



April 2018

Honorable Mayor and Members of the City Council:

I am pleased to present this year's proposed FY2019 budget that continues the organization's strong work towards achieving fiscal sustainability. Through the Great Recession and recovery, the City of Hayward has continued to provide quality services and has worked to invest in its future. While the City has taken significant steps towards attaining fiscal sustainability over the last five years, much work remains and we continue to struggle with a structural budget gap driven by increasing costs of operations and the rising costs of labor. Achieving progress during the Great Recession and the subsequent period of slow recovery is a testament to the hard work and dedication of all City employees and the City Council. Hayward continues to see positive economic improvement in many of its key General Fund revenues, such as Property Tax and Sales Tax, but we continue to experience an astronomical rise in employee benefit costs, particularly pension and post-employment healthcare costs. The phased in lowering of the CalPERS discount rate to 7% and modification to the mortality and investment risk assumptions only exacerbate the already steep growth in retirement benefit rates for cities. Unfortunately, CalPERS is likely not done with these types of changes that will make it harder for cities, including Hayward, to fund ongoing operations and services to the communities we serve while also continuing to provide our employees with a sustainable retirement.

This budget is being proposed with limited growth in necessary areas and is "balanced" with the assumed use of \$5.5 million of the General Fund Reserves. This reflects a significant decrease from last year's initial FY 2018 proposed budget, which identified a use of approximately \$10 million of General Fund Reserves. This proposed budget reinstates the one-time reductions that were used in FY 2018 to ultimately balance the budget.

Nevertheless, the structural gap continues to grow in future years absent additional cost cutting measures and expanded or increased sources of revenue. During the October 14, 2017 Fiscal Sustainability Worksession, the Council provided clear direction to address the gap and staff has worked to advance the strategies supported to do so; however, many of the strategies require voter approval or will take additional time for the City to receive the benefiting fiscal impact.

As we struggle to address and resolve the City's ongoing structural deficit, we must also strategically address staffing needs throughout the organization to manage increasing workloads and service requests from our community. Our deferred infrastructure and capital needs, along with our unfunded liabilities like CalPERS, must also be accommodated in both our short and long-range financial planning.

A continuing challenge to balance...

While the FY 2019 General Fund budget is balanced with the reluctant use of General Fund Reserves, achieving even this delicate balance is the result of some difficult choices faced by Council and employees alike. For example, while the City is committed to paying down its unfunded liabilities, the FY 2019 proposed budget includes funding the pay as you go portion of \$3.4 million and an additional \$2.0 million towards the annually required contribution (ARC) amount for retiree healthcare (OPEB) contributions, totaling \$5.4 million in FY 2019 for OPEB payments. Council has provided clear intent to fund the OPEB ARC by phasing it in over the next five fiscal years.



Additionally, while the budget does not contain expenditure reductions, it maintains current service levels and includes limited growth in necessary areas. Given these facts, the City is still struggling to meet the rising costs of doing business and the proposed budget requires a use of \$5.5 million in General Fund Reserves.

While the City certainly faces its financial challenges, the voters of Hayward have been a wonderful partner in our mission to achieve long-term fiscal sustainability. "Measure A," passed in June 2009 and re-approved for 20 years by 73.3% of the voters in June 2016, generates approximately \$16.6 million annually in Utility Users Tax (UUT) funds. This has allowed us to maintain staffing levels in public safety, as well as other critical City services. Absent re-approval, the City would have had an enormous financial gap that would have required drastic and immediate measures (including service reductions) to correct.

The community should take pride in all the successful efforts we have made to effectively utilize the Measure A revenue in a way intended by Council and the voters. Even during the darkest period of the recent Great Recession, we have been able to maintain the same number of sworn personnel as before the recession, in both Fire and Police. We did that while maintaining other essential services, albeit with a reduced staff.

Additionally, Measure C, a 0.5% sales tax add-on, was approved for 20 years by 67.4% of the voters in June 2016. This has generated approximately \$13.5 million a year to fund debt service for the financing and construction of the new Library and Community Learning Center and adjacent plaza, improvements to fire stations, a new fire training center, and the repaving of many City streets, as well as providing funding for increased police and maintenance staffing and services.

While the Great Recession severely impacted cities throughout the nation, the State and more specifically the East Bay have seen healthy economic growth over the past year. The nation as a whole has added nearly 200,000 jobs per month since early 2010 and California job growth leads the nation. California added 19,393 jobs in February 2018; 2.3% greater than the year prior. State unemployment is down to 4.3% and the economy is being driven by increases in construction, healthcare, and consumer spending. East Bay unemployment was 3.3% as of January 2017 and continues to remain lower than the State average.

Nevertheless, despite these encouraging signs, the economy is on the 9th year of its recovery and seems due for a correction based on normal economic cycles. While no economist can definitively predict the next recession, many are forecasting a slowdown around FY 2019, albeit forecasters predict one much less severe than the Great Recession. Additionally, the new Trump administration produces much uncertainty and anxiety for California as its policies are often diametrically opposed to the core values and beliefs the State prides itself on. Of particular concern is the proposed restriction or "clawback" of grant funding for cities that adopt sanctuary city status as it relates to cooperation with Federal immigration officials. While the ability of the Federal government to take this action will likely not stand up on legal grounds, it nevertheless presents cities, like Hayward that value diversity and inclusion, with many challenges and concerns. In reality though, no one truly knows what the current administration will actually do, not even the President's own political party; this poses the greatest anxiety of all. Thus, the City of Hayward needs to prepare itself for the possibility of and work further towards measures that will achieve long-term fiscal sustainability and to prepare to react and respond to actions coming out of Washington.

The City of Hayward has long prided itself on being a lean, efficient, and nimble organization, making the most of the resources entrusted to us. The previous recession forced the organization to make hard choices about which services were provided to the community, and how best to provide them. In addition, our employees were a key element in our financial survival during the Great Recession as they provided significant additional benefit cost sharing

with the City. Through it all, the organization has continued to do more with less, based on a strong ethic of commitment to the community we serve; and to do it with creative energy and an innovative approach.

While the proposed budget reflects the presumed spending plan for FY 2019 in keeping with City Council priorities, there are many unfunded needs not represented in this budget that will impact future funding levels – including critical staffing, capital infrastructure, and technology. The budget does however work towards achieving the goals set forth by the Complete Communities, Complete Streets, and Tennyson Corridor initiatives adopted in 2017. The City also continues to work towards a Safe, Clean, Green, and Thriving community and these initiatives will help to ensure that Hayward is not only an outstanding place to live, work, and play, but also a place that is convenient and accessible to all.

Balancing the budget and staffing resources to meet service demands...

Staffing resources in the General Fund are at 664.1 positions, down from a high in FY 2003 of 773 General Fund positions. Total citywide staffing (inclusive of all operating funds) hit a high of 937 in FY 2003; in FY 2019, 895.3 positions are proposed. This loss of resources did not translate to a reduction in service demands. In fact, the City has enhanced and improved its quality services over the years and is now at a breaking point – particularly as service demands continue to increase. As might be expected, we are a victim of our own success: the more we do, the more that is expected from us. This is a problem we embrace and to which we proudly respond. Even with this positive attitude and deep commitment, we are reaching the breaking point and risk burning out employees.

Nevertheless, we must be mindful that increases to staffing absent additional funding sources only widen the structural budget gap and exponentially increase unfunded liabilities for CalPERS (retirement) and OPEB (retiree medical benefits). The adopted budget has extremely limited staffing growth. The City will continue to be strategic in its staffing decisions as it looks towards fiscal sustainability.

The quest towards long-term fiscal sustainability...

For the past several years, we have worked towards moving away from the use of the reserves to balance the budget; and yet, the proposed budget includes the use of some General Fund Reserves. We continue to make remarkable progress in our elusive quest for fiscal sustainability, but as previously stated, work remains. During FY 2018, we developed a new ten year financial model and identified a number of budget balancing strategies that the Council reviewed and prioritized during the October 2017 work session. We will continue our work implementing these strategies and working with all departments to identify operational efficiencies that can be implemented. While difficult decisions may be necessary, the General Fund Ten-Year Plan clearly demonstrates that we cannot continue to balance the budget with the use of Reserves. At our current pace, projections show the City depleting its reserves by FY 2020.

If we cannot resolve our structural gap over the long-term, future budgets must contain recommendations for service reductions even if the economy holds or continues to improve. It is better to act now when our actions will have greater impact and will not need to be so severe before the City risks fiscal insolvency and has to implement more drastic and emergency measures in the future. No matter how much progress we make in economic recovery, operating expenses, primarily employee benefit costs, continue to grow faster than revenue and will continue to do so for the foreseeable future absent substantive action.

In this struggle to resolve our structural deficit and meet the demands of the future, I want to recognize and be thankful for the leadership and courage of our Mayor and Council. The decisions you have had to make over the last eight or more years have been extremely difficult,

and you met them each with honesty, fairness, and a keen sense of your responsibilities to both the organization and its employees and the community you represent. It is largely through the partnership with our elected officials, our executives and unrepresented employees, and our multiple bargaining groups that the City works every year to close the annual operating deficit in a variety of ways.

I look to a bright future for all of us as we make more progress toward fiscal stability in FY 2019, as well as continuing to improve the quality of services we deliver to Hayward residents and businesses. We must always be mindful of the future and the long-term consequences of our actions today. We will work towards solutions that have meaningful impact together. Hayward is a wonderful community that understands and truly honors the value of diversity in every facet of life. Our municipal organization is committed to the value of being a "family" despite our immediate differences; one that has shown its grit and mettle over the tough years and one that looks to the future with maturity, strength, and a strong commitment to service. Thank you for the honor and the privilege of being your City Manager and leading such a fantastic organization in service to our community.

Sincerely,

A handwritten signature in blue ink, appearing to read "Kelly McAdoo".

Kelly McAdoo
City Manager
ICMA-CM

Attachment: FY 2019 Budget Overview