviewing alternatives for these crossings to further narrow and select the preferred alternative(s) for recommendation to the City Council. Studies were completed to refine underpass alternatives by seeking input from stakeholders such as the Pedestrian and Bicycle Advisory Committee, Palo Alto Unified School District, and Stanford University to assist in narrowing down grade separation alternatives.

Following locally preferred alternative selection, the next phase will include preparing preliminary engineering and environmental documents for the three crossings. The Valley Transportation Authority (VTA) 2016 Measure B Caltrain Grade Separation funding is available to the City for additional studies and the next phases of the project which include preliminary engineering and environmental review, right-of-way, design, and construction. In addition to this, the City Council adopted advisory spending guidelines stating its intention to expend a portion of the revenues from the Business Tax on the rail grade separation project (Supplemental Memorandum AA1[3]).

The full funding needed to complete the grade crossings project is estimated as part of the capital projects that were established; however, funding necessary to complete this work will exceed funding currently identified for this project through the VTA and Business Tax revenue. Therefore, additional resources will need to be explored to plan and fund these grade separations, including City staff pursuing additional funding through grant opportunities as they become available and other financing mechanisms. Staff has been successful in grant applications and received notifications of grant awards for $6 million for Preliminary Engineering and Environmental work from the Federal Rail Administration and $23.8 million for final design of Churchill Avenue from the State.

Parks Master Plan: The Parks Master Plan[4] 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.

City owned assets operated by non-profit organizations: This Forecast does not include any additional capital or operating investments for partners of the City such as but not limited to the Avenidas Senior Center, the Ventura Child Care Center, Palo Alto Animal Shelter facility, Palo Alto History museum (300 Homer Avenue Roth facility), Project Homekey, or the Sea Scout Building. Many of these have estimates or current projected liabilities, however, as projects evolve and

[3] City Council, August 10, 2022, Supplemental Memorandum #AA1: https://www.cityofpaloalto.org/files/assets/public/agendas-minutes-reports/at-places-memo/20220810apmccsm.pdf

[4] Palo Alto Parks, Trails, Natural Open Space & Recreation Master Plan: https://www.cityofpaloalto.org/files/assets/public/public-works/palo-alto-parks-master-plan.pdf

costs change these are not included. As costs around potential capital or operating investments for these assets solidify, staff will return to City Council to address them as appropriate. As part of the FY 2023 Adopted Capital Budget the City Council established the Roth Building Rehabilitation Phase 1 capital project (PF-23001) and directed a funding strategy for the Roth Building Rehabilitation Project, which consists of utilizing $5.4 million from a variety of funding sources.

Cubberley Community Center Redevelopment: A new lease between the City and PAUSD for the school district owned portion of Cubberley commenced on July 1, 2020 and reduced the amount of building space leased to the City (discussed in the General Expense - Cubberley Lease section of this report). On March 13, 2023 the PAUSD Board of Education provided a letter to the City Council inviting the City to submit one or more proposals to transfer a portion of PAUSD-owned land at Cubberley to the City. This could be through a land swap, acquisition or ground lease. Based on discussions with Council (CMR 2380-1949[5]) an Ad Hoc of the City Council and staff are developing the proposal. Staff is working on next steps for repair of Cubberley Gyms A and B, which have been closed since February 2022 due to damage caused by water line breaks. Remediation work of damaged areas has started, and the final phase of the repair work is scheduled to begin in February 2024. Replacement of the gym's heating system is not included in the scope of the remediation project.

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. Additions and other initiatives funded in other funds may need financial support from the General Fund to ensure they are fully implemented, examples include cashflow needs for the Regional Water Quality Control Plant upgrades, or major capital investments in which financing could be secured at a later time (e.g. a loan for the airport fund was established to ensure matching grant funds for major capital improvements).

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. As the potential impacts of various legislative initiatives are 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.

Aging or Noncompliant Infrastructure: The City maintains indoor and outdoor facilities, many of which have been identified in the City's ADA transition plan and by the Infrastructure Blue Ribbon Commission as requiring capital project work to bring them up to full ADA compliance and/or

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[5] City Council, October 16, 2023, CMR 2308-1949:
https://cityofpaloalto.primegov.com/portal/viewer?id=9323&type=3

sufficient conditions. Facilities of concern include Cubberley Community Center, Foothills Park Restrooms, and Lucie Stern Community Theatre restrooms. Staff continues to program work needed in this area as part of the Americans with Disabilities Act Compliance capital project (PF-93009); however, the entire scope of work needed in this area exceeds current resources.

General Liability Umbrella Excess Premiums: The City's General Liability Program provides funding to cover various insurance policies for City-owned equipment and machinery. The City is self-insured for the first $1.0 million in losses per occurrence and participates in a Joint Powers Authority for coverage up to $55 million per occurrence. These expenses are allocated to citywide departments. General Liability Umbrella Excess Premiums are anticipated to increase in future years due to significant national events and natural disasters such as claim costs for Hurricane Ian. Staff will bring forward adjustments for these costs as part of future budget cycles as they become available.

Significant Projects or Changing Operational Needs:
Updates to several significant programs, codes and ordinances are expected to be necessary in the near future as staff work to implement programs and investments to major plans such as the City's housing element, fee and organizational studies for services such as planning and development services, and new facility needs under review such as a fire training center. Many of these projects and organizational needs are under way or being studies for further planning and will likely have financial impacts that are unknown at this time.

Limited Term Programs: There are several programs currently in progress that are funded on a limited term basis per Council approval. If these programs are recommended to continue through the ten-year forecast period additional resources would be needed.

- The Psychiatric Emergency Response Team (PERT) program in the Police Department pairs a police officer in plain clothes and a mental health clinician to respond to calls for mental health emergencies. PERT is recommended to be supported with Stanford University Medical Center (SUMC) funding through FY 2027. To continue the program in FY 2027, an additional $0.2 million would be needed, with an ongoing cost of $0.4 million annually starting in FY 2028.
- PA Link, the on-demand transit service, is currently being administered as a pilot program with grant funding from the VTA. The program is partially funded in FY 2025, but an additional $0.7 million would be needed to fully fund the program with an ongoing annual need of approximately $1.8 million starting in FY 2026.
- The Downtown Streets Team that provides cleaning services in the University Avenue area was previously funded through the Community Development Block Grant (CDBG); however, in FY 2023 this funding source was determined to be ineligible for these services and costs were shifted to the General Fund on a one-time basis. Funding for the program has been programmed through FY 2025; however, $0.2 million would be needed annually to maintain this program.

Vehicle Fleet Electrification: Currently the City's policy is to consider electric vehicles and then other alternative fuel vehicles when replacing existing vehicles. Transitioning the vehicle fleet to full Electric Vehicles (EVs) is part of the City's sustainability goals. As part of the FY 2024 budget process, it was estimated that approximately $6.0 million across all funds will be needed annually ($2.6 million above the FY 2024 budget) in order to replace all City vehicles with EVs.

FY 2025 Budget Development Guidelines

As discussed earlier in this document, this preliminary forecast represents the initial steps of the FY 2025 budget development process. 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. The FY 2025 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.

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.

Human Services Resource Allocation Process (HSRAP) Funding Referral

As part of the FY 2024 Adopted Budget, the Council directed staff to follow-up with additional work to, "Consider pegging HSRAP budget allocations to a benchmark, such as percentage of General Fund budgeted expenditures." In prior years funding has not been tied to a percentage of the General Fund budgeted expenditures, and the last time this was reviewed by the Policy and Services Committee (CMR 7289[6]) there were four options for augmenting the HSRAP funding, but ultimately none of them were approved for recommendation to the Council. The status quo of increasing the funding by the Consumer Price Index (CPI) as funding was available in the General Fund continued. Attachment E contains additional historical data and analysis regarding the impacts on the LRFF base case for FY 2025 through FY 2027.

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[6] November 29, 2016 Policy and Services CMR 7289: https://www.cityofpaloalto.org/files/assets/public/v/1/agendas-minutes-reports/reports/city-manager-reports-cmrs/year-archive/2016/id-7289-hsrap.pdf

Conclusion

This forecast maintains current service levels approved in FY 2024 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 similar to where it was a year ago in terms of impacts from economic and geo-political uncertainty and evaluating potential impacts on the local economy. Positive trends in major tax revenue categories that occurred in FY 2023 caused a one-time surplus of $3.3 million. These trends continue in the forecast, although increases in the near term may be flattened due to economic stagnation. Staff will return to Council in February 2024 with the FY 2024 Mid-Year Review to recommend, in alignment with Council policy specifying that the City Manager may direct amounts exceeding the BSR target, that the $3.3 million surplus be allocated to the Infrastructure Reserve (IR) in the Capital Improvement Fund ($1.65 million) and the City's Section 115 Pension Trust Fund ($1.65 million), as outlined in the Retirement Benefit Funding Policy.

The LRFF Base Case assumes a weak economy in 2024, followed by a return to trend growth rates by 2025 and through the remaining ten-year forecast period. Revenue growth is anticipated to stagnate through the end of FY 2025 as a result of monetary policy tightening actions by the US Federal Reserve continuing in an effort to achieve a "soft landing", whereby a slowdown in economic growth avoids recession by stopping the economy from overheating and higher inflation. As a result, the LRFF projects a shortfall of $6.0 million in FY 2025, followed by shortfalls ranging from $5.4 million in FY 2026 down to $0.5 million in FY 2029. FY 2030 has a surplus of $6.6 million which continues to grow through FY 2034. These amounts are consistent with previous projections used as part of the two-year budget balancing strategy when adopting the FY 2024 Budget. Additionally, this LRFF projects $282.7 million in total revenues in FY 2024, reflecting $3.1 million or 1.1% above adopted budget levels. If these additional revenues materialize in FY 2024, staff anticipates returning to Council as part of the FY 2024 Mid-Year Budget Review to recommend using this funding to increase the uncertainty reserve to help mitigate impacts from a recession as well as smooth the near-term shortfalls seen in the first few years of this LRFF.

Funding of approximately $10.1 million remains in an Uncertainty Reserve that was established as part of the FY 2023 Mid-Year Review to fund the two-year budget strategy for FY 2024 and FY 2025. The $10.1 million was assumed to be used to fund items deferred from the FY 2024 Adopted Budget as part of the FY 2024 Mid-Year Review ($1.1 million) and any potential shortfall in FY 2025 ($9.0 million). These funds are one-time in nature so once they are spent, they are not available for ongoing needs.

In addition to the Base Case Forecast, staff modeled an alternate forecast scenarios that are discussed below. The first alternative reflects a 1% loss in economically sensitive revenue in FY 2025 compared to the Base Case, and increases the General Fund shortfall over the next ten years. FY 2025 increases from a shortfall of $6.0 million to $8.1 million, and revenues are not anticipated to be able to fund the annual expenditures until FY 2030. Staff also modeled an alternate forecast that reflects a 1% compensation adjustment and the impacts on the General Fund over the next ten years. The surplus in FY 2024 increases to $1.1 million, the shortfall in FY 2025 reduces to $1.9 million, and FY 2026 changes from a shortfall to a small surplus. These alternate forecasts were done separately to show the impacts of each scenario in isolation; however, aspects of both alternate forecasts may occur in conjunction in the future.

Alternative Scenarios for Consideration

Alternative Forecast Scenario A: Economically Sensitive Revenue Loss

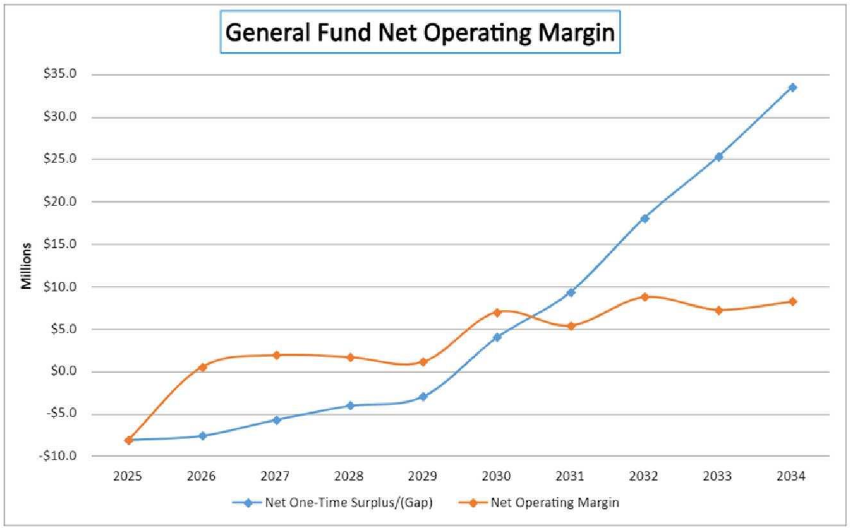
This alternative forecast models the impact of a 1% revenue loss on economically sensitive revenue. Since it is difficult to predict the timing of a recession, this scenario shows the cost of a revenue loss in FY 2025 and how it would impact the subsequent years of the forecast. The major taxes, charges for services, and permits and licenses revenue categories are typically impacted by economic changes, so the impact has been calculated on these revenue sources. The 1% loss from these revenue sources would reduce the overall revenue in FY 2025 by $2.1 million. The Base Case projected that by FY 2030, the City would begin to have a positive surplus; this alternative forecast increases the operating shortfalls from $0.5 million to $3.0 million in FY 2030. In this alternative, the General Fund would have a shortfall of approximately $8.1 million in the first year of the forecast. The summary table for this alternative forecast and the Net Operating Margin graph for this alternative forecast are below.

TABLE 8: FY 2025 – FY 2034 Long Range Financial Forecast
Alternative Forecast A

ALTERNATIVE SCENARIO: RECESSION (1% Loss of Economically Sensitive Revenue in FY 2025)

	Actual 2023	Adopted 2024	Projected 2024	2025	2026	2027	2028	2029	2030	2031	2032	2033	2034
Total Revenue	$254,799	$261,141	$264,281	273,760	286,825	298,692	310,138	322,682	337,041	350,335	362,971	376,979	390,943
BSR Contribution (One-Time)	-	$3,440	$3,440	-	-	-	-	-	-	-	-	-	-
Reappropriated Funds (One-Time	-	$15,000	$15,000	-	-	-	-	-	-	-	-	-	-
Total Source of Funds	$254,799	$279,581	$282,722	$273,760	$286,825	$298,692	$310,138	$322,682	$337,041	$350,335	$362,971	$376,979	$390,943
Year over Year increase (revenue only)				*4.8%*	*4.8%*	*4.1%*	*3.8%*	*4.0%*	*4.4%*	*3.9%*	*3.6%*	*3.9%*	*3.7%*
Total Expenditures	243,695	279,581	279,282	281,887	294,471	304,463	314,251	325,705	333,097	341,028	344,930	351,718	357,513
Total Use of Funds	$243,695	$279,581	$279,282	$281,887	$294,471	$304,463	$314,251	$325,705	$333,097	$341,028	$344,930	$351,718	$357,513
Year over Year increase				*0.8%*	*4.5%*	*3.4%*	*3.2%*	*3.6%*	*2.3%*	*2.4%*	*1.1%*	*2.0%*	*1.6%*
Net One-Time Surplus/(Gap)	$11,104	($0)	$3,440	(8,128)	($7,646)	($5,771)	($4,112)	($3,023)	$3,944	$9,307	$18,041	$25,261	$33,431
Cumulative Net Operating Margin (One-Time)													$61,304
Net Operating Margin				($8,128)	$481	$1,876	$1,658	$1,089	$6,968	$5,363	$8,733	$7,221	$8,169
Cumulative Net Operating Margin													$33,431

TABLE 9: FY 2025 –2034 Long Range Financial Forecast Net Operating Margin Alternative Forecast A



Alternative Forecast Scenario B: One-time Compensation Adjustment, Additional 1%

Consistent with City Council direction and past practice, the Base Case assumes a 2% general wage adjustment in the years beyond the terms of existing Memorandum of Agreements (MOAs) since negotiated wage rates do not yet exist for that time. As of the timing of this forecast, MOAs are in effect through January 2025 (Service Employees International Union) (SEIU) and June 2025 (all other full-time labor groups). To support ongoing efforts for competitive wages and other terms of employment, the Base Case forecast includes a reserve for potential changes to future labor costs including, changes in vacancy rates, labor and benefit rate variability, and inflation assumptions. Offering competitive compensation plans aligns with industry standards for attracting and retaining a skilled and motivated workforce and better positions the City of Palo Alto as an employer of choice. This level of funding is intended to offset potential future costs and may differ from actual outcomes. Negotiations for new labor agreements are anticipated to occur in the next year for new terms beginning in FY 2025-26.

This alternative scenario models the impact of a one-time adjustment in FY 2026 to increase compensation by an additional 1% above assumptions in the Base Case; this is the first full fiscal year for new MOA terms with all labor groups. As with other assumptions in the LRFF, this model is for forecasting purposes and does not reflect future commitment.

The one-time compensation adjustment would increase expenditures in FY 2026 by $1.2 million. The Base Case projected that by FY 2030, the City would begin to have a positive surplus; this alternative forecast increases the operating shortfalls in the near-term, resulting in losses ranging from $6.0 million in FY 2026 to $1.9 million in FY 2029. Based on this scenario, the cumulative net operating margin, or ongoing surplus, during the forecast period is a surplus of $35.0 million. The summary table for this alternative forecast and the Net Operating Margin graph for this alternative forecast are below.

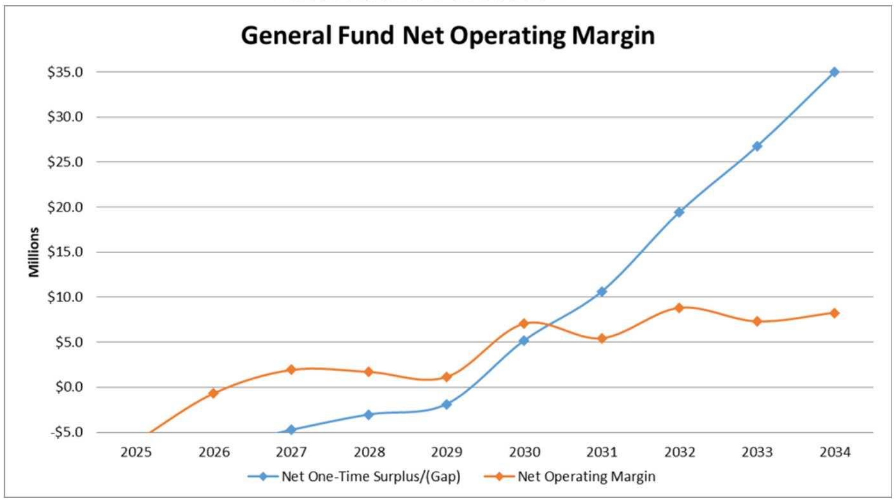
TABLE 10: FY 2025 – FY 2034 Long Range Financial Forecast
Alternative Forecast B

ALTERNATIVE SCENARIO: ONE-TIME COMPENSATION ADJUSTMENT (ADDITIONAL 1%) in FY 2026

	Actual 2023	Adopted 2024	Projected 2024	2025	2026	2027	2028	2029	2030	2031	2032	2033	2034
Total Revenue	$254,799	$261,141	$264,281	275,889	$289,060	$301,025	$312,564	$325,208	$339,684	$353,085	$365,820	$379,944	$394,026
BSR Contribution (One-Time)	-	$3,440	$3,440	-	-	-	-	-	-	-	-	-	-
Reappropriated Funds (One-Tim	-	$15,000	$15,000	-	-	-	-	-	-	-	-	-	-
Total Source of Funds	$254,799	$279,581	$282,722	$275,889	$289,060	$301,025	$312,564	$325,208	$339,684	$353,085	$365,820	$379,944	$394,026
Year over Year increase (revenue only)				*5.6%*	*4.8%*	*4.1%*	*3.8%*	*4.0%*	*4.5%*	*3.9%*	*3.6%*	*3.9%*	*3.7%*
Total Expenditures	243,695	279,581	279,282	281,887	295,719	305,761	315,587	327,082	334,501	342,460	346,392	353,208	359,033
Total Use of Funds	$243,695	$279,581	$279,282	$281,887	$295,719	$305,761	$315,587	$327,082	$334,501	$342,460	$346,392	$353,208	$359,033
Year over Year increase				*0.8%*	*4.9%*	*3.4%*	*3.2%*	*3.6%*	*2.3%*	*2.4%*	*1.1%*	*2.0%*	*1.6%*
Net One-Time Surplus/(Gap)	$11,104	($0)	$3,440	(5,998)	($6,659)	($4,735)	($3,023)	($1,874)	$5,183	$10,625	$19,429	$26,736	$34,993
Cumulative Net Operating Margin (One-Time)													$74,676
Net Operating Margin				($5,998)	($661)	$1,924	$1,712	$1,149	$7,057	$5,442	$8,804	$7,307	$8,258
Cumulative Net Operating Margin													$34,993

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

TABLE 11: FY 2025 – 2034 Long Range Financial Forecast Net Operating Margin
Alternative Forecast B



FISCAL/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 2025 budget.

STAKEHOLDER ENGAGEMENT
The preliminary forecast for 2025-2034 represents the beginning of the fiscal year 2025 budget development process. Information provided in this report will be discussed with the City Council after the Finance Committee reviews and provides recommendations. 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 2024, according to the standard budget adoption process.

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

ATTACHMENTS
Attachment A: FY 2025 Budget Policy Guidelines
Attachment B: The Economy
Attachment C: General Fund Base Case Revenue Assumptions
Attachment D: General Fund Base Case Expense Assumptions
Attachment E: Human Services Resource Allocation Process (HSRAP) Funding Referral

APPROVED BY:
Kiely Nose, Assistant City Manager

FY 2025 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) Review resource allocation for City Council's existing priorities and identify priority funding needs.

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.

ATTACHMENT B

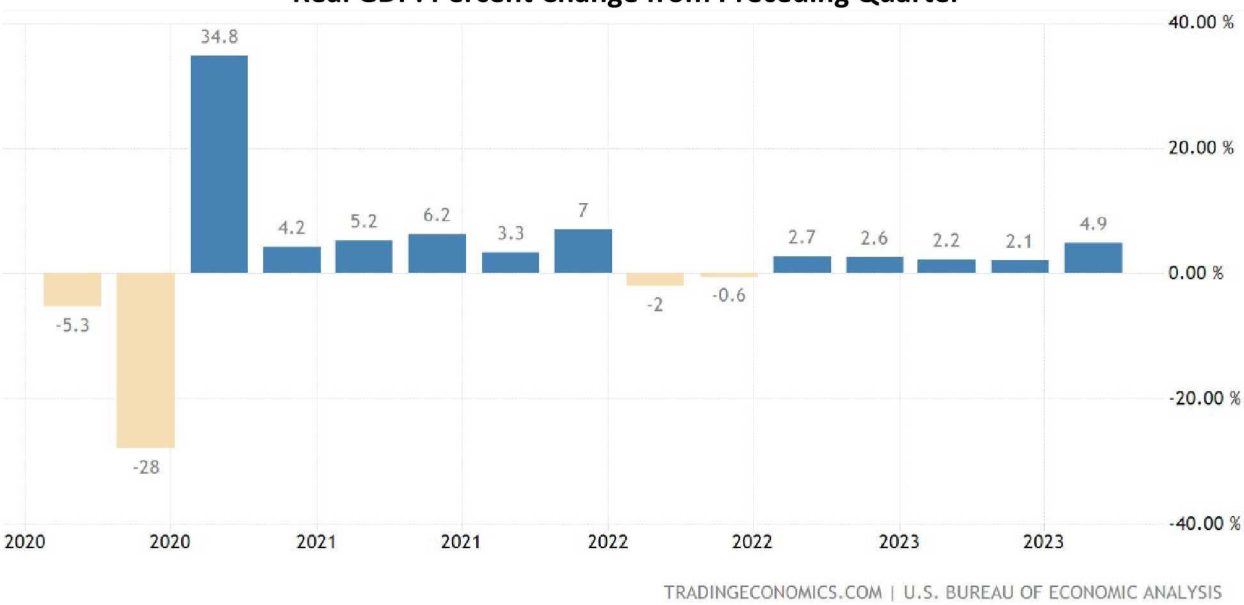
The Economy

At the national level, economic growth through the third quarter of calendar year 2023, was led by robust consumer (retail) spending despite a persistent high inflation rate and high borrowing costs with interest rates at their highest level in 22 years, 5.25% to 5.5%. The gross domestic product (GDP), a measure of all goods and services produced in the economy, increased at an annualized rate of 4.9%, well above the 2% range in the prior quarters and above the 2% expectation. As of October 2023, the consumer price index (CPI) which measures changes in the prices paid by consumers for a basket of goods and services, was 3.2%. This is lower than the 7.7% CPI from a year ago, but still indicates increasing costs. The unemployment rate, as of October 2023, is 3.9% which is up from 3.4% at the beginning of the 2023 calendar year and may indicate an economic slowdown in the coming quarters. The unemployment rate has been ranging between 3% to 4% as the economic cooling down is expected to bring the elevated inflation closer to the 2% federal reserve target goal. The above outlook is predicated on the federal reserve achieving a "soft landing" whereby there's a slowdown in economic growth that avoids recession for the purpose of stopping the economy from overheating and continuing to experience higher inflation. The UCLA Anderson outlook is "The oft-predicted but never seen 'recession next quarter' has now faded in the face of expansionary fiscal policy, a new national industrial policy, and a consumer who is happy to continue spending." This outlook projects a weak economy in 2024 followed by a return to trend growth rates by 2025. This weaker outlook translates into 1% to 2% GDP growth for the remainder of 2023 with the expectation this will gradually increase to a 2% to 3% growth through 2024. The elevated core inflation is expected to come down slowly with lower GDP growth which could allow the federal reserve to mildly cut rates in mid to late 2024. There are risks to monitor that could change the expected growth pattern such as a future protracted (U.S.) government shutdown, geopolitical events, and election resulting in changing national economic policies in 2025.

The local economy continues to show strong performance in the first half of calendar year 2023. The UCLA Anderson outlook for California does not forecast a recession based on the state's strong employment and economic growth through, "the onshoring of technical activities and new investments in green technology and AI that should keep California growing faster than the U.S". The "continued demand for a limited housing stock, coupled with state policies inducing new home building" is expected to facilitate economic recovery for the next few years. The real personal income is forecasted to remain flat in 2023 and grow between 1% to 2% through 2025. California's unemployment rate, similar to the national trend, has risen in calendar year 2023 and is expected to be in the mid to high 4% through 2025.

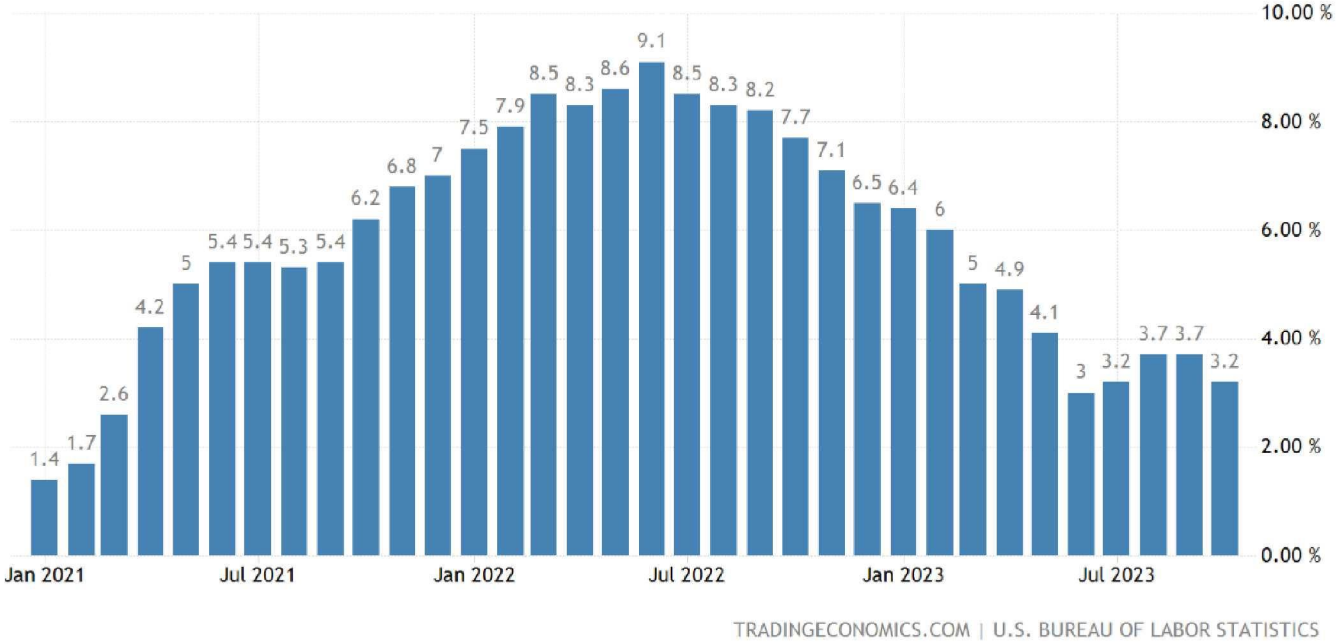
According to the U.S. Bureau of Economic Analysis (BEA), the "advance" estimate of the U.S. economy's real gross domestic product (GDP) percentage change, from the preceding quarter, changed in the second and third (calendar) quarters of 2023 at an annual rate of 2.1% and 4.9%, respectively. Real GDP is an inflation-adjusted measure that reflects the value of all goods and services produced by an economy in a given year. According to the BEA, in the third quarter the increase in real GDP reflected increases in consumer spending, private inventory investment, exports, state and local government spending, federal government spending, and residential fixed investment that were partly offset by a decrease in nonresidential fixed investment. Of the third quarter 4.9% increase, consumer spending represents rose 4%, led by consumption of housing and utilities, health care, financial services and insurance, food services and accommodations and nondurable goods (led by prescription drugs), recreational goods and vehicles. Imports, which are a subtraction in the calculation of GDP, increased.

Table 1: National Gross Domestic Product (GDP)
Real GDP: Percent Change from Preceding Quarter



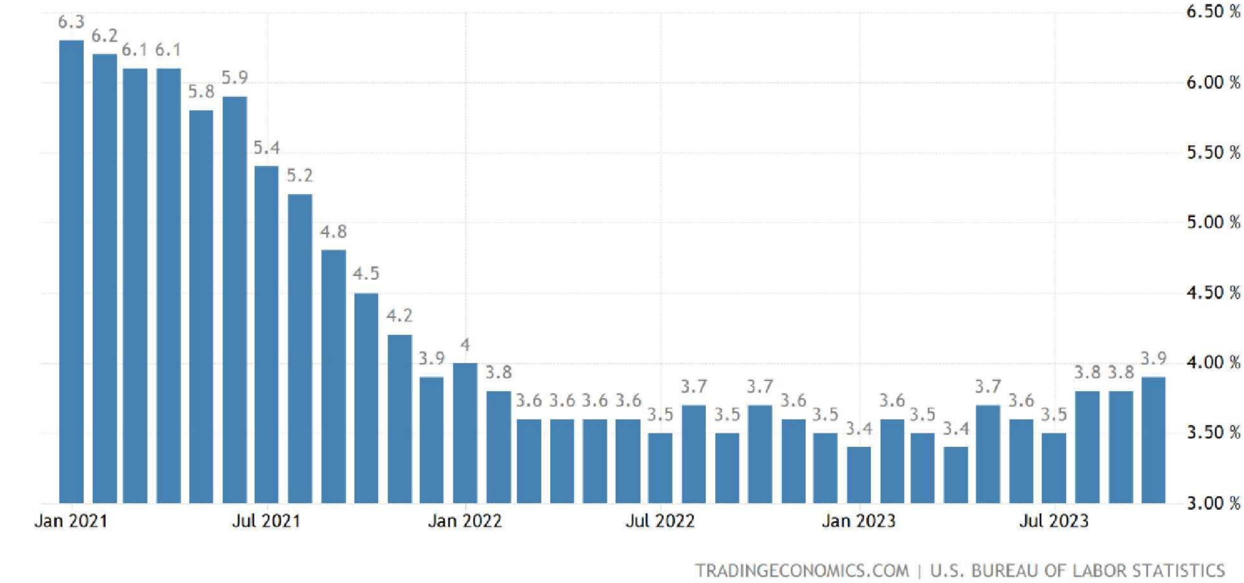
The national inflation rate remained steady but still high compared to the 2% rate targeted by the federal reserve at 3.2% in October 2023, as a softer decline in energy prices offset slowing inflationary pressures in other categories. Energy costs fell by 4.5% versus -0.5% in September with gasoline declining 5.3%, utility gas service falling 15.8%, and fuel oil singing 21.4%. Additionally, prices increased at softer rates for food (3.3%), new vehicles (1.9%), apparel (2.6%), medical care commodities (4.7%), shelter (6.7%), and transportation services (9.2%).

Table 2: National Inflation Rate (aka Consumer Price Index (CPI))



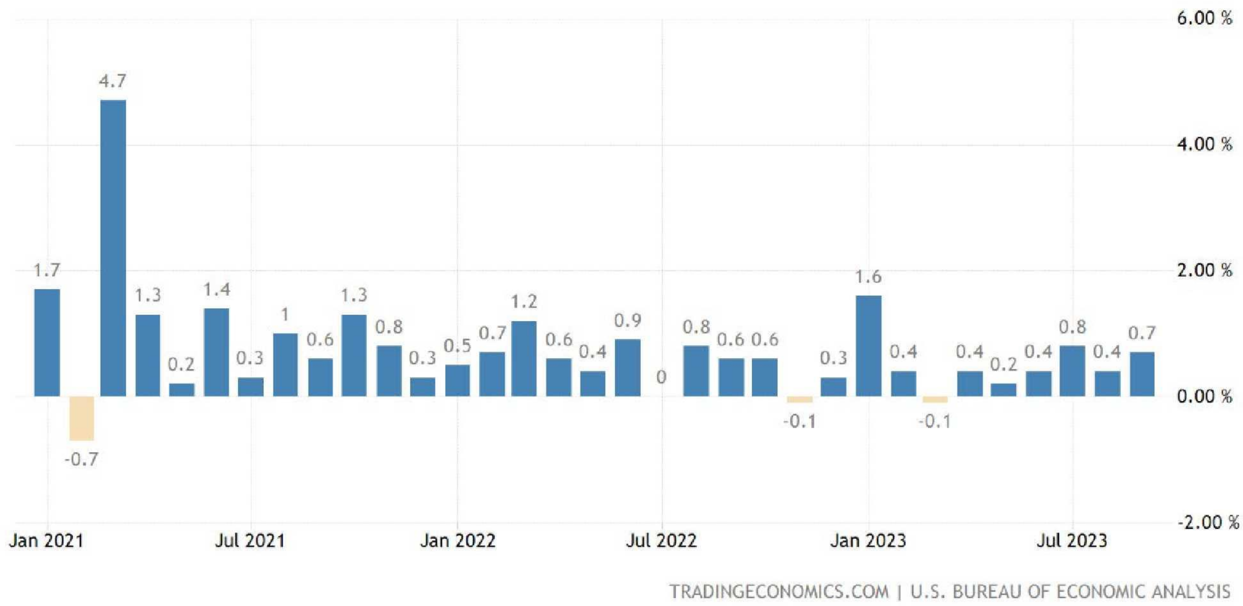
The nation's unemployment rate is 3.9% as of October 2023, compared to a record high of 14.7% at the height of the pandemic in April 2020. According to UCLA Anderson outlook, the recent rise in unemployment is due to new entrants to the labor market rather than layoffs which is at historical low level. It is expected, by the U.S. Bureau of Labor Statistics, that the unemployment rate will rise due actions by the Federal Open Market Committee (FOMC or federal reserve) to further bring down the elevated inflation rate as well as more the new entrants into the labor market. Per the State of California's Employment Development Department, the state's unemployment rate as of September 2023 is 4.7% with the prior year being 4% and the County of Santa Clara is 3.2%. 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 and Palo Alto is 3% and 2.8% respectively as of September 2023; last year it was 2.3% and 1.9%, respectively.

Table 3: U.S. Unemployment Rate



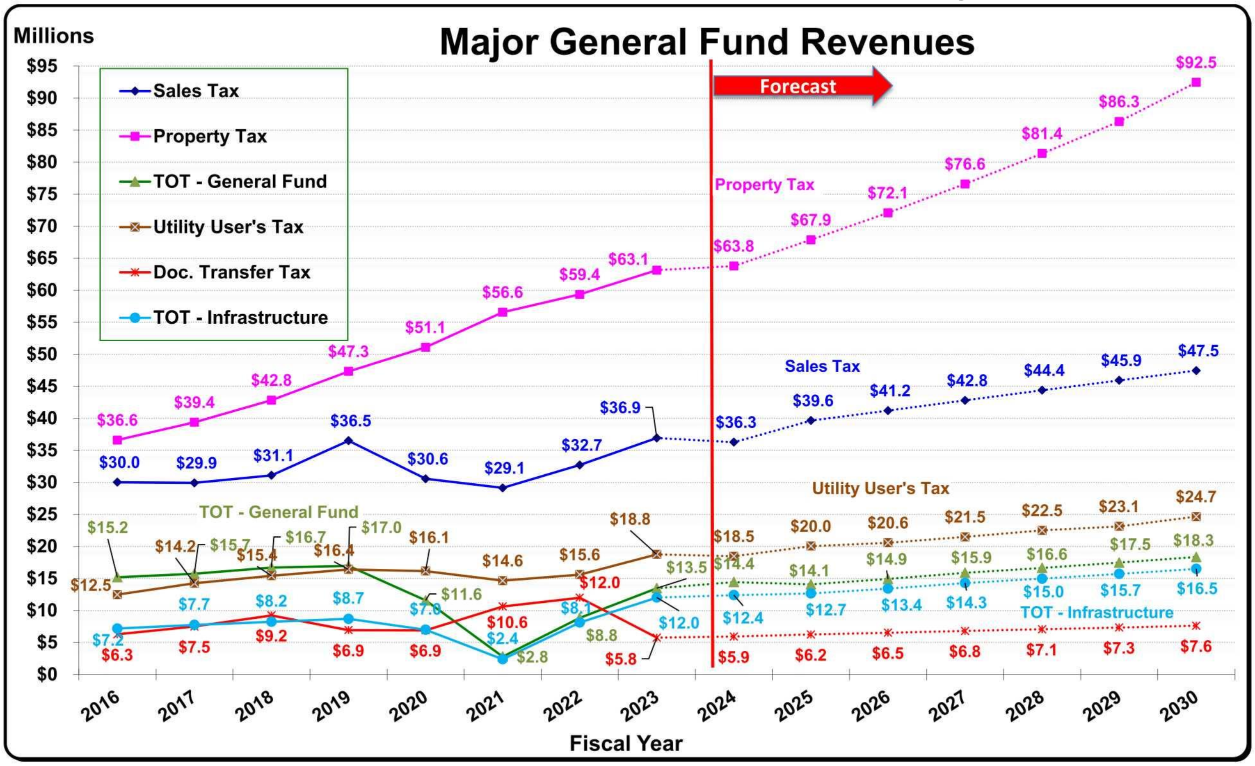
The elevated inflation rate has resulted in the continued erosion of purchasing power; however, there is still growth in U.S. consumer spending. Personal consumption expenditures (PCE) are the primary measure of consumer spending on goods and services in the U.S. economy. It accounts for about two-thirds of domestic final spending, and thus it is one of the main factors that indicates future economic growth. Strength in PCE spending tends to prompt additional business spending. National personal spending increased by 0.7% and 0.4% over the prior months in August and September 2023, respectively. Services spending rose by 0.8% and spending on goods rose by 0.7%. Services spending was up for international travel, housing and utilities (mainly housing expenses), health care, and transportation. Goods spending was led by prescription drugs, motor vehicles and parts, and new motor vehicles.

Table 4: Personal Consumption Spending Growth



ATTACHMENT C

Table 1: General Fund Base Case Revenue Assumptions

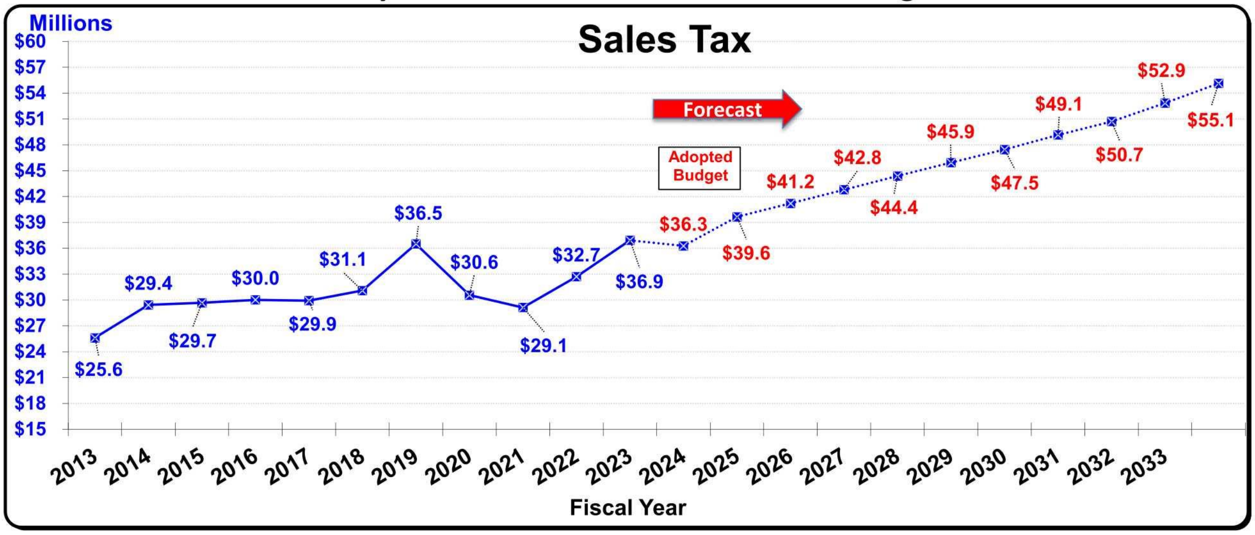


Sales Tax

Compared to FY 2019 pre-pandemic actuals of $36.5 million, sales tax revenue declined by $7.4 million, or 20.2%, during the pandemic in FY 2021. The recovery, which began in the last quarter of FY 2021, resulted in the FY 2022 and FY 2023 receipts increasing by $3.6 million or 12.3% and $4.2 million or 12.9%, respectively. This recovery growth has slowed in the first quarter of FY 2024, with the City's sales tax consultant forecasting a modest increase over the prior year. The general retail, food products (includes restaurants), and business to business (includes car leasing) categories experienced increases. This economic trend was mixed in the San Francisco Bay Area and in California. A few municipalities had double digit increases in the FY 2023 while most had single digit gains or decreases.

The FY 2024 Adopted Budget for Sales Tax is $36.3 million, a $0.6 million or 1.8% decline from FY 2023 actuals of $36.9 million. However, in the revised forecast, FY 2024 is expected to earn $37.7 million, a 2.2% increase over FY 2023 actuals. In FY 2025, this revenue is anticipated to increase to $39.7 million, a $2.0 million or 5.3% increase over the FY 2024 revised forecast. The Base Case assumes 3.2 to 5.1% growth over the length of the forecast with a 10-year compound annual growth rate (CAGR) of 3.4%.

TABLE 2: City of Palo Alto Sales Tax Revenues through FY 2034



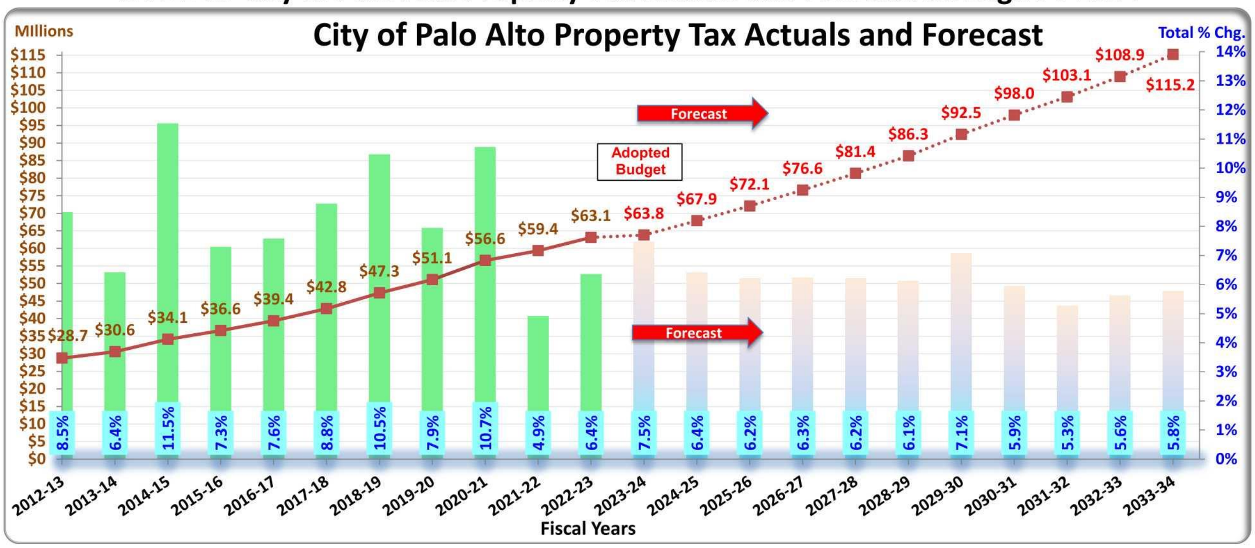
Property Tax

Property tax revenue is the General Fund's largest revenue source and represents approximately 25% of the total revenues. Historically, the 10-year compound annual growth rate (CAGR) was 8.2% with a low of 4.9% in FY 2022 and a high of 11.5% in FY 2015. During economic downturns, impacts to property tax occur a year later, as a result, the $2.8 million or 4.9% growth in FY 2022 was the lowest in the past decade. This category also includes receipts for excess Educational Revenue Augmentation Fund (ERAF) distributions from the County of Santa Clara. 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 even though it has performed strongly in the past decade.

ERAF Reserve: Since FY 2021, the City has engaged in several disputes over the calculation and disbursement of excess ERAF Funds. In response, the City established reserves for potential estimated losses at 25% of total Excess ERAF receipts. There were favorable resolutions with the State and Santa Clara County, followed by the State and California School Board Association, for two prior disputes. The associated reserves have been released to the Budget Stabilization Reserve (BSR) or consolidated for potential future at-risk amounts.

As of the timing of this LRFF, the State Controller's Office issued a negative audit finding against Marin County. The state asserts that former Redevelopment Agency funds, which are now part of the regular property taxes, should be excluded from the excess ERAF calculation. Marin County is challenging this finding, and it is not known if this will be elevated to a court case. The estimate is, if this audit finding is sustained, 22% of excess ERAF is at risk for fiscal years 2021, 2022, and 2023. If the finding holds, the County of Santa Clara, as well as other Excess ERAF counties, could face similar audit findings likely starting in FY 2025. In FY 2023, $4.1 million was set aside for the Reserve of excess ERAF for the at-risk amount. In addition, 22% or $1.5 million in FY 2024 budget has been reduced by this amount. Staff will continue to monitor the status of this audit finding and report on any significant developments.

TABLE 3: City of Palo Alto Property Tax Actuals and Forecast through FY 2034



Transfer of ownership has been a significant driver of past growth; however, that growth is expected to moderate in FY 2024 due to the expected economic slowdown and the higher mortgage rates. For example, the median sales price of single family residential in the first (fiscal year) quarter of FY 2024 declined by 3% over the prior quarter.

The FY 2024 Adopted Budget for Property Tax is $63.8 million, a $0.7 million or 1.1% increase over the FY 2023 actuals of $63.1 million. However, in the revised forecast, FY 2024 is expected to earn $64.6 million or 1.3% increase over the FY 2024 adopted amount. In FY 2025, this revenue is anticipated to increase to $67.9 million, a $3.3 million or 5.1% increase over the FY 2024 revised forecast level. The Base Case assumes 5.1 to 7.1% growth over the length of the forecast with a 10-year CAGR of 5.4%.

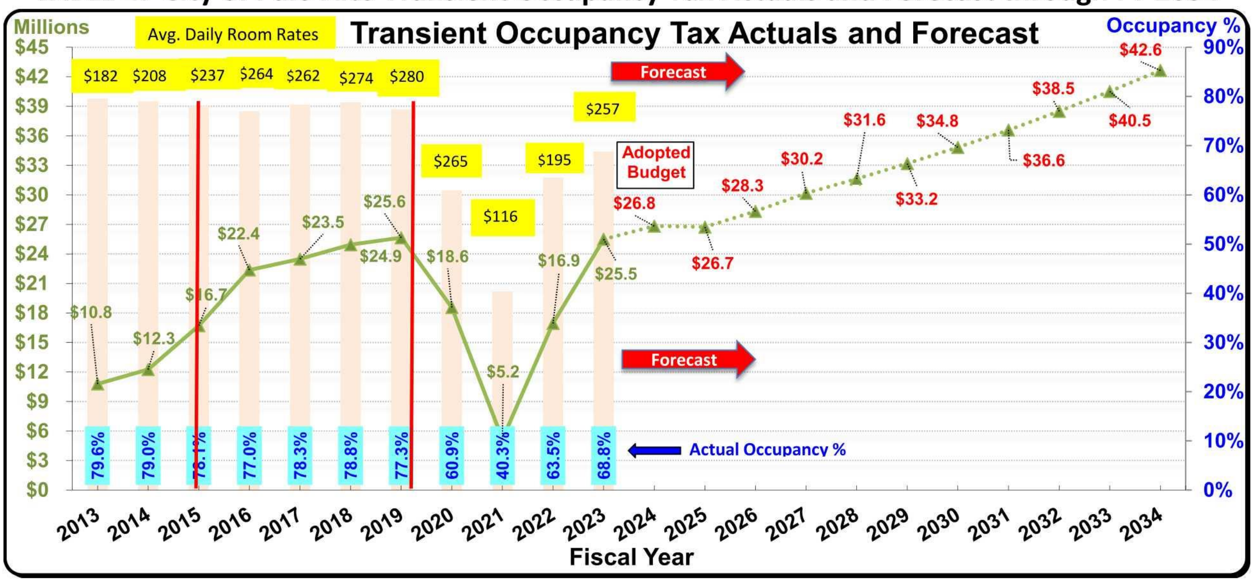
Transient Occupancy Tax (TOT)

Revenue in this category is impacted by business and other leisure/non-leisure travel and experienced significant reductions in FY 2020 and FY 2021 due to public health orders, travel restrictions, and diminishing business and personal travel plans resulting from the pandemic. TOT revenue declined by $20.5 million or 79.8% in FY 2021, when comparing the FY 2019 pre-pandemic actuals of $25.6 million. As public health conditions improved and travel resumed, this revenue began to recover, significantly grew in FY 2022, and in FY 2023, this revenue recovered to pre-pandemic levels. The opening of the two Marriott hotels in mid and late FY 2021 and the re-opening of multiple hotels in FY 2021 and FY 2022 were positive developments that helped drive recovery for this tax revenue.

The FY 2024 Adopted Budget for TOT revenue is $26.8 million, a $1.3 million or 5.3% increase over FY 2023 actuals of $25.5 million. In the revised forecast, FY 2024 is expected to earn $25.5

million, which matches the FY 2023 actuals. In FY 2025, this revenue is anticipated to continue to plateau as the economy slows down to $26.7 million. Year-to-date (as of August 2023), daily average room rates declined by 11.4% from $252 per day to $223 per day while occupancy rate decreased by 9.6% from 74.3% to 67.1%. Revenue in this category is experiencing a near term stagnation; however, it's anticipated to continue growth in FY 2026 and beyond with 4.6 to 6.5% growth over the length of the forecast with a 10-year CAGR of 4.8%.

TABLE 4: City of Palo Alto Transient Occupancy Tax Actuals and Forecast through FY 2034

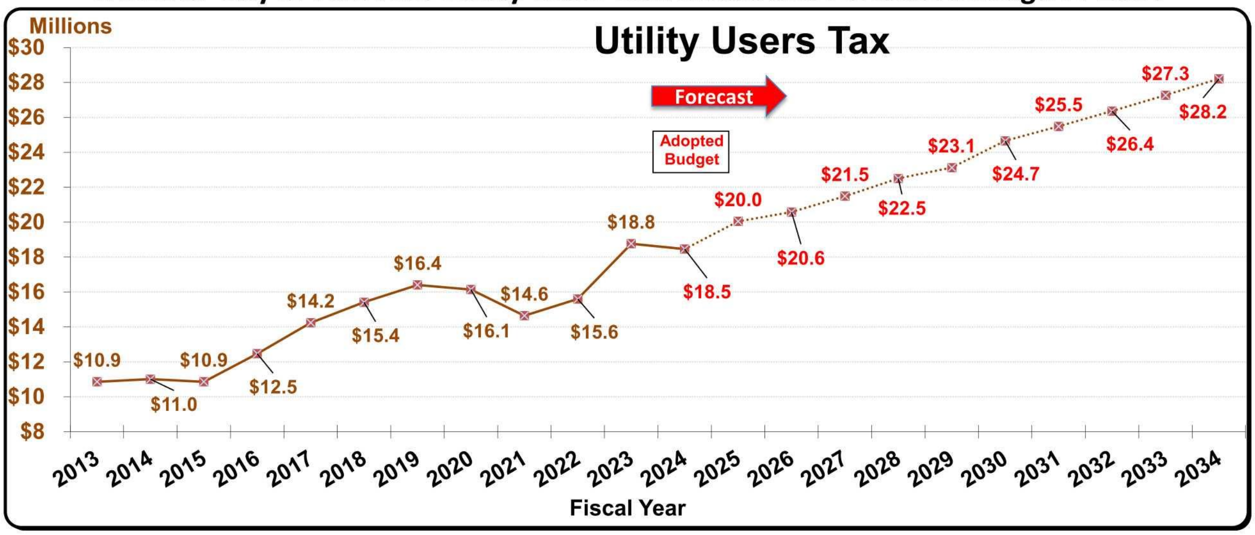


Note: January 2015, TOT Rate went from 12% to 14%
April 2019, TOT Rate went from 14% to 15.5%

<u>*Utility User's Tax (UUT)*</u>

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 conservation programs and reduced workforces and business closures during the pandemic. This revenue has recovered as the local economy recovered and workers returned to the office in FY 2023. In addition, higher utility commodity costs resulted in sizable utility rate increases and higher UUT revenues. The FY 2024 Adopted Budget for UUT is $18.5 million, similar to the FY 2023 actuals of $18.8 million., however, the updated forecasted amount for FY24 is anticipated to be to be $19.7 million. In FY 2025, this revenue is anticipated to increase to $20.0 million, a $0.3 million or 1.5% increase over the FY 2024 forecasted amount. Revenue in this category is expected to experience growth at 2.6 to 6.6% over the length of the forecast with a 10-year CAGR of 3.5%.

TABLE 5: City of Palo Alto Utility Users Tax Actuals and Forecast through FY 2034

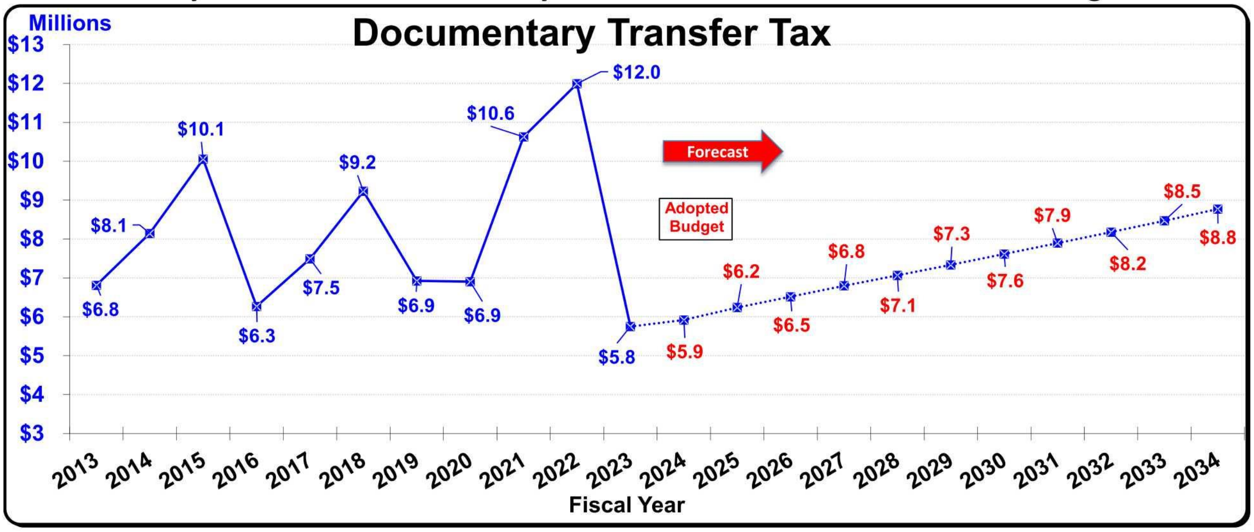


<u>Documentary Transfer Tax (DTT)</u>

Revenue in this category is highly volatile and dependent on sales volume and the mix of commercial and residential sales. DTT experienced record receipts in FY 2021 and FY 2022 at $10.6 million and $12.0 million, respectively which was followed by a sharp decline in FY 2023 at $5.8 million. In both record years receipts, these milestones were a result of large commercial transactions, six in FY 2021 and nine in FY 2022, and robust residential sales. FY 2023, sales activities normalized. The FY 2024 Adopted Budget for DTT is $5.9 million, $0.2 million or 2.9% lower than FY 2023 actuals of $5.8 million. In FY 2025, this revenue is anticipated to increase to $6.2 million, a $0.4 million or 5.3% increase, from the FY 2024 forecast level of $5.8 million.

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 2023 (190) is the same as October 2022 with the total revenue from these transactions increasing by 15.1%. 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 predicated economic downturn and higher mortgage rate will impact property sales activity in FY 2024.

TABLE 6: City of Palo Alto Documentary Transfer Tax Actuals and Forecast through FY 2034

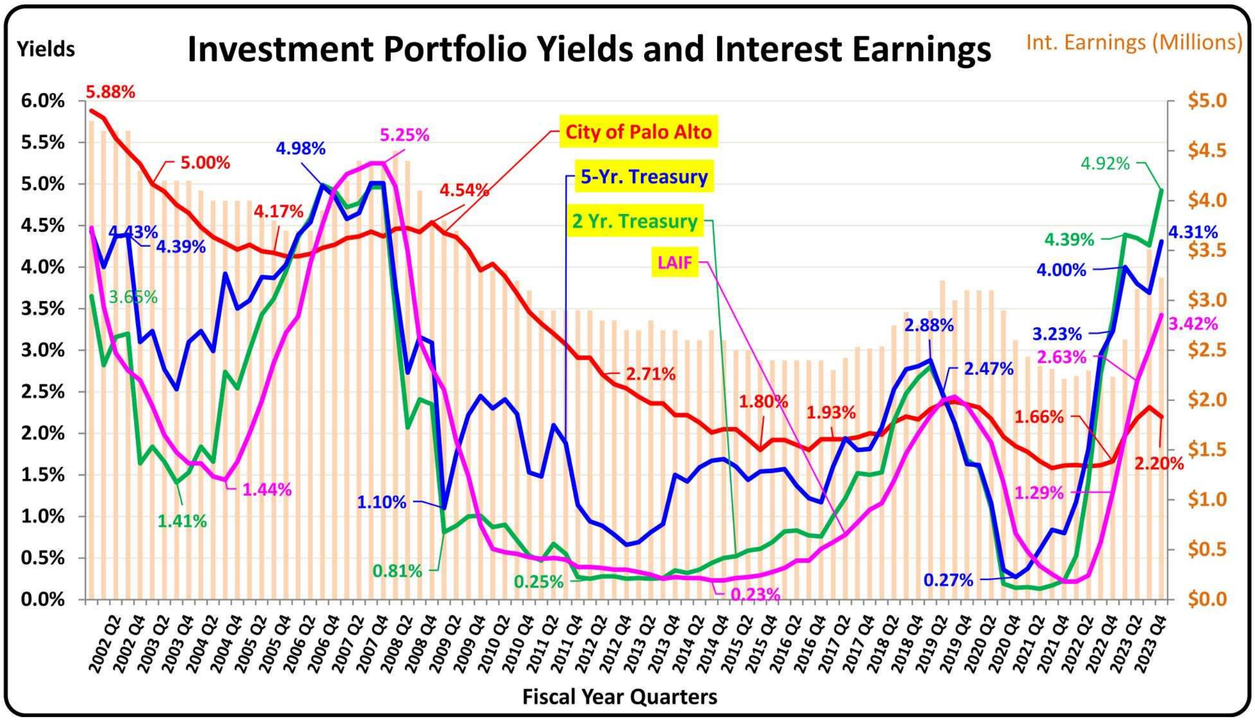


Return on Investment

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. As of the timing of this LRFF, the Federal Open Market Committee (FOMC) has raised the federal funds rate 11 times, from 0.25% to 5.55% (525 basis points) since it began tightening money policy in March 2022. It is expected that interest rates will be held steady, as inflation is expected to return to the 2% target in the economic outlook over the medium term.

The average portfolio rate of return for the first quarter of FY 2024 was 2.20%, and a 2.31% average yield as of the fourth quarter of FY 2023. The adopted budget General Fund FY 2024 interest earning is $1.8 million. This is below the FY 2023 actual of $2.5 million, but the expectation is the actuals in FY 2024 will come in higher at $2.9 million. In FY 2025, the forecast reflects a 3.3% increase in interest earnings to $3.1 million with 3.0 to 4.2% increases through the ten-year period.

TABLE 7: Palo Alto Historical Investment Portfolio Yields and Citywide Interest Earnings



Rental Income

Rental Income of $16.9 million in FY 2025 primarily reflects rent paid to the General Fund from the City's Enterprise Funds and tenants at the Cubberley Community Center. There is an increase in rental income of $1.0 million compared to the FY 2024 Adopted Budget. 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.

The City is no longer receiving rental income from the former Los Altos Treatment Plant (LATP) site, because the site is no longer available for traditional rental as a laydown yard. The site is planned for two uses: 1) an interim housing project with Project Homekey to provide opportunities for homeless individuals and families, and 2) a joint water purification project with the Santa Clara Valley Water District. Please see the Expense Assumptions General Expenses section of this report for additional information regarding Project Homekey developments at the former LATP site. The water purification project is being funded in the Wastewater Treatment Fund, so it is not part of the General Fund LRFF; however, funding needs for the project will be discussed in the development of the FY 2025 budget for the Wastewater Treatment Fund.

Charges for Services and Permits and Licenses

Revenues in the 'Charges for Services' and the 'Permits and Licenses' categories are anticipated to be $36.9 million and $11.5 million, respectively, in FY 2025. Together, these amounts total

$48.4 million and are approximately $3.1 million higher than the FY 2024 Adopted Budget of $45.3 million. Increases in these categories are primarily due to revenue adjustments for the agreement with Stanford to provide Fire and Dispatch services and adjustments to development center revenues.

The revenue estimates in these categories are based on current activity levels. These revenue sources are primarily driven by the cost of staff to provide services to the community. Therefore, as part of the FY 2025 Municipal Fee process, staff will evaluate and bring forward recommendations to align fees with target cost recovery levels to cover general salary and benefits increases and CPI trends. One exception to this is 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 2025 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 extended through June 2023, with annual renewals in effect through June 2028 unless otherwise terminated. The agreement includes a 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 over the forecast period. Similarly, changes to the revenue received for dispatching services have been aligned with the operating expenses in the Technical Services Division of the Police Department where the costs to provide these services are budgeted. For fire and police revenue, additional adjustments may be applicable if new labor agreements are negotiated for the forecast period. Revenues for these services are based on current anticipated changes in salary and benefits costs within the Fire Department and Police Department Dispatch Unit.

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 2025 estimate for Charges to Other Funds of $13.2 million reflects a decrease of $2.3 million or 15.0% from the FY 2024 Adopted amount of $15.9 million. This is primarily attributed to adjusting the proportion of the allocated charges split between the General Fund and other funds to account for large capital projects, mainly in the enterprise funds. This adjustment will account for the portion of projects that are supported by internal support departments, but exclude the larger construction cost portions to better align the cost plan methodology.

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 $26.1 million, a $2.2 million increase from the FY 2024 level of $23.9 million due to the increase from the Gas Fund.

In accordance with the methodology approved by the City Council in June 2009, the electric to general fund equity transfer has been calculated by applying a rate of return on the capital asset base of the Electric Fund. 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 gas to general fund equity transfer calculation was updated based on the passage of Measure L on the November 2022 ballot. As outlined in the ballot measure language, the gas to general fund equity transfer can be up to 18% of annual gross gas retail revenue. In order to maintain steady gas rate projections and avoid a spike in the gas equity transfer, this LRFF increases the transfer to 16% in FY 2025 and FY 2026 and up to 18% by FY 2027 through FY 2034.

Other Revenue and Revenue from Other Agencies

Funding in these two categories is expected to be $3.8 million in FY 2025, which is slightly down by $0.2 million from $4.0 million in FY 2024. These two revenue categories mainly account for grants or reimbursements from the federal and state governments or other local jurisdictions. Other Revenue increases slightly by $0.1 million in FY 2025 as a result of limited time funding from LifeMoves for reimbursement related to the Homekey Facility; however, this funding is removed in FY 2026 through the end of the LRFF period. Revenue from Other Agencies decreases by $0.3 million in FY 2025 and then by another $0.8 million in FY 2026, because FY 2025 is the last year of the Staffing for Adequate Fire and Emergency Response (SAFER) grant funding awarded to the City in FY 2022.

ATTACHMENT D

General Fund Base Case Expense Assumptions

Salary and Benefits
Consistent with prior years, the FY 2025 salaries and benefits costs represent approximately 62% of the General Fund budget expenditures. Salary and Benefits are projected to increase $7.1 million or 4.3% from the prior year, from $166.9 million to $174.0 million. Discussed in the following sections, this is primarily attributable to increases in salaries ($2.9 million or 3.1%) and pension costs ($4.5 million or 10.2%). These increases are partially offset by reductions in department allocations for Workers' Compensation expense (-$0.3 million or -5.3%).

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 2023. 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).

In FY 2023, the City Council engaged with labor groups to negotiate new agreements for wages, benefits, and other terms and conditions of employment. These agreements extend through January 2025 (SEIU) and June 2025 (all other labor groups) for full-time staffing and include target market adjustments to align salaries with benchmark studies, Cost of Living Adjustments (COLAs), and other benefits such as a flexible compensation benefit.

The forecast assumes step increases for employees in applicable positions, including Service Employees International Union (SEIU), International Association of Fire Fighters (IAFF), and Palo Alto Peace Officers' Association (PAPOA), and merit increases for Management and Professional employees including Utilities Management & Professional Association of Palo Alto (UMPAPA). A general wage adjustment of 2% is included for all employees starting in either January 2025 or July 2025 for all years of the forecast since no MOA's would be in effect at that time. This is consistent with prior Council direction in previous LRFF reporting to use the 2% increase as a forecasting assumption, not as a commitment to future negotiations. The FY 2025 Budget includes MOA terms for a 4% COLA adjustment (all labor groups), 2% market alignment (Safety only), and increase in flexible compensation payment from $100 to $200 per month (all labor groups except SEIU).

A reserve is included for potential changes to future labor costs including changes in vacancy rates, labor and benefit rate variability, and inflation assumptions. Offering competitive compensation plans aligns with industry standards for attracting and retaining a skilled and motivated workforce and better positions the City of Palo Alto as an employer of choice. This level of funding does not reflect a commitment to future negotiations and may differ from actual outcomes. Negotiations for new labor agreements are anticipated to occur in the next year for new terms beginning in FY 2025-26. An alternative scenario is included in this report for increases beyond the assumptions described above.

Additionally, the budget includes vacancy savings that are expected to materialize as positions are vacated and new employees are hired through the normal course of business. As of the timing of this LRFF, the vacancy rate is approximately 13.5% in the General Fund, excluding public safety. This preliminary vacancy rate is point in time and does not consider actions currently in progress for recruitments, promotions, and other staffing shifts. Vacancy savings from public safety positions are typically exhausted by uses such as backfill, hire ahead programs, and overtime. To better align with the status of vacancies, this forecast increases the vacancy estimate from previously assumed rate of 3% to 5% in all years. This results in additional savings of approximately $2.5 million annually, or $5-6 million total each year. Consistent with past practice, the vacancy assumption is lower than the actual vacancy rate to allow departmental use of those savings for other staffing strategies, such as filling staffing gaps by contracting for professional services, hiring ahead to allow overlap and smooth transitions, piloting new technologies to increase efficiency in the absence of staff, and supporting a summer internship program.

Benefits

Pension: Pensions are budgeted based on CalPERS determined rates as of the June 30, 2022 valuation for the City's miscellaneous and safety plans (CMR 2308-1860[1]). 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.

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[1] Finance Committee, September 19, 2023, CMR 2308-1860:
https://cityofpaloalto.primegov.com/Portal/Meeting?meetingTemplateId=13152

In the miscellaneous plan, total costs are projected to increase from the current 44.8% in FY 2024 to 47.4% in FY 2025. In the safety plan, total costs are projected to increase from the current 74.0% in FY 2024 to 83.1% in FY 2025. 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 LRFF presumes that the miscellaneous plan will pick up 1 to 2% of the employer pension cost and that safety plan members will pick up 3 to 4%.

The FY 2024 and FY 2025 budgets are impacted by significant swings in investment gains and losses earned by CalPERS in the periods ending June 30, 2021 and 2022. The FY 2024 budget reflects significant investment returns of +21.3% (+6.8% target) and changes to economic and demographic assumptions resulting from the CalPERS Asset Liability Management (ALM) process and Experience Study completed in November 2021. As part of the ALM, the CalPERS board approved a reduction to the discount rate (from 7.0 to 6.8%), revised actuarial assumptions (price inflation from 2.5 to 2.3%), and a new asset allocation targeting 1/3 investment in private assets, 5% leverage, and reduced public equity exposure. FY 2025 in the LRFF reflects an investment loss of -6.1% (+6.8% target), nearly offsetting the positive impacts experienced in the prior year's investment gains.

Since the issuance of the current valuation, CalPERS announced a preliminary investment return of +5.8% (+6.8% target) for the period ending June 30, 2023[2]. These results will be included in the CalPERS valuation report issued in Fall 2024 to inform the development of the 2026-2035 LRFF and FY 2026 budget. The resulting liability from investment returns that did not meet target levels will be amortized over 20 years with a 5-year ramp-up period. To inform this LRFF, staff used the CalPERS Pension Outlook Tool to calculate the estimated impacts, resulting in additional costs of $0.2 million ($0.1 million in the General Fund) in FY 2026, and increasing to $1.2 million ($0.5 million in the General Fund) at the peak of the 5-year ramp in FY 2030.

In the General Fund, it is anticipated the City will spend a total of $49.0 million on total pension costs in FY 2025, including both CalPERS contributions and supplemental Pension Trust Fund contributions. This is approximately $4.6 million higher than the prior year costs of $44.4 million, or a 10.2% increase. These expenses represent approximately 17% of the General Fund's total expenses.

TABLE 1: CalPERS' Projected FY 2024-2034 Blended Retirement Rates

(percentage of payroll)

	FY 2024	FY 2025	FY 2026	FY 2027	FY 2028	FY 2029	FY 2030	FY 2031	FY 2032	FY 2033	FY 2034
Miscellaneous	44.8	47.4	45.5	42.0	42.4	44.6	44.1	43.4	39.7	38.1	35.2
Safety	74.0	83.1	84.5	85.7	86.2	89.5	88.5	86.8	82.6	79.9	74.8

[2] CalPERS Reports Preliminary 5.8% Investment Return for 2022-23 Fiscal Year: https://www.calpers.ca.gov/page/newsroom/calpers-news/2023/calpers-preliminary-investment-return-fiscal-year-2022-23?utm_source=esubscriptions&utm_medium=email&utm_campaign=CalPERS-News

Retiree Healthcare/Other Post-Employment Benefits (OPEB): Retiree Medical is based on the June 30, 2021 actuarial study prepared by Foster & Foster (previously Bartel Associates), which is completed every two years. The most recent study was completed in June 2022 to inform the development of the FY 2023 and FY 2024 operating budgets (CMR 14112 as amended by CMR 14502[3]). An updated valuation as of June 30, 2023 to inform FY 2025 and FY 2026 is expected to be transmitted in June 2024. Consistent with City Council direction and the Retiree Benefit Funding Policy, this forecast continues the practice to budget the full payment of the Actuarial Determined Contribution (ADC) for retiree healthcare and uses alternative assumptions, such as a more conservative 5.75% discount rate (6.25% assumption), to transmit amounts above the recommended payment as an additional discretionary payment ("prefunding") to the California Employers' Retiree Benefit Trust (CERBT) Fund.

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. The LRFF estimates $16.9 million ($10.8 million in the General Fund) in FY 2025 for ADC, an approximate $0.5 million or 2.9% increase from FY 2024 levels of $16.4 million ($10.5 million in the General Fund). The implied subsidy is $3.3 million in FY 2025 and effectively lowers the funding necessary to meet the ADC.

TABLE 2: Retiree Medical General Fund Contributions

FY 2024	FY 2025	FY 2026	FY 2027	FY 2028	FY 2029	FY 2030	FY 2031	FY 2032	FY 2033	FY 2034
$10.5	$10.8	$11.1	$11.4	$11.8	$12.1	$12.5	$12.9	$13.4	$13.8	$14.2

Retiree Benefit Funding Policy (formerly "Pension Funding Policy"): 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 California Employers' Retiree Benefit Trust (CERBT) Fund, and adopting a policy that guides financial planning of these benefits (CMR 11722 as modified by 2212-0513[4]).

The City initially contributed to the Pension Trust in FY 2017 on an ad-hoc basis, using one-time savings or excess revenues. Beginning in FY 2019, the City Council directed staff to use a more conservative discount rate as compared to CalPERS for the Normal Cost (NC) portion of the

[3] Finance Committee, June 7, 2023, CMR 14112 as amended by CMR 14502:
https://www.cityofpaloalto.org/files/assets/public/agendas-minutes-reports/agendas-minutes/finance-committee/2022/20220607/20220607pfcsm-final.pdf

[4] City Council, November 30, 2020, CMR 11722:
https://www.cityofpaloalto.org/files/assets/public/agendasminutes-reports/reports/city-manager-reports-cmrs/year-archive/2020-2/id-11722.pdf
City Council, February 6, 2023, CMR 2212-0513:
https://cityofpaloalto.primegov.com/Portal/Meeting?meetingTemplateId=1067

payment and transferring the supplemental funding beyond CalPERS required employer contributions to the Pension Trust. This practice was reinforced with Council approval of the Retiree Benefit Funding Policy, and as of FY 2024 the City's NC discount rate is 5.3% as compared to CalPERS 6.8%. Additionally, one-time contributions continue to be made each year if excess revenues or unspent savings are available, subject to City Council approval. As part of policy goals, the City seeks to reach a 90% funded status by FY 2036.

Every four years, the City's Retiree Benefit Funding Policy requires that staff consult with an actuary to inform the City Council of progress the City has made towards achieving a 90% funded status goal and assess and respond to changes impacting the City's retiree benefit plans. This comprehensive review was most recently completed in FY 2023 and resulted in several policy revisions, most notably reducing the discount rate used to calculate supplemental contributions to the Pension Trust from 6.2% to 5.3% and extending actuary reporting from 3 to 4 years to align with the CalPERS ALM Study. Additionally, the title of the policy was revised from the Pension Policy to the Retiree Benefit Policy to recognize actions approved by the City Council to proactively plan for retiree healthcare plans in a similar manner to pensions, including the use of a lower 5.75% discount rate (CMR 2212-0513[5]). The most recent actuary analysis projects that the City will meet a 90% funded goal for pension plans by FY 2034 (miscellaneous plan) and FY 2036-37 (safety plan); the City's practice of transmitting excess one-time savings will help reach these goals sooner.

In this forecast, approximately $13.8 million ($8.3 million in the General Fund) in supplemental contributions to the City's Pension Trust is assumed in FY 2025. This reflects a $0.5 million ($0.4 million in the General Fund) increase over the prior year, primarily due to the addition of new staff. Through FY 2024, a total of $67.6 million ($44.6 million in the General Fund) in principal contributions are expected to be made to the Pension Trust for pension benefits. Through FY 2024, it is expected that $11.1 million in principal contributions will be made to the CERBT Fund for retiree healthcare benefits.

Healthcare: Consistent with the most recent labor agreements between the City and its bargaining units, 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).

Workers' Compensation: The budget appropriation for workers' compensation includes an estimate for claims incurred and reserves for current filings at an 85% confidence level, based on actuarial studies completed by Bickmore. In FY 2023, program expenditures decreased by $3.0 million or 50%, from $6.0 million to $3.0 million from the prior year. The lower year over year claims is reflective of delays for claims incurred but not yet reported, and trend of declining total

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[5] City Council, February 6,2023, CMR 2212-0513: https://cityofpaloalto.primegov.com/portal/viewer?id=6143&type=3

claims, along with rising cost on a per claim basis, and reduction of claims with high costs and severity. This forecast uses savings accumulated in fund balance to reduce department allocations by $0.4 million ($0.3 million in the General Fund) in FY 2025 and maintains allocations at the same level through FY 2027. Actuarial estimates completed in August 2022 informed FY 2024 budget levels of $7.3 million (approximately 65% in the General Fund). More recent actuary estimates completed in August 2023 project expense levels consistent with current budgeted levels. Staff will continue to monitor expenditures in the fund and bring forward adjustments as necessary. Claim estimates and reserves for FY 2025 are $7.6 million, representing a $0.3 million or 4.0% increase from the FY 2024 Adopted Budget. Estimates for workers' compensation increase in the forecast at rates consistent with general CPI increases.

Contract Services

This forecast assumes contract services of $29.3 million in FY 2025, a 2.0% increase from the FY 2024 Adopted budget of $28.8 million. This increase is driven primarily by new negotiated contracts for citywide services such as custodial, landscaping, and management of the animal shelter partially offset by the removal of one-time costs adopted in FY 2024 for S/CAP studies and Plan Check Review. The increase is also supported by a general 4.0% CPI cost increase through the ten-year forecast period on smaller contracts that do not have defined annual increases, 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 to adjust contract funding needs as part of the FY 2025 budget process.

Contract Services - Committed Additions

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 within the ten-year forecast period. Costs for projects that came online in FY 2024 have been annualized into the ongoing General Fund operating budget as part of the LRFF. The preliminary total estimate is $44,500 for costs associated with the following projects anticipated to come online in FY 2025: Dog Park Installation (PG-18001), Library Automated Materials Handling (LB-21000), and Park Restroom Installation (PG-19000). Also, estimated operating impacts from the Fire Station 4 (PE-18004) project are included starting in FY 2026. Additional cost increases of 4.0% annually are included throughout the ten-year forecast 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. Timing and analysis of the funding needs for these projects will be evaluated as part of the FY 2025 Budget process and development of the 2025-2029 Capital Improvement Plan (CIP).

TABLE 3: FY 2024 – FY 2033 Committed Additions (Millions)

FY 2025	FY 2026	FY 2027	FY 2028	FY 2029	FY 2030	FY 2031	FY 2032	FY 2033	FY 2034
$0.04	$0.07	$0.07	$0.08	$0.09	$0.10	$0.11	$0.12	$0.13	$0.14

Supplies and Materials

The FY 2024 Adopted Budget for the General Fund included $3.3 million for Supplies and Materials, which is anticipated to increase by a 4.0% CPI cost increase in FY 2025 to $3.5 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. This annual increase is continued through the ten-year forecast period. It is expected that the estimated CPI increases will be substituted with department base budget requests to adjust funding for supplies and materials as part of the FY 2025 budget process.

General Expense

This category includes costs for travel and meetings, telephone and non-city utilities, contingency accounts and reserves, bank card service charges, and subsidies and grants provided through the Human Services Resource Allocation Program (HSRAP). The FY 2024 Adopted Budget of $19.1 million is expected to decrease to $9.3 million in FY 2025, primarily due to the anticipated use of the Budget Uncertainty Reserve to balance the FY 2025 budget. This $14.0 million reserve was partially used to balance the FY 2024 Adopted Budget ($3.9 million), leaving approximately $10.1 million to fund one-time needs in the FY 2024 Mid-Year Budget Review ($1.1 million) and an anticipated gap in FY 2025 ($9.0 million). The reduction is partially offset by a 4.0% annual CPI cost increase on smaller items that do not have a set annual budget, 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 to adjust funding for general expense items as part of the FY 2025 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[6]). This project will 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 site will be operated for at least fifteen years as interim housing per the program's durational requirement. This project will 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 FY 2025 through FY 2031). This funding was previously programmed from FY 2023 through FY 2029; however, the first two years of operating funding was redirected to the Homekey Facilities capital project (PE-24005) in order to complete the

[6] City Council, September 27,2021, CMR 13595: https://www.cityofpaloalto.org/files/assets/public/agendas-minutes-reports/agendas-minutes/city-council-agendas-minutes/2021/09-september/20210927/210927accsm-amended-final.pdf

housing infrastructure. This LRFF maintains the original $7.0 million commitment from the City. 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[7]). A new Cubberley lease was approved by the City Council in June 2020 (CMR 11460[8]) for a smaller portion of the Cubberley site with a correspondingly lower base rent payment (CMR 11386[9]). As part of the original lease agreement, the City Council approved creation of the Cubberley Infrastructure Improvements Fund supported by an annual $1.9 million transfer from the General Fund, which is classified as an Operating Transfer-Out and discussed in further detail in that section of this report below. With the Cubberley Infrastructure funds set aside, the annual base rent for the Cubberley premises is $2.6 million plus an additional $0.8 million for child daycare sites and utilities. A pending factor at the Cubberley site that is part of ongoing discussions, but not included in the LRFF estimates, is a proposal to lease the Cubberley site from PAUSD (CMR 2308-1949[10]) in order to facilitate the development of a new community center facility.

Rents and Leases

The Rents and Leases expense category for FY 2025 is estimated to increase from the FY 2024 Adopted Budget level by approximately 2.7% to $1.4 million. This is based on current lease terms that include previously negotiated lease increases 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[11]). The lease was amended in September 2022 to extend the term initially for 12 months with the right to automatically extend for four successive 12-month periods, potentially through January 31, 2028 (CMR 14713). 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[12]). As expenses for rent for Development Services are adjusted, a corresponding revenue adjustment will be made to ensure Development Services maintains cost recovery levels.

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[7] City Council, October 7, 2019, CMR 10730: https://www.cityofpaloalto.org/civicax/filebank/documents/73558

[8] City Council, June 23, 2020, CMR 11460: http://cityofpaloalto.org/civicax/filebank/documents/77365

[9] City Council, June 15, 2020, CMR 11386: http://cityofpaloalto.org/civicax/filebank/documents/77073

[10] City Council, October 16, 2023, CMR 2308-1949: https://cityofpaloalto.primegov.com/portal/viewer?id=9323&type=3

[11] City Council, December 14, 2020, CMR 11426: https://www.cityofpaloalto.org/files/assets/public/agendas-minutes-reports/reports/city-manager-reports-cmrs/year-archive/2020-2/id-11426.pdf?t=59979.32

[12] City Council, June 21, 2021, CMR 12334: https://www.cityofpaloalto.org/files/assets/public/agendas-minutes-reports/reports/city-manager-reports-cmrs/2021/id-12334.pdf

Facilities and Equipment

Along with funding for various equipment needs across departments, this budget category includes subscription payments for equipment like public safety radios. The Facilities and Equipment expense category is expected to increase from the FY 2024 Adopted level of $460,000 to $480,000 due to a 4.0% 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. It is expected that the estimated CPI increases will be substituted with department base budget requests to adjust funding for equipment needs as part of the FY 2025 budget process.

Allocated Charges

Allocated Charges represent expense allocations by the City's Enterprise and Internal Service Funds for services and products they provide to other departments. The FY 2024 Adopted Budget for the General Fund included $25.8 million for these expenses, including utilities usage, general liability insurance, technology costs, vehicle equipment maintenance and replacement costs, and other charges for services provided by other City departments and funds. The FY 2025 allocated charges in the LRFF update the revenues and expenses for these various allocations based on the information available at the time of the LRFF development. FY 2025 is anticipated to experience an increase of 7.2% to a total of $27.7 million. This increase is primarily due to anticipated higher costs associated with technology services and utilities for City facilities such as water, electricity, and gas.

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 2024 Adopted Budget included Operating Transfers Out of $5.0 million. In FY 2025, Operating Transfers Out are anticipated to increase to $6.5 million due to anticipated funding needs in the University Avenue, California Avenue, and Residential Permit Parking Funds. One-time loans of $450,000 and $50,000 to the California Avenue and Residential Permit Parking Funds, respectively, were approved in FY 2024; however, a total of $2.0 million across all three funds is factored into this LRFF. Staff will continue evaluating these funds as part of the FY 2025 budget development and will bring forward recommendations as needed to keep the parking permit funds solvent.

Transfer to Infrastructure

Recovery from the COVID-19 pandemic is reflected in improved revenue levels in the FY 2024 budget compared to the FY 2023 budget. The total General Fund transfer to the Capital Improvement Fund budgeted in FY 2024 is $24.7 million compared to the $22.9 million transferred in FY 2023. This is comprised of a $12.3 million base transfer including interest earnings, and $12.4 million from TOT revenue generated through voter-approved rate increases and new hotels that is dedicated to the Capital Improvement Fund to support the 2014 Council Infrastructure Plan, consistent with City Council direction. Estimated transfers from TOT revenues in FY 2025 are currently projected to increase to $13.0 million and the base transfer to increase to $15.2 million for a total $28.2 million transfer to the Capital Improvement Fund. This forecast continues the goal established as part of the 2022-2026 Capital Improvement Plan (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. This transfer to the Cubberley Property Infrastructure Fund supports facility systems maintenance needs at the Cubberley Community Center facility as well as capital improvement projects to maintain and upkeep the facility.

ATTACHMENT E

Human Services Resource Allocation Process (HSRAP) Funding Referral

As part of the FY 2024 Adopted Budget, the Council directed staff to follow-up with additional work to, "Consider pegging HSRAP budget allocations to a benchmark, such as percentage of General Fund budgeted expenditures." Staff researched previous discussion of this item and found a reference of a recommendation for increasing HSRAP funding as part of a Policy and Services meeting on November 29, 2016 (CMR 7289[1]). There were four options for augmenting the HSRAP funding, but ultimately none of them were approved for recommendation to the Council. The status quo of increasing the funding by the Consumer Price Index (CPI) as funding was available in the General Fund continued.

Staff also compiled historical data back to FY 2001 to determine the percentage of funding for human services programs compared to the General Fund expenditures budget in each year, and what amount of funding would be needed if funding for human services programs was pegged to 1% of the General Fund expenditures budget in the future using the base case LRFF numbers. Prior to FY 2016 funding for Avenidas and Palo Alto Community Childcare (PACCC) was determined as part of the HSRAP process; however, starting in FY 2016 these two programs were funded through a direct funding allocation and separated from the HSRAP process. Table 1 below shows the total funding for human services programs with funding projections through FY 2027, the first three years of the LRFF.

Table 1

Fiscal Year	HSRAP Funding	Avenidas & PACCC Funding	Total Human Services Funding	General Fund Adopted Budget	% of GF Budget	
					HSRAP	Total Human Services Funding
FY 2001	$386,245	$845,716	$1,231,961	$108,778,000	0.36%	1.13%
FY 2002	$433,254	$871,088	$1,304,342	$125,766,000	0.34%	1.04%
FY 2003	$444,862	$897,221	$1,342,083	$125,908,000	0.35%	1.07%
FY 2004	$335,835	$870,220	$1,206,055	$116,686,000	0.29%	1.03%
FY 2005	$375,835	$870,220	$1,246,055	$116,015,000	0.32%	1.07%
FY 2006	$331,453	$845,936	$1,177,389	$120,692,000	0.27%	0.98%
FY 2007	$331,453	$845,936	$1,177,389	$125,074,000	0.27%	0.94%

[1] November 29, 2016 Policy and Services CMR 7289:
https://www.cityofpaloalto.org/files/assets/public/v/1/agendas-minutes-reports/reports/city-manager-reports-cmrs/year-archive/2016/id-7289-hsrap.pdf

Fiscal Year	HSRAP Funding	Avenidas & PACCC Funding	Total Human Services Funding	General Fund Adopted Budget	% of GF Budget	
					HSRAP	Total Human Services Funding
FY 2008	$300,453	$860,941	$1,161,394	$139,185,000	0.22%	0.83%
FY 2009	$300,453	$860,941	$1,161,394	$145,308,000	0.21%	0.80%
FY 2010	$285,430	$817,894	$1,103,324	$142,089,000	0.20%	0.78%
FY 2011	$285,430	$817,894	$1,103,324	$146,711,000	0.19%	0.75%
FY 2012	$300,737	$809,715	$1,110,452	$146,360,000	0.21%	0.76%
FY 2013	$300,737	$809,715	$1,110,452	$152,800,000	0.20%	0.73%
FY 2014	$348,163	$881,950	$1,230,113	$159,700,000	0.22%	0.77%
FY 2015	$425,594	$890,583	$1,316,177	$171,100,000	0.25%	0.77%
FY 2016*	$436,660	$913,738	$1,350,398	$185,700,000	0.24%	0.73%
FY 2017	$448,013	$937,495	$1,385,508	$194,200,000	0.23%	0.71%
FY 2018	$503,213	$960,933	$1,464,146	$210,400,000	0.24%	0.70%
FY 2019	$515,793	$984,956	$1,500,749	$210,700,000	0.24%	0.71%
FY 2020	$535,908	$1,023,369	$1,559,277	$230,800,000	0.23%	0.68%
FY 2021	$549,306	$1,048,953	$1,598,259	$196,900,000	0.28%	0.81%
FY 2022	$549,306	$1,048,953	$1,598,259	$209,200,000	0.26%	0.76%
FY 2023	$622,377	$1,093,009	$1,715,386	$247,400,000	0.25%	0.69%
FY 2024	$851,035	$1,147,660	$1,998,695	$279,581,000	0.30%	0.71%
FY 2025	$885,076	$1,193,566	$2,078,643	$281,887,000	0.31%	0.74%
FY 2026	$920,479	$1,241,309	$2,161,789	$294,473,000	0.31%	0.73%
FY 2027	$957,299	$1,290,961	$2,248,260	$304,465,000	0.31%	0.74%

* FY 2016 was the first year Avenidas and Palo Alto Community Childcare (PACCC) were funded through separate human service contracts

For HSRAP funding, the average percentage of funding compared to the General Fund budgeted expenditures is 0.26% from FY 2001 through FY 2024. Comparing total funding for human services programs from FY 2001 through FY 2024, including HSRAP, Avenidas, and PACCC, to the General Fund budgeted expenditures shows that the percentage has ranged from over 1% down to 0.68% with an average of 0.83%.

For FY 2025 through FY 2027, numbers from the base case LRFF indicate that human services funding will be approximately 0.74% of the General Fund budgeted expenditures. To increase human services funding to 1% of the General Fund budgeted expenditures in the future, an additional $0.8 million would need to be allocated for human services programs annually. This would increase the current projected deficits in FY 2025 through FY 2027 to $6.8 million, $6.2 million, and $4.2 million respectively.

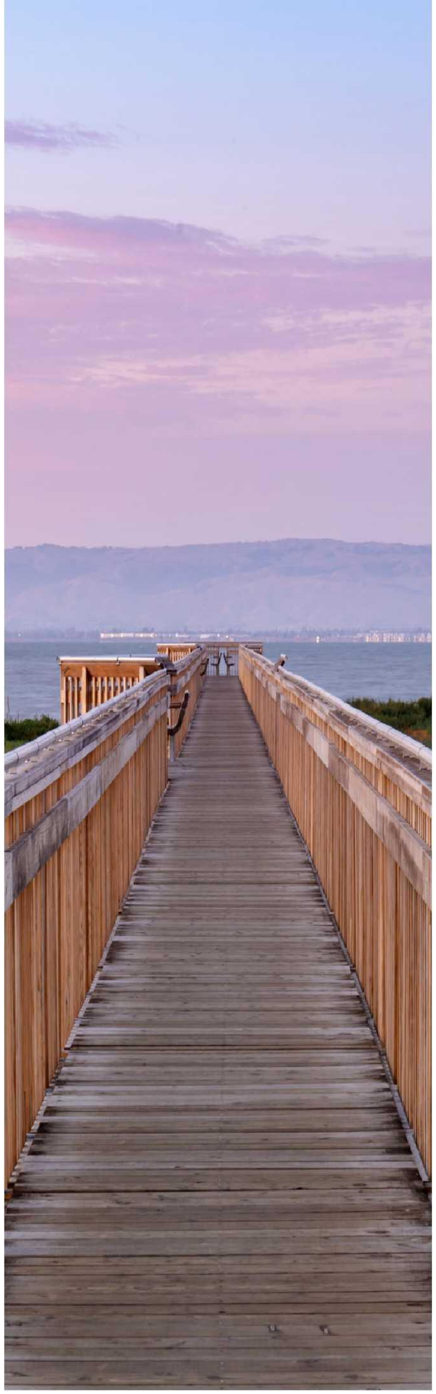
CITY OF
PALO ALTO

FY 2025 – FY 2034 LONG RANGE FINANCIAL FORECAST

Finance Committee Item #1

DECEMBER 5, 2023

www.cityofpaloalto.org



OVERVIEW

- Economy continues to demonstrate resiliency to formal recession
  - Forecast reflects stagnation offset by inflation

- LRFF consistent with FY 24 Adopted Budget, reflects near-term deficits
  - FY 2025 shortfalls resolved with Uncertainty Reserve
  - Consistent with FY 2024 Adopted Budget two-year strategy
  - Measure K (Business Tax) included for approved projects
  - Measure L (Equity Transfer) phased to 18% by FY 2027

- Expense projections based on current approved service levels
  - Assumes 20% BSR to mitigate uncertainty (typical target = 18.5%)
  - Cost of labor, inflation, and vacancies are key factors

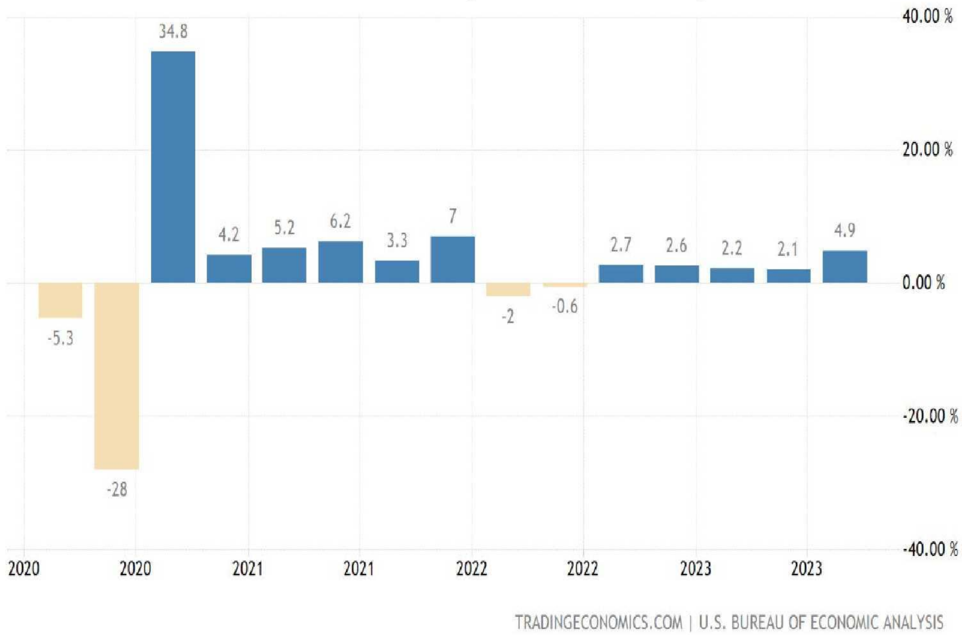
- Estimated surplus in FY 2024 ($3.4M) from Major Tax Revenue; to be reviewed at Mid-Year

THE ECONOMY

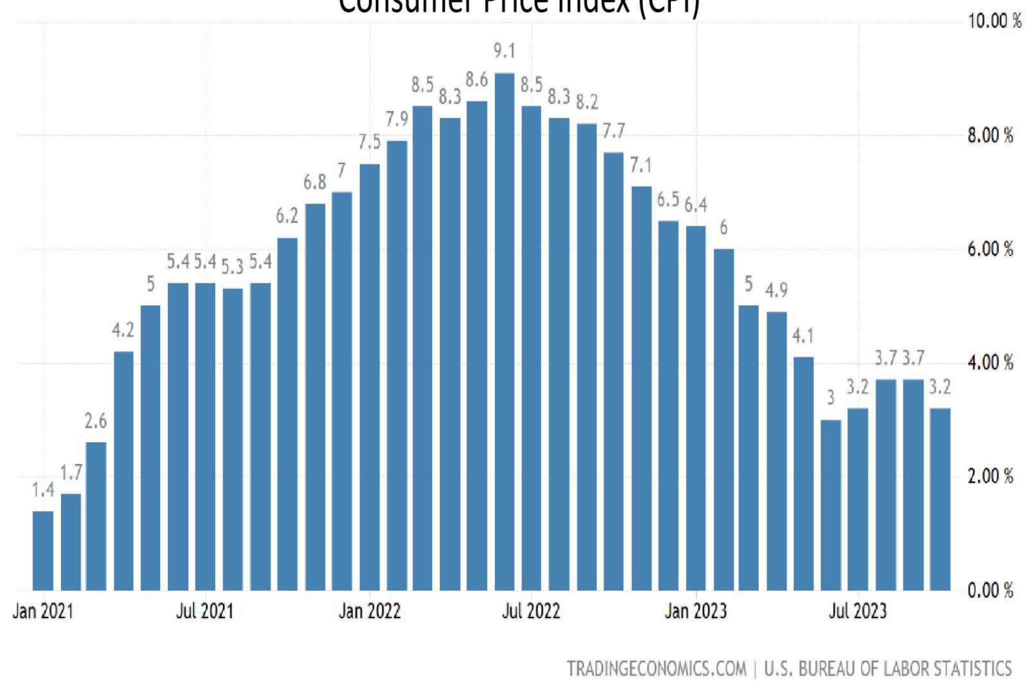
Local economy continues to show strong performance in the first half of calendar year 2023 and indicators reflect strong employment and economic growth

UCLA Anderson forecasting in line with Palo Alto that a recession is unlikely; this LRFF assumes economic stagnation at the beginning of the 10-year period

National Gross Domestic Product (GDP)
Real GDP: Percent Change from Preceding Quarter



National Inflation Rate /
Consumer Price Index (CPI)



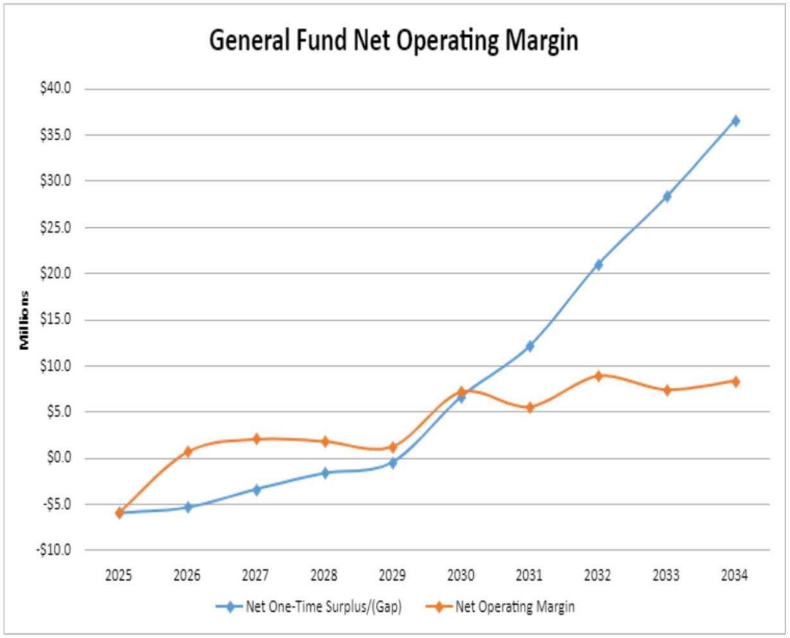
FISCAL YEAR 2025 - 2034 BASE CASE FORECAST

CITY OF PALO ALTO

	Actual 2023	Adopted 2024	Projected 2024	2025	2026	2027	2028	2029	2030	2031	2032	2033	2034
Total Revenue	$254,799	$261,141	$264,281	275,889	$289,060	$301,025	$312,564	$325,208	$339,684	$353,085	$365,820	$379,944	$394,026
BSR Contribution (One-Time)	-	$3,440	$3,440	-	-	-	-	-	-	-	-	-	-
Reappropriated Funds (One-Time)	-	$15,000	$15,000	-	-	-	-	-	-	-	-	-	-
Total Source of Funds	$254,799	$279,581	$282,722	$275,889	$289,060	$301,025	$312,564	$325,208	$339,684	$353,085	$365,820	$379,944	$394,026
Year over Year increase (revenue only)				5.6%	4.8%	4.1%	3.8%	4.0%	4.5%	3.9%	3.6%	3.9%	3.7%
Total Expenditures	$243,695	$279,581	$279,282	$281,887	$294,473	$304,465	$314,253	$325,708	$333,099	$341,030	$344,933	$351,721	$357,516
Total Use of Funds	$243,695	$279,581	$279,282	$281,887	$294,473	$304,465	$314,253	$325,708	$333,099	$341,030	$344,933	$351,721	$357,516
Year over Year increase				0.8%	4.5%	3.4%	3.2%	3.6%	2.3%	2.4%	1.1%	2.0%	1.6%
Net One-Time Surplus/(Gap)	$11,104	($0)	$3,440	($5,998)	($5,414)	($3,440)	($1,689)	($500)	$6,585	$12,055	$20,887	$28,223	$36,511
Cumulative Net Operating Margin (One-Time)													$87,220
Net Operating Margin				($5,998)	$585	$1,974	$1,751	$1,189	$7,085	$5,470	$8,832	$7,336	$8,288
Forecasted One-Time Gap after Use of Uncertainty Reserve				*($0)*									
Cumulative Net Operating Margin													$36,511

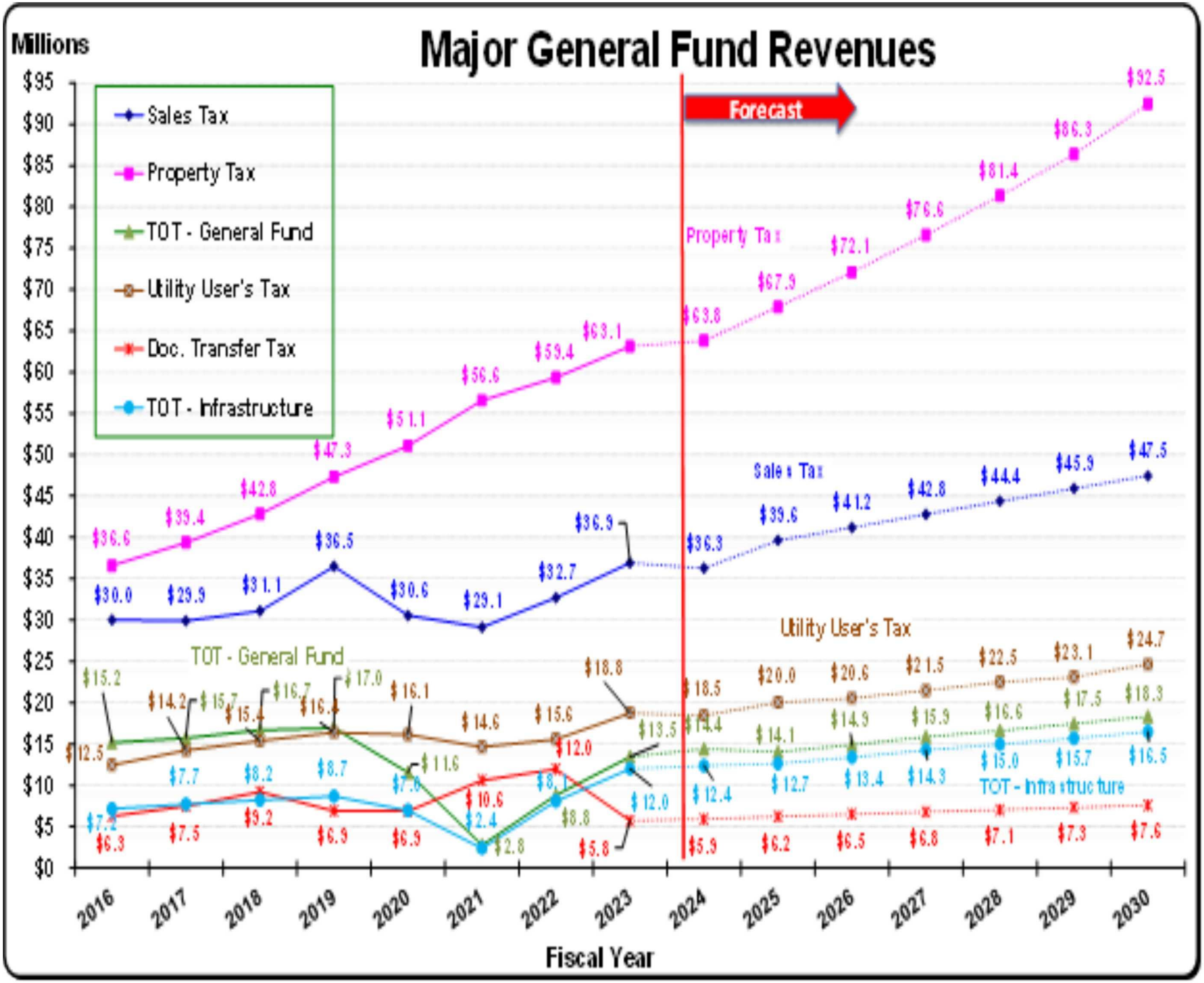
Assumes that the annual shortfalls are solved with ongoing solutions and annual surpluses are spent for ongoing expenditures

- Revenues catch up to Expenses in FY 2030
- Mild economic stagnation through end of FY 2025
- Uncertainty Reserve offsets FY 2025 shortfall, consistent with 2-yr balancing strategy in prior year



MAJOR TAX REVENUE PROJECTIONS

CITY OF PALO ALTO



ASSUMPTIONS NOT INCLUDED IN FORECAST

- Labor Negotiations (contracts expire in Jan/Jun 2025);
  LRFF includes an estimated reserve for changes in vacancy rates, labor and benefit variability, and inflation
- Capital Improvements: Parks Master Plan, Railroad Grade Separation, Vehicle Fleet Electrification
- Cubberley Community Center Redevelopment
- Limited Term Programs:
  - Psychiatric Emergency Response Team (PERT)
  - PA Link
  - Downtown Streets Team
  - Project Homekey

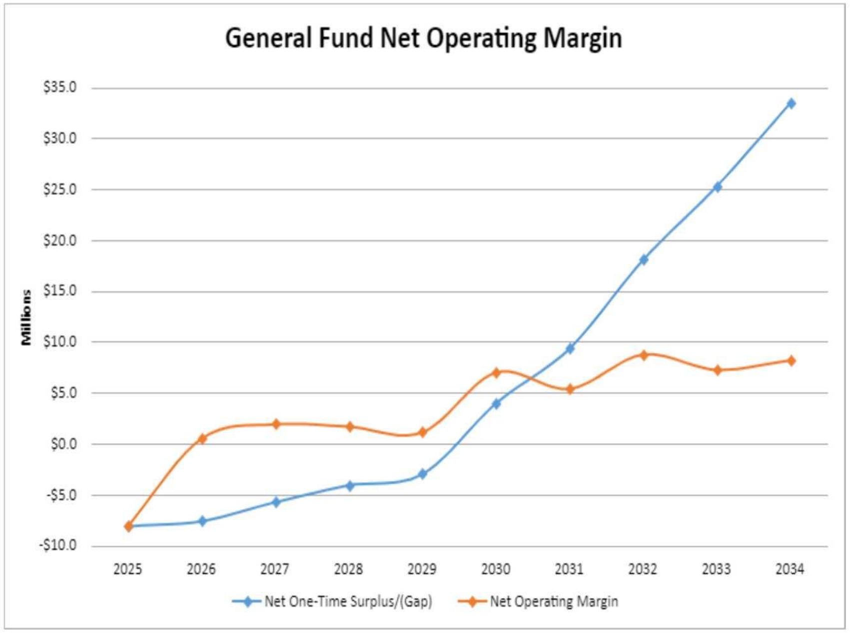
ALT SCENARIO A: ECONOMICALLY SENSITIVE REVENUE IN FY25

CITY OF PALO ALTO

	Actual 2023	Adopted 2024	Projected 2024	2025	2026	2027	2028	2029	2030	2031	2032	2033	2034
Total Revenue	$254,799	$261,141	$264,281	273,760	286,825	298,692	310,138	322,682	337,041	350,335	362,971	376,979	390,943
BSR Contribution (One-Time)	-	$3,440	$3,440	-	-	-	-	-	-	-	-	-	-
Reappropriated Funds (One-Time)	-	$15,000	$15,000	-	-	-	-	-	-	-	-	-	-
Total Source of Funds	$254,799	$279,581	$282,722	$273,760	$286,825	$298,692	$310,138	$322,682	$337,041	$350,335	$362,971	$376,979	$390,943
Year over Year increase (revenue only)				*4.8%*	*4.8%*	*4.1%*	*3.8%*	*4.0%*	*4.4%*	*3.9%*	*3.6%*	*3.9%*	*3.7%*
Total Expenditures	243,695	279,581	279,282	281,887	294,471	304,463	314,251	325,705	333,097	341,028	344,930	351,718	357,513
Total Use of Funds	$243,695	$279,581	$279,282	$281,887	$294,471	$304,463	$314,251	$325,705	$333,097	$341,028	$344,930	$351,718	$357,513
Year over Year increase				*0.8%*	*4.5%*	*3.4%*	*3.2%*	*3.6%*	*2.3%*	*2.4%*	*1.1%*	*2.0%*	*1.6%*
Net One-Time Surplus/(Gap)	$11,104	($0)	$3,440	(8,128)	($7,646)	($5,771)	($4,112)	($3,023)	$3,944	$9,307	$18,041	$25,261	$33,431
Cumulative Net Operating Margin (One-Time)													$61,304
Net Operating Margin				($8,128)	$481	$1,876	$1,658	$1,089	$6,968	$5,363	$8,733	$7,221	$8,169
Cumulative Net Operating Margin													$33,431

Models the impact of a 1% loss in revenue from major taxes, charges for services, and permits and licenses

Revenues decrease by $2.1M in FY 2025 and increase projected shortfalls



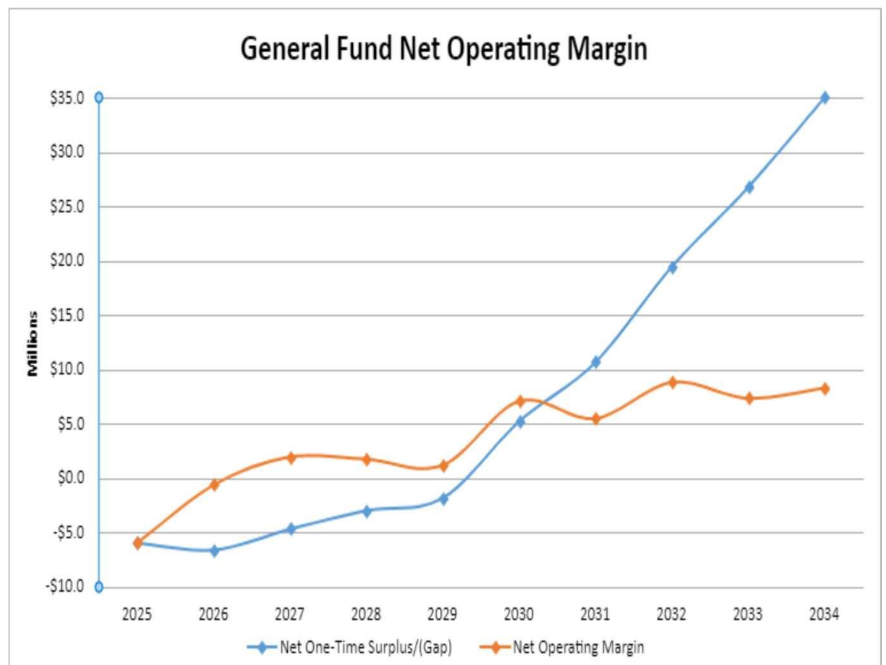
CITY OF PALO ALTO

ALT SCENARIO B: COMPENSATION ADJUSTMENT IN FY26

	Actual 2023	Adopted 2024	Projected 2024	2025	2026	2027	2028	2029	2030	2031	2032	2033	2034
Total Revenue	$254,799	$261,141	$264,281	275,889	$289,060	$301,025	$312,564	$325,208	$339,684	$353,085	$365,820	$379,944	$394,026
BSR Contribution (One-Time)	-	$3,440	$3,440	-	-	-	-	-	-	-	-	-	-
Reappropriated Funds (One-Time)	-	$15,000	$15,000	-	-	-	-	-	-	-	-	-	-
Total Source of Funds	$254,799	$279,581	$282,722	$275,889	$289,060	$301,025	$312,564	$325,208	$339,684	$353,085	$365,820	$379,944	$394,026
Year over Year increase (revenue only)				*5.6%*	*4.8%*	*4.1%*	*3.8%*	*4.0%*	*4.5%*	*3.9%*	*3.6%*	*3.9%*	*3.7%*
Total Expenditures	243,695	279,581	279,282	281,887	295,719	305,761	315,587	327,082	334,501	342,460	346,392	353,208	359,033
Total Use of Funds	$243,695	$279,581	$279,282	$281,887	$295,719	$305,761	$315,587	$327,082	$334,501	$342,460	$346,392	$353,208	$359,033
Year over Year increase				*0.8%*	*4.9%*	*3.4%*	*3.2%*	*3.6%*	*2.3%*	*2.4%*	*1.1%*	*2.0%*	*1.6%*
Net One-Time Surplus/(Gap)	$11,104	($0)	$3,440	(5,998)	($6,659)	($4,735)	($3,023)	($1,874)	$5,183	$10,625	$19,429	$26,736	$34,993
Cumulative Net Operating Margin (One-Time)													$74,676
Net Operating Margin				($5,998)	($661)	$1,924	$1,712	$1,149	$7,057	$5,442	$8,804	$7,307	$8,258
Cumulative Net Operating Margin													$34,993

Models the impact of a 1% compensation adjustment once negotiated agreements sunset

Expenses increase by $1.2M in FY 2026 and increase projected shortfalls



FY 2025 BUDGET DEVELOPMENT GUIDELINES (Attachment A)

- Develop a structurally balanced budget to maintain fiscal sustainability
- Examine appropriate use of surpluses
- Review resource allocation for City Council's identified priorities
- Focus on business process redesign and explore alternative service delivery models
- Explore expansion of existing revenue sources or the addition of new revenue sources
- Continue to prioritize proactively funding long term liabilities

HSRAP FUNDING REFERRAL (Attachment E)

Council Referral: Consider pegging the Human Services Resource Allocation Process (HSRAP) budget allocations to a benchmark, such as percentage of General Fund budgeted expenditures.

- HSRAP funding averaged 0.26% of the General Fund budget from FY 2001 – FY 2024
- Total human services funding averaged 0.83%
- $0.8M needed annually to increase total human services funding to 1% of the General Fund budget in FY 2025 – FY 2027 of the LRFF base case
- Human services funding never approved to be tied to the General Fund budget
- Prior to FY 2016 HSRAP included Avenidas & Palo Alto Community Childcare (PACCC), after FY 2016 these programs were funded through direct allocation separate from HSRAP

CONCLUSION AND NEXT STEPS

- Revenue trends indicate near term economic stagnation followed by return to growth
- 2025-2034 LRFF consistent with FY 2024 Adopted Budget two-year strategy
  - Focus on investing only in key areas of priority or urgent needs
  - Alternative scenarios increase projected shortfalls
  - Uncertainty Reserve and one-time surpluses are critical to manage the near-term fiscal stability and investments in priority initiatives
- FY 2024 Mid-Year will include recommendations for addition of key resources and appropriation of funds as directed by Council
  - Review of objectives deferred as outlined in FY 2024 Adopted Budget

Next Steps Annual Budget Process

- *Jan 2024:* Council review LRFF
- *Feb 2024:* FY 2024 Mid-Year Budget
- *May 2024:* FY 2025 Proposed Budget

RECOMMENDED ACTION

Staff recommends that the Finance Committee:

Review and recommend that the City Council accept the Fiscal Year 2025 – 2034 Long Range Financial Forecast Base Case and the FY 2025 Budget Development Guidelines (Attachment A).

Direct staff to use this forecast as a starting point for the FY 2025 budget process.

CITY OF

PALO

ALTO

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FY 2025 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) Review resource allocation for City Council's existing priorities and identify priority funding needs.

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.

ATTACHMENT C

Additional information as Requested by Finance Committee

Vacancy Analysis

The current vacancy rate is approximately 13.5% in the General Fund, excluding public safety. This preliminary vacancy rate is point in time and does not consider actions currently in progress for recruitments, promotions, and other staffing shifts. Vacancy savings from public safety positions are typically exhausted by uses such as backfill, hire ahead programs, and overtime. To better align with the status of vacancies, this forecast increases the vacancy estimate from previously assumed rate of 3% to 5% in all years. This results in additional savings of approximately $2 million annually, or a projected $5 million in total vacancy savings each year. This additional funding fully forecasts the savings the City has seen in recent years of $1.7 million as shown in Table 1.

Consistent with past practice, the vacancy assumption is lower than the actual vacancy rate to allow departmental use of those savings for other staffing strategies, such as filling staffing gaps by contracting for professional services, hiring ahead to allow overlap and smooth transitions, piloting new technologies to increase efficiency in the absence of staff, and supporting a summer internship program. For example, vacancy savings have been used to hire on-call inspectors and planners on a limited-term basis to meet changing demands. Additionally, these savings have bridged changes in employee compensation when labor terms are completed outside of the regular budget cycle, and they support professional recruitment services for hard to fill positions. Lastly, these savings give flexibility to start or expand projects and programs during the fiscal year, ahead of the formal budget process. A recent example is the Planning and Development Services Department's use of vacancy savings to hire consultancy services to advance work related to the North Ventura Coordinated Area Plan (NVCAP). This approach facilitates continuity of the project while the department continues efforts to fill staffing vacancies in the Long-Range Planning division.

Table 1 provides a historical summary of budget to actuals variance in the Salary and Benefits category for General Fund departments. The budget includes the budgeted vacancy factor assumption, therefore this savings is what has been achieved beyond planned levels. The table includes the annual vacancy rate and the percentage difference from budgeted funding levels. As shown below, the vacancy savings from the previous year have varied from -$1.7 million to +$1.7 million over the last five years from the budgeted vacancy assumption, reflecting a variance of less than 1.5% as compared to the budgeted.

TABLE 1: Historical General Fund Vacancy Savings ($'s in Millions)

	2019	2020**	2021**	2022	2023

ATTACHMENT C

Additional information as Requested by Finance Committee

Total General Fund Vacancy Savings	$1.3M	$1.3M	-$1.7M	$1.6M	$1.7M
Annual Vacancy Rate	12%	12%	15%	12%	13%
General Fund Adjusted Budget*	$123.3M	$134.7M	124.1M	$134.3M	$148.4M
Variance to Budget	1.1%	1.0%	-1.4%	1.2%	1.2%

* The annual budget reflects s*alaries and benefits net of the forecaste*d *vacancy factor each year*.
** FY 2020 and FY 2021 are anomaly years as they were significantly impacted by adjustments made due to the COVID-19 pandemic where a number of factors are impacting these rates including but not limited to a hiring freeze as well as eventual position reductions citywide.

<u>Economic Recovery Advisory Report</u>

During the LRFF review, the Finance Committee raised questions regarding the processes to develop LRFF assumptions and variability in actual results. As a follow up to this discussion, this report includes references to an audit completed by the Office of the City Auditor (OCA) in April 2022 to review the City's long-term financial planning models and inputs (CMR 13915[1]). The purpose of this audit was to offer recommendations for improvement, identify and evaluate key revenue source categories that present long term risk to the City's financial sustainability and perform scenario analysis. The OCA conducted analysis of major revenue sources, including historical trends, the distribution of revenue by type, identification of major payors and their geographic locations, historical relationships between economic factors and revenue, sensitivity analysis based on relevant drivers, and a comparison of per-capita revenues by type to those of similar cities. The analysis also involved evaluating economic factors affecting each revenue source and assessing the use of relevant factors for predictive purposes. The OCA results indicated that the City's was able to forecast revenues at no more than a 9% difference from original estimates over a five-year period, from FY 2016 to FY 2020. Further, the results indicated that the City has a robust process for forecasting and uses reliable information for assumptions. Overall, the OCA determined that the City's long-term financial planning models and inputs align with the OCA's considerations and best practices.

<u>Historical Grant Funding and Funding from Other Agencies</u>

From FY 2019 through FY 2023, various federal, state, local, and other agencies allocated funds for programs and initiatives across the General Fund and the Capital Improvement Fund. The City's practice is to recommend allocation of these funds after formal agreements are in place with the granting agency or jurisdiction. In addition, since these funds are designated for specific needs, staff strives to use these funding sources first in order to maximize resources.

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[1] City Council, April 11, 2022; Staff Report # 13915, https://portal.laserfiche.com/Portal/DocView.aspx?id=59425&repo=r-704298fc&searchid=4fe0b40a-9941-44aa-8e0d-6479fb037f48

ATTACHMENT C

Additional information as Requested by Finance Committee

Operating - General Fund

	2019	2020	2021	2022	2023
Funding by Fiscal Year (in Millions)	$0.8	$0.8	$1.1	$8.8	$12.1

Notably, the Federal Transportation Agency (FTA) contributed to transportation-related projects along with the Santa Clara County Measure B Transportation Improvement Program, and Stanford University supporting the PA Link program. The Institute of Museum and Library Services (IMLS) and Pacific Library Partnership (PLP) supported library partnerships and initiatives and Federal Health and Human Services (HHS) funding was appropriated for mental health services. The funding landscape also encompassed grants for housing and planning awarded by the Metropolitan Transportation Commission (MTC) and California Senate Bill 2 (CA SB2), COVID-19 relief through CARES and American Rescue Plan Act (ARPA) funds, fire fighter staffing funding via Staffing for Adequate Fire and Emergency Response (SAFER), and investments in safety equipment through the Santa Clara County Office of Emergency Services (SCC OES). Significant sources of funding in each year are as follows:

- 2019: FTA and PLP
- 2020: FTA, SCC OES, CA SB2, and IMLS
- 2021: CARES Act and IMLS
- 2022: ARPA, SAFER, and MTC
- 2023: ARPA, Measure B, Federal HHS, SAFER, MTC, and Stanford (via transit revenue sharing)

Capital Improvement Fund

External revenues supporting capital improvement projects fall into three broad categories: local/regional grants (including Measure B), state grants, and federal grants. The table below summarizes the amounts, sources, and uses of these revenues by fiscal year from FY 2019-FY 2023. The amounts in each fiscal year, which total $50.5 million, do not include reappropriations.

	2019	2020	2021	2022	2023
Funding by Fiscal Year (in Millions)	$12.4	$4.3	$12.6	$4.0	$17.0

Details of funding sources and capital projects supported are discussed below.

- 2019: Local/regional grants comprised $8.4M
        - $7M supporting the Highway 101 pedestrian/bicycle overpass
        - $1.4M of Measure B supporting transportation projects
    - State grants of $3M for the Newell Road/San Francisquito Creek bridge replacement

Additional information as Requested by Finance Committee

  - $1M of federal grants supported street maintenance
- 2020: Local/regional grants comprised $3.4M
    - $2M supporting the Highway 101 pedestrian/bicycle overpass
    - $1.4M of Measure B supporting transportation projects.
  - $0.5M of federal grants supported Churchill Avenue/Alma Street railroad crossing safety improvements
  - $0.4M of state grants supported street maintenance
- 2021: State grants comprised $5.1M
    - $4.6M supporting the Newell Road/San Francisquito Creek bridge replacement
    - $0.5M supporting street maintenance
  - Federal funding comprised $4.3M
    - $4.0M for Churchill Avenue/Alma Street railroad crossing safety improvements,
    - $0.3M was given in support of JMZ renovation.
  - Local/regional grants comprised $3.3M
    - $1.5M went to the Highway 101 pedestrian/bicycle overpass
    - $1.3M of Measure B for transportation projects and street maintenance
    - 0.5M supported Safe Routes to School and JMZ renovation
- 2022: Local/regional grants comprised $2.6M
    - $2M of Measure B supporting transportation projects and street maintenance
    - $0.6M of other grants supporting the Highway 101 pedestrian/bicycle overpass and the Civic Center electrical upgrade & EV charger installation
  - $1M of state grants supported the Newell Road/San Francisquito Creek bridge replacement and street maintenance
  - $0.3M of federal grants supported JMZ renovation
- 2023: State grants comprised $13.3M
    - $12.5M for the Newell Road/San Francisquito Creek bridge replacement,
    - $0.5M for street maintenance
    - $0.3M for Boulware Park improvements and the Charleston/Arastradero Corridor
  - Local/regional grants comprised $4.8M,
    - $2.5M supported Roth Building rehabilitation
    - $1.3M of Measure B supported transportation projects.

Turning to currently budgeted revenues in the Capital Improvement Fund, the table below shows how Measure K, the City of Palo Alto's business tax, and Measure B, a Santa Clara sales tax that benefits transportation projects, are currently planned to be allocated across capital

Additional information as Requested by Finance Committee

improvement projects based on the 2024-2028 Capital Improvement Plan (CIP). These allocations may change based on staff recommendations and Council direction during the FY 2025 budget and 2025-2029 CIP development cycle.

	2024	2025	2026	2027	2028
Measure K - City of Palo Alto Business Tax	**$0.75**	**$1.5**	**$3.0**	**$3.0**	**$3.0**
PL-24000 - Meadow Dr./ Charleston Rd. Rail Grade Separation and Safety Improvements	$0.43	$0.75	$2.0	$2.0	$2.0
PL-24001 - Churchill Avenue Rail Grade Separation and Safety Improvements	$0.32	$0.75	$1.0	$1.0	$1.0
Measure B - Santa Clara County Sales Tax	**$10.5**	**$7.8**	**$27.3**	**$27.3**	**$20.3**
PL-05030 - Traffic Signal and Intelligent Transportation Systems	$0.6	$0.3	$0.3	$0.3	$0.3
PL-12000 - Transportation and Parking Improvements	$0.5	-	-	-	-
PL-17001 - Railroad Grade Separation and Safety Improvements	$1.9	$1.0	$2.0	$2.0	$1.0
PL-24000 - Meadow Dr./Charleston Rd. Rail Grade Separation and Safety Improvements	$4.5	$4.5	$15.0	$15.0	$15.0
PL-24001 - Churchill Avenue Rail Grade Separation and Safety Improvements	$3.0	$2.0	$10.0	$10.0	$4.0

Human Services Resource Allocation Process (HSRAP)

As part of the LRFF, staff provided additional details to facilitate the City Council's review of a referral to consider pegging HSRAP budget allocations to a benchmark, such as a percentage of General Fund budgeted expenditures. Staff confirmed that funding levels in prior years were not tied to a percentage of the General Fund budgeted expenditures. The Policy and Services Committee's previous review (CMR 7289[2]) presented four options for augmenting HSRAP funding, but none were approved for recommendation to the City Council. Instead, funding has been adjusted based on the Consumer Price Index (CPI) as funds were available in the General Fund. As part of the LRFF review, the Finance Committee elected to continue the discussion on this referral in February 2024 with any recommended changes forwarded to the City Council for consideration as part of the FY 2025 budget process. The status of the referral has been updated from 'complete' to 'in progress', as indicated in the status update completed on December 5, 2023 (CMR 2307-1794[3]).

[2] Policy and Services Committee, November 29, 2016; Staff Report # 7289, https://www.cityofpaloalto.org/files/assets/public/v/1/agendas-minutes-reports/reports/city-manager-reports-cmrs/year-archive/2016/id-7289-hsrap.pdf

[3] Finance Committee, December 5, 2023; Staff Report # 2307-1794,

Additional information as Requested by Finance Committee

https://portal.laserfiche.com/Portal/DocView.aspx?id=69142&repo=r-704298fc&searchid=b316cc0f-f843-4290-8390-b2abbc3f61d4

COUNCIL MEETING
1/22/24
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12

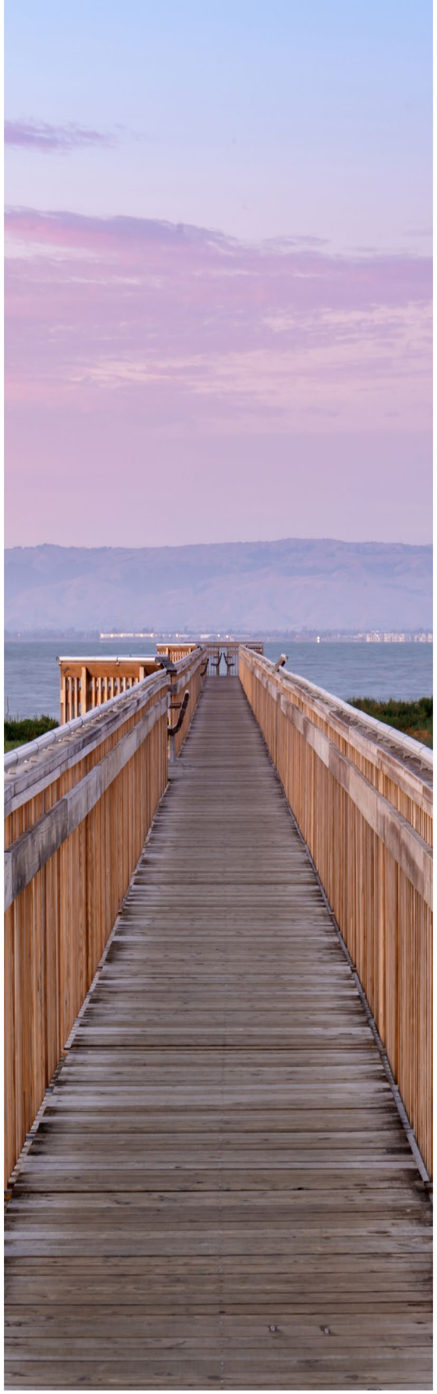
CITY OF
PALO ALTO

FY 2025 – FY 2034 LONG RANGE FINANCIAL FORECAST

City Council Item #12

JANUARY 22, 2024

www.cityofpaloalto.org



OVERVIEW

- Economy continues to demonstrate resiliency to formal recession
  - Forecast reflects stagnation offset by inflation

- LRFF consistent with FY 24 Adopted Budget, reflects near-term deficits
  - FY 2025 shortfalls resolved with Uncertainty Reserve
  - Consistent with FY 2024 Adopted Budget two-year strategy
  - Measure K (Business Tax) included for approved projects
  - Measure L (Equity Transfer) phased to 18% by FY 2027

- Expense projections based on current approved service levels
  - Assumes 20% BSR to mitigate uncertainty (typical target = 18.5%)
  - Cost of labor, inflation, and vacancies are key factors

- Estimated surplus in FY 2024 ($3.4M) from Major Tax Revenue; to be reviewed at Mid-Year

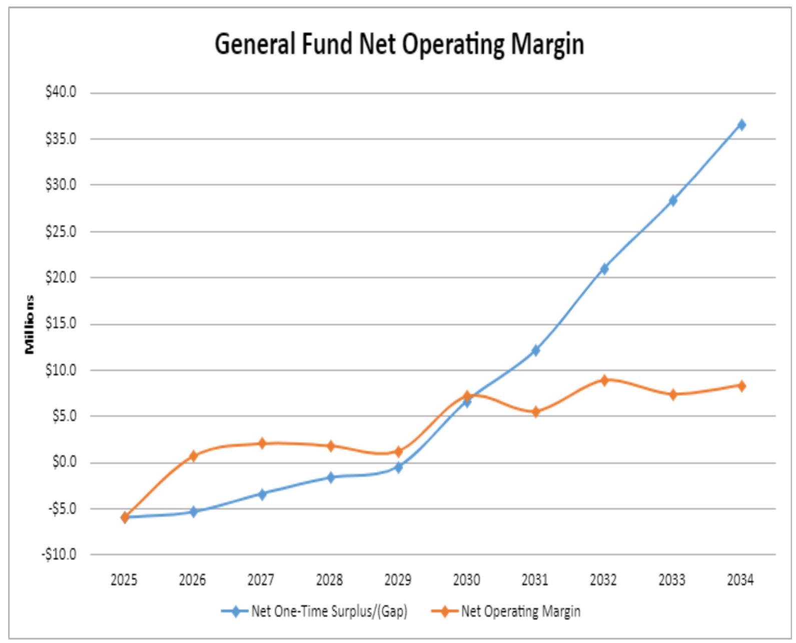
FISCAL YEAR 2025 - 2034 BASE CASE FORECAST

CITY OF PALO ALTO

	Actual 2023	Adopted 2024	Projected 2024	2025	2026	2027	2028	2029	2030	2031	2032	2033	2034
Total Revenue	$254,799	$261,141	$264,281	275,889	$289,060	$301,025	$312,564	$325,208	$339,684	$353,085	$365,820	$379,944	$394,026
BSR Contribution (One-Time)	-	$3,440	$3,440	-	-	-	-	-	-	-	-	-	-
Reappropriated Funds (One-Time)	-	$15,000	$15,000	-	-	-	-	-	-	-	-	-	-
Total Source of Funds	$254,799	$279,581	$282,722	$275,889	$289,060	$301,025	$312,564	$325,208	$339,684	$353,085	$365,820	$379,944	$394,026
Year over Year increase (revenue only)				*5.6%*	*4.8%*	*4.1%*	*3.8%*	*4.0%*	*4.5%*	*3.9%*	*3.6%*	*3.9%*	*3.7%*
Total Expenditures	$243,695	$279,581	$279,282	$281,887	$294,473	$304,465	$314,253	$325,708	$333,099	$341,030	$344,933	$351,721	$357,516
Total Use of Funds	$243,695	$279,581	$279,282	$281,887	$294,473	$304,465	$314,253	$325,708	$333,099	$341,030	$344,933	$351,721	$357,516
Year over Year increase				*0.8%*	*4.5%*	*3.4%*	*3.2%*	*3.6%*	*2.3%*	*2.4%*	*1.1%*	*2.0%*	*1.6%*
Net One-Time Surplus/(Gap)	$11,104	($0)	$3,440	($5,998)	($5,414)	($3,440)	($1,689)	($500)	$6,585	$12,055	$20,887	$28,223	$36,511
Cumulative Net Operating Margin (One-Time)													$87,220
Net Operating Margin				($5,998)	$585	$1,974	$1,751	$1,189	$7,085	$5,470	$8,832	$7,336	$8,288
Forecasted One-Time Gap after Use of Uncertainty Reserve				*($0)*									
Cumulative Net Operating Margin													$36,511

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

- Revenues catch up to Expenses in FY 2030
- Mild economic stagnation through end of FY 2025
- Uncertainty Reserve offsets FY 2025 shortfall, consistent with 2-yr balancing strategy in prior year



ASSUMPTIONS NOT INCLUDED IN FORECAST

- Labor Negotiations (contracts expire in Jan/Jun 2025);
  LRFF includes an estimated reserve for changes in vacancy rates, labor and benefit variability, and inflation
- Capital Improvements: Parks Master Plan, Railroad Grade Separation, Vehicle Fleet Electrification
- Cubberley Community Center Redevelopment
- Limited Term Programs:
  - Psychiatric Emergency Response Team (PERT)
  - PA Link
  - Downtown Streets Team
  - Project Homekey

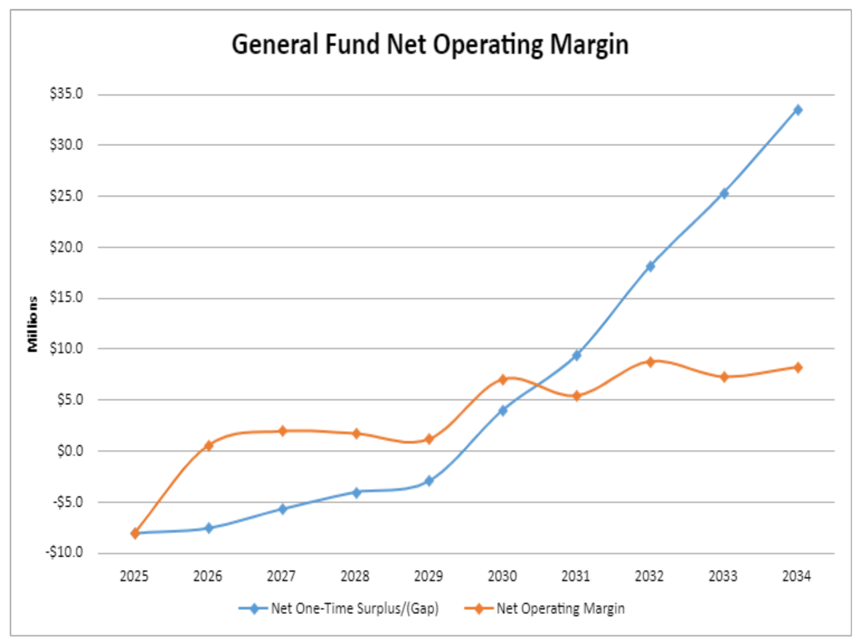
ALT SCENARIO A: ECONOMICALLY SENSITIVE REVENUE IN FY25

CITY OF PALO ALTO

	Actual 2023	Adopted 2024	Projected 2024	2025	2026	2027	2028	2029	2030	2031	2032	2033	2034
Total Revenue	$254,799	$261,141	$264,281	273,760	286,825	298,692	310,138	322,682	337,041	350,335	362,971	376,979	390,943
BSR Contribution (One-Time)	-	$3,440	$3,440	-	-	-	-	-	-	-	-	-	-
Reappropriated Funds (One-Time)	-	$15,000	$15,000	-	-	-	-	-	-	-	-	-	-
Total Source of Funds	$254,799	$279,581	$282,722	$273,760	$286,825	$298,692	$310,138	$322,682	$337,041	$350,335	$362,971	$376,979	$390,943
Year over Year increase (revenue only)				*4.8%*	*4.8%*	*4.1%*	*3.8%*	*4.0%*	*4.4%*	*3.9%*	*3.6%*	*3.9%*	*3.7%*
Total Expenditures	243,695	279,581	279,282	281,887	294,471	304,463	314,251	325,705	333,097	341,028	344,930	351,718	357,513
Total Use of Funds	$243,695	$279,581	$279,282	$281,887	$294,471	$304,463	$314,251	$325,705	$333,097	$341,028	$344,930	$351,718	$357,513
Year over Year increase				*0.8%*	*4.5%*	*3.4%*	*3.2%*	*3.6%*	*2.3%*	*2.4%*	*1.1%*	*2.0%*	*1.6%*
Net One-Time Surplus/(Gap)	$11,104	($0)	$3,440	(8,128)	($7,646)	($5,771)	($4,112)	($3,023)	$3,944	$9,307	$18,041	$25,261	$33,431
Cumulative Net Operating Margin (One-Time)													$61,304
Net Operating Margin				($8,128)	$481	$1,876	$1,658	$1,089	$6,968	$5,363	$8,733	$7,221	$8,169
Cumulative Net Operating Margin													$33,431

Models the impact of a 1% loss in revenue from major taxes, charges for services, and permits and licenses

Revenues decrease by $2.1M in FY 2025 and increase projected shortfalls



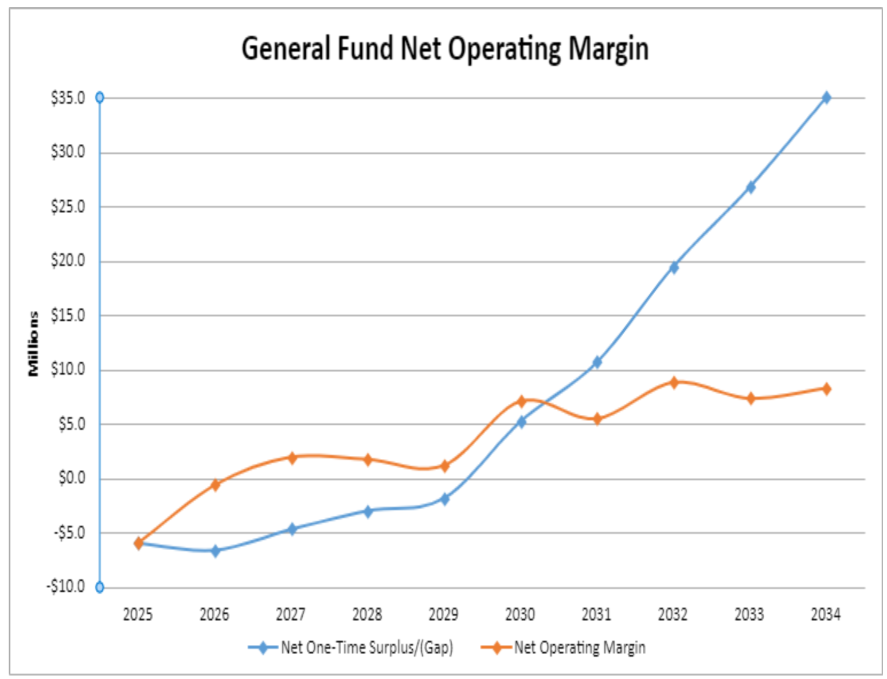
ALT SCENARIO B: COMPENSATION ADJUSTMENT IN FY26

CITY OF PALO ALTO

	Actual 2023	Adopted 2024	Projected 2024	2025	2026	2027	2028	2029	2030	2031	2032	2033	2034
Total Revenue	$254,799	$261,141	$264,281	275,889	$289,060	$301,025	$312,564	$325,208	$339,684	$353,085	$365,820	$379,944	$394,026
BSR Contribution (One-Time)	-	$3,440	$3,440	-	-	-	-	-	-	-	-	-	-
Reappropriated Funds (One-Time)	-	$15,000	$15,000	-	-	-	-	-	-	-	-	-	-
Total Source of Funds	$254,799	$279,581	$282,722	$275,889	$289,060	$301,025	$312,564	$325,208	$339,684	$353,085	$365,820	$379,944	$394,026
Year over Year increase (revenue only)				*5.6%*	*4.8%*	*4.1%*	*3.8%*	*4.0%*	*4.5%*	*3.9%*	*3.6%*	*3.9%*	*3.7%*
Total Expenditures	243,695	279,581	279,282	281,887	295,719	305,761	315,587	327,082	334,501	342,460	346,392	353,208	359,033
Total Use of Funds	$243,695	$279,581	$279,282	$281,887	$295,719	$305,761	$315,587	$327,082	$334,501	$342,460	$346,392	$353,208	$359,033
Year over Year increase				*0.8%*	*4.9%*	*3.4%*	*3.2%*	*3.6%*	*2.3%*	*2.4%*	*1.1%*	*2.0%*	*1.6%*
Net One-Time Surplus/(Gap)	$11,104	($0)	$3,440	(5,998)	($6,659)	($4,735)	($3,023)	($1,874)	$5,183	$10,625	$19,429	$26,736	$34,993
Cumulative Net Operating Margin (One-Time)													$74,676
Net Operating Margin				($5,998)	($661)	$1,924	$1,712	$1,149	$7,057	$5,442	$8,804	$7,307	$8,258
Cumulative Net Operating Margin													$34,993

Models the impact of a 1% compensation adjustment once negotiated agreements sunset

Expenses increase by $1.2M in FY 2026 and increase projected shortfalls



FY 2025 BUDGET DEVELOPMENT GUIDELINES

- Develop a structurally balanced budget to maintain fiscal sustainability
- Examine appropriate use of surpluses
- Review resource allocation for City Council's identified priorities
- Focus on business process redesign and explore alternative service delivery models
- Explore expansion of existing revenue sources or the addition of new revenue sources
- Continue to prioritize proactively funding long term liabilities

HSRAP FUNDING REFERRAL

Council Referral: Consider pegging the Human Services Resource Allocation Process (HSRAP) budget allocations to a benchmark, such as percentage of General Fund budgeted expenditures.

Finance Committee recommends continuation of this item in February 2024

- HSRAP funding averaged 0.26% of the General Fund budget from FY 2001 – FY 2024
- Total human services funding averaged 0.83%
- $0.8M needed annually to increase total human services funding to 1% of the General Fund budget in FY 2025 – FY 2027 of the LRFF base case
- Human services funding never approved to be tied to the General Fund budget
- Prior to FY 2016 HSRAP included Avenidas & Palo Alto Community Childcare (PACCC), after FY 2016 these programs were funded through direct allocation separate from HSRAP

INFO REQUESTED BY FINANCE COMMITTEE (ATTACHMENT C)

- Variability in LRFF Assumptions and Actual Results
  - Economic Advisory Report issued by Office of City Auditor (OCA) (CMR 13915)
  - Actual results within 9% of original estimates
  - Long-term financial planning models and inputs align with the OCA's considerations and best practices
- Historical Vacancy Analysis – General Fund
  - Up to $1.7M savings in prior years, above budget assumptions for a 3% vacancy factor
  - Prior year actuals remained within 1.5% of budgeted levels
  - LRFF adjusts the vacancy factor to 5%, increasing potential savings by $2M

	2019	2020*	2021*	2022	2023
Total Savings/(Loss) *actual salary and benefit costs vs. adjusted budget*	$1.3M	$1.3M	($1.7M)	$1.6M	$1.7M
Annual Vacancy Rate	12%	12%	15%	12%	13%
Total Adjusted Budget *net of vacancy factor*	$123.3M	$134.7M	$124.1M	$134.3M	$148.4M
Variance to Budget	1.1%	1.0%	(1.4%)	1.2%	1.2%

**FY20 and FY21 are anomaly years due to the pandemic*

INFO REQUESTED BY FINANCE COMMITTEE (ATTACHMENT C)

- Grants and Funding from Other Agencies

	2019	2020	2021	2022	2023
General Fund	$0.8M	$0.8M	$1.1M	$8.8M	$12.1M
Capital Fund	$12.4M	$4.3M	$12.6M	$4.0M	$17.0M

- The General Fund is supported by diverse external funding sources, with the most significant contributions coming from federal, state, and county funding, transportation initiatives, library partnerships, and emergency response.
- External revenues supporting capital improvement projects fall into three broad categories: local/regional grants (including Measure B), state grants, and federal grants, with local/regional grants comprising the largest source in three of the five years.

CONCLUSION AND NEXT STEPS

- Revenue trends indicate near term economic stagnation followed by return to growth

- 2025-2034 LRFF consistent with FY 2024 Adopted Budget two-year strategy
  - Focus on investing only in key areas of priority or urgent needs
  - Alternative scenarios increase projected shortfalls
  - Uncertainty Reserve and one-time surpluses are critical to manage the near-term fiscal stability and investments in priority initiatives

- FY 2024 Mid-Year will include recommendations for addition of key resources and appropriation of funds as directed by Council
  - Review of objectives deferred as outlined in FY 2024 Adopted Budget

Next Steps Annual Budget Process

- *Feb 2024:* FY 2024 Mid-Year Budget
- *May 2024:* FY 2025 Proposed Budget
- *June 2024:* FY 2025 Budget Adoption

RECOMMENDED ACTION

The Finance Committee and Staff recommend that the City Council:

Accept the Fiscal Year 2025 – 2034 Long Range Financial Forecast Base Case and the FY 2025 Budget Development Guidelines (Attachment B)

Direct staff to use this forecast as a starting point for the FY 2025 budget process

CITY OF
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