

TRANSMITTAL LETTER

July 1, 2024

To the Honorable Mayor and City Council

2025 Fiscal Year Adopted Operating & Capital Budget Transmittal

Honorable Mayor and Council Members:

In accordance with the City Charter, I am presenting the City of Palo Alto's Fiscal Year 2025 Adopted Operating Budget and Fiscal Year 2025 Adopted Capital Budget along with the 2025-2029 Capital Improvement Plan (CIP).

This adopted budget represents a continuation of the significant investments made by the Council last year while reflecting a need to manage investments with cautious optimism, focusing on organizational resilience, and providing innovative service delivery resulting in a total budget of \$1.1 billion including the FY 2025 Capital Budget of \$441.8 million and a Capital Plan of \$1.7 billion over the five-year CIP. The City's General Fund Budget of \$306.9 million further invests in high-quality services for the community and advances City Council priorities.

Reflecting on Key Milestones

Palo Alto has made significant strides in restoring services cut during 2020, because of the pandemic. Reinvesting in community needs such as public safety services, affordable housing and unhoused services, and transportation and grade separation priorities are a direct result of voter support of Measure L and K, which will continue to be critical as we look ahead towards the future. This coming year, the City and community will celebrate the opening of the new and seismically-resilient Public Safety Building; continue construction of Palo Alto Homekey's innovative interim housing; make progress on infrastructure investments at the Regional Water Quality Control Plant, Fire Station 4 replacement, and modernization of the City's electrical grid; and implement critical elements of the City's Sustainability & Climate Action Plan.

Setting the path forward through fiscal stability, innovative services, and organizational resilience

The adopted budget balances continued unknowns that could impact the City's fiscal health such as economic uncertainty, plateauing inflation, and supply chain impacts and invests in organizational resilience to ensure our ability to withstand and recover from challenges through targeted resources for workforce attraction and retention. From the pandemic, stagflation, economic uncertainty, to unprecedented weather events, the City and community have demonstrated an ability to adjust and stay focused on advancing priorities and addressing changing community needs. Generational investments in electrification, transportation safety at railroad grade crossings, and fiber to the premises are key initiatives that continue to make tremendous strides. This budget provides significant investments in innovative services such as affordable housing and homeless services and supplemental funding for on-demand transportation services through Palo Alto Link. Rather than simply bouncing back to pre-pandemic services, this budget invests in service delivery for a sustainable future. This budget continues to reflect our ability to bounce forward.

The FY 2025 Adopted Budget continues the two-year budget balancing strategy from FY 2024. FY 2025 reflects cautious optimism as inflation and other economic, global and labor market factors impact both the pace of revenue and expense growth. Through this budget process, the City will set a course for near- and mid-term service levels.

Looking beyond this two-year budget strategy, we expect to continue facing deficits with our current Long-Range Financial Forecast ranging from \$3.4 million in FY 2027 down to \$0.5 million in FY 2029. A measured approach to ongoing costs is needed to ensure that current one-time surpluses are managed in a way that will not exacerbate future deficits. With this approach in mind, the adopted budget limits ongoing spending, sets aside higher reserve levels, fully funds anticipated legal liabilities, and maintains proactive investment in long-term liabilities.

Reinvesting in Services through One-time Funds, While Continuing to Mitigate Risks

Investing in long-term service delivery and capital improvement and mitigating risk through conservative fiscal strategies such as a prudent budget stabilization reserve continues in this adopted budget. The importance of stability for the organization remains a core value as staff works to navigate the difficulty of financial forecasting in this environment.

Although staff remains optimistic and continues to recommend investment, continued economic uncertainty, inflation, and predictions of economic stagnation loom ahead. To balance the recommended service increases, this budget carries a Budget Stabilization Reserve (BSR) of \$54.4 million at 18.5%. This is within the Council approved range of 15-20% of General Fund expenses and at the target level of 18.5%.

The Council proactively set aside funds in the FY 2023 Mid-Year Budget Review and established a Budget Uncertainty Reserve to bridge the funding needed to address community service needs in FY 2024 and FY 2025. The FY 2025 budget relies on \$6.1 million from the Budget Uncertainty Reserve, leaving a balance of

\$6.1 million, including using \$2.6 million from the BSR to increase the Uncertainty Reserve to fund shortfalls expected in FY 2026 (\$11.0 million), as part of the multi-year budget balancing strategy.

It also mitigates risks by addressing long-term liabilities with the prudence of the Retiree Benefit Policy, that proactively funds pension liability at the lower 5.3% discount rate to accelerate the funding goals, results in reduced liability, manages costs, and ensures fiscal stability.

Also, the FY 2025 adopted budget includes the City Council's direction for a Gas Utility Equity Transfer of 14.5% with the plan to reach the 18% limit in FY 2026. This transfer aligns with the voter approved Measure L to fund additional investments in services and capital improvements.

The use of one-time funding and reserves support near-term funding priorities and bridge projected shortfalls as part of the FY 2025 budget development, with the anticipation that in the longer term the economic recovery and a more diverse revenue base will help to stabilize the fiscal outlook.

FY 2025 Adopted Budget Highlights

The Adopted FY 2025 Budget of \$1.1 billion reflects an 11.2% increase over the FY 2024 Adopted Budget of \$1.0 billion, primarily driven by a 2.6% operating expense increase plus a 8.6% increase in the City's Capital Improvement Program. Funding for the Capital Budget of \$441.8 million includes \$228.7 million in reappropriations from FY 2024 to FY 2025 to continue work on ongoing projects.

This budget recommends Citywide staffing levels to increase by 29.00 FTE for a total authorized staffing of 1,092.10 FTE in FY 2025. The City was able to authorize total staffing back to pre-pandemic levels in the FY 2024 Adopted Budget. Additional staffing recommended in FY 2025 will support high-quality services across the City as well as expansion of programs and services for City Council priorities.

City Council Priority Objectives Investments

The proposed budget advances the City Council's annual priorities and objectives by investing in key actionable and time bound efforts that deliver community services, looks toward the future by addressing climate action goals, and furthers critical needs in the areas of housing, infrastructure, community health and safety and much more. In January of this year, the City Council selected the following 2024 priorities: Economic Development & Transition, Climate Change & Natural Environment – Protection & Adaptation, Housing for Social & Economic Balance, and Community Health, Safety, Wellness & Belonging. After these four Council priorities were selected, the Council adopted 78 specific objectives to advance the priorities in 2025. This clarity and prioritization provides the foundation for the budget strategies contained in the FY 2025 Adopted Budget.

Operating Budget Recommendations by City Service Area

In FY 2024, staffing levels increased by 45.25 FTE for a total authorized staffing of 1,063.10 FTE, which is above pre-pandemic levels. The FY 2025 adopted budget recommends increasing staffing levels by 29.00

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FTE for a total authorized staffing of 1,092.10. The FY 2025 budget funds these positions, enhances organizational resilience and leads innovative services, while balancing financial stability, as outlined by City Service Area:

- **Community & Library Services:** Additional resources to support overnight warming locations (OWL), summer concert series, adult and special interest classes, and the Arts Center. Continues funding resources for extended hours at all 5 branches and numbers of open days per branch, per week at Mitchell Park (7 days), Rinconada (7 days), Children's (6 days), Downtown (5 days), and College Terrace (5 days). Funding City programming and La Comida leasing at the 445 Bryant Street facility, additional staffing and promotion for the Junior Museum and Zoo (JMZ), and establishing dedicated funding for Citywide Special Events and Programming.
- **Public Safety:** Upstaffing Fire Engine 62 at Fire Station #2 to full-service with three sworn firefighter positions, bringing firefighting capacity from four stations to five. Enhancing organizational resilience with an additional Police Lieutenant offset by deletion of a Community Service Officer, reclassification of Property & Evidence Technicians, and realignment of Fire Prevention reporting structure. Additional resources for police and fire equipment replacements and vehicles.
- **Planning, Transportation & Infrastructure:** Supplemental funding to continue Palo Alto Link on an alternative programming and revenue model. Investments in development center staffing to support economic recovery efforts, housing for social and economic balance, and Safe Routes to School. Increasing resources for Sustainability Climate Action Plan (S/CAP) programming, and community awareness and climate implementation outreach. Increasing resources to support capital investments, water Cross Connection Control Program, Advanced Metering Infrastructure (AMI) meter project, and electric grid modernization.
- **Internal Support & Administration:** Maintaining proactive funding of long-term liabilities (pension and retiree medical) at a more conservative calculation for the normal cost (5.3% discount rate) in alignment with the revised Retiree Benefit Policy. Fully funding the adopted labor agreements for all labor groups. Reserving funds for property investments within the City. Supporting organizational resilience with funding for recruitment manager to augment talent recruitment and acquisition, employee childcare pilot program (year 2), management fellow, grants administration, and information technology staffing.

Capital Budget Recommendations

The adopted budget continues progress on the City Council 2014 Infrastructure Plan and additional projects that help advance continued infrastructure replacement, improvements and repairs. The FY 2025 capital budget advances critical projects that furthers innovative services and enhances organizational resilience, while balancing financial stability.

Key investments include:

- 2014 Council Infrastructure Plan projects: completion of the Public Safety Building in Fall 2024, award construction of the Fire Station 4 replacement project
- Regional Water Quality Control Plant (RWQCP) facility upgrades

- Electric Operations office facility improvements
- Contingency plan to fund the Newell Road San Francisquito Creek replacement project
- Park improvements at Cameron, Peers, Ramos, Robles, and Rinconada Parks, El Camino Park turf replacement, Foothills Nature Preserve improvements, Boulware Park update and expansion, and new park restrooms
- Recognizing investments in grade separation projects including Meadow Drive, Charleston Road, and Churchill Avenue, and continuing quiet zone study at Palo Alto Avenue
- Planning for construction costs for train crossing safety improvements (partially funded by Measure K proceeds)
- Improving traffic intersection accessibility and implementing the Automated Traffic Signal Performance Measures (ATSPM) at Embarcadero/E. Bayshore, San Antonio Road/Middle Field, Stanford/Escondido, and Meadow/Cowper.
- Funding construction of the Homekey Palo Alto interim housing
- Completing the Cubberley Gym HVAC system replacement and continuing scheduled roof replacements at the Cubberley Community Center
- Improving 445 Bryant Street facility for activation
- Additional funding for Roth Building Rehabilitation (PF-23001)
- Planning for City Council Chambers technology upgrade
- Upgrading infrastructure for stormwater systems drain pipes, wastewater collection main and treatment systems, and water mains.
- Planning for electric grid modernization and deploy phase 1 pilot of fiber to the premises/dark fiber rebuild

Stakeholder engagement

In May and June, several days of Finance Committee budget hearings, Council discussions, and a Community Budget Informational Session were scheduled to review, discuss, and consider revisions to the Proposed Budget documents before they are adopted by the Council. Community members were involved and joined these discussions to help inform decisions that the City Council considered for adoption. A calendar of these meetings and discussions can be found in the Budget Process and Document section of this budget document.

Changes from the Proposed Budget document to the Adopted Budget document are summarized by department and by fund in the memorandum that recommends approval of the FY 2025 budget adoption ordinance (Staff Report # 2406-3140). This report can be found on the City's website: www.cityof-paloalto.org/City-Hall/City-Council/CouncilAgendas-Minutes under the June 17, 2024 meeting agenda.

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In Closing

While there are continued unknowns and uncertainties ahead, the FY 2025 Adopted Budget offers the Council, City Staff, and the community a sense of optimism as we look forward to 2025. This budget invests in community priorities and continues robust City services that the community expects through balanced conservative fiscal strategies. This budget makes solid progress towards addressing Council's 2024 Priorities and priority objectives. It also enhances organizational resilience, supports innovative services, while balancing financial stability. I look forward to the budget conversations with the City Council and our community over the next several months.

Acknowledgments

I would like to thank the City Council for your leadership and our Executive Leadership Team and the entire staff of the City for providing outstanding services to our community. The Palo Alto community should be proud of your leadership and commitment to service.

A citywide budget requires countless hours of teamwork, collaboration, and patience to produce. I would like to offer special thanks to the dedicated Office of Management and Budget Team - Paul Harper, Kayla Shapiro, Peter Hoang, Naomi Hsu, Katie Lee, Rene Escobar-Mena, Alyssa Ching, Chaitali Paliwal, Kitty Dandan, and Joshua Martinez. This team's dedication, expertise, and willingness to continue to adapt to evolving circumstances is a testament to their commitment to this organization and to the community. I also thank our Executive Leadership Team especially our Department Directors and their teams who worked on the recommendations and materials to respond to the City Council and community priorities and the leadership they have demonstrated in the information contained in these policy documents.

Respectfully Submitted,



Ed Shikada
City Manager

Online Resource to Learn More About the City Budget

Learn about City Council Priorities and Objectives at
www.cityofpaloalto.org/councilpriorities

Join the Budget Conversation at www.cityofpaloalto.org/budget