



DATE: October 29, 2024
TO: Council Budget and Finance Committee
FROM: Director of Finance
SUBJECT:

RECOMMENDATION

That the Committee reviews and receives the high-level overview of varying budget balancing strategies.

SUMMARY

The City of Hayward continues to review and plan for ongoing structural deficits that have led to the use of General Fund reserves over the last two years, and currently projected into the future. In anticipation of a continued need to use reserves to balance the General Fund, the City is reviewing potential fiscal policies to both enhance revenue growth and reduce expenditures. The following report summarizes some general concepts and strategies related to both revenue enhancements and expenditure reductions and realignments.

BACKGROUND

The City of Hayward is currently projecting a budgetary shortfall in General Fund in FY 2025 and the coming years. Over the last two fiscal years the City has had to rely on General Fund reserves to balance the operating budget. Led by strong leadership by Council and conservative fiscal management, the City has not fully realized the use of reserves as projected over the last two years. In an effort to work toward addressing both short-term and long-term fiscal sustainability, staff is exploring best practices, industry standards, and innovative strategies to assist in closing the projected structural budget gap. Staff is also exploring strategies that had been previously implemented by the City during financially challenging times, such as during the great recession, and the Covid-19 pandemic.

In 2017 the City projected a similar use of reserves and held a budget work session held in 2017 for Council to consider potential options to be used to address the projected structural deficit. At that time the City worked with a consultant to build a robust General Fund Long-Range Financial Model, which assisted in a staff lead work session with Council to discuss and receive direction of the exploration and implementation of several budget strategies, including revenue generation and cost reductions. Based on direction from Council, the City explored and implemented several strategies to assist in achieving long-term fiscal sustainability, which included two key voter approved revenue generating measures: 1) an

increase to the City's Real Property Transfer Tax (RPTT) increasing the tax from \$4.50/\$1,000 to \$8.50/\$1,000; and 2) Transient Occupancy Tax (TOT) which allowed the Council to increase the tax from 8.5% up to a maximum of 14%. the City's TOT currently remains set at 8.5%.

The City has faced fiscal challenges before, weathering the storms of the Great Recession, the COVID-19 pandemic, and other periods of economic contraction by employing various strategies that sustained service delivery and fiscal stability. Now, it is essential for the City to stay focused and proactive in addressing both short-term and long-term structural deficits. This requires building on past experiences and exploring innovative solutions to achieve robust fiscal health. In this spirit, staff has developed a comprehensive list of strategies for the Committee's review and consideration.

DISCUSSION

REVENUE ENHANCEMENTS

Many times, in municipal government, taxes and fees serve as the two primary sources of revenue, but differ in purpose, structure, application and adoption. In reviewing and considering revenue enhancements, municipalities will explore adjustments to its taxes and fees.

Taxes

Taxes are mandatory contributions imposed by the local government on residents, businesses, and property owners, typically used to fund essential public services such as policing, fire protection, public education, infrastructure maintenance, and social services. Taxes are not tied to any specific service; instead, they go into the general budget and are used across various functions of the government. They are assessed based on factors like income, property value, sales, or other local criteria, and are usually levied on a recurring basis. Taxes are generally set by voter approval. Taxes are levied by local governments, to generate revenue for public services and infrastructure. Common municipal taxes include, property taxes, sales taxes, business taxes, cannabis taxes, transient occupancy taxes, and utility taxes. In reviewing potential tax revenue generation strategies, the City, like other municipalities, should review existing taxes to ensure full authority is exercised in collection of taxes, and explore potential increases to existing taxes.

Potential Tax Considerations:

Cannabis Tax

Cannabis tax refers to the various taxes imposed on the sale and distribution of cannabis products, which can include cultivation, manufacturing, and retail sales. These taxes vary widely depending on the jurisdiction and can take several forms. In November 2016 the voters of Hayward approved Measure EE authorizing the City to impose a local tax not exceeding fifteen percent of gross sales on recreational and medical cannabis. The tax may be

applied to the cultivation, distribution, manufacturing, business-to-business sales, as well as retail sales. Exercising the full tax could serve as a long-term revenue generating strategy.

Fiscal Impact Range: \$0.7 million – \$0.9 million

Transient Occupancy Taxes (TOT)

TOT, also known as a hotel tax, is imposed on individuals who rent lodging in hotels, motels, and vacation rentals. TOT rates are approved by voters via ballot measure and can vary by jurisdiction. In 2020, voters in Hayward approved an increase in TOT up to 14.5 percent. Executing the full tax could serve as a revenue generating strategy to assist with long-term fiscal sustainability.

Fiscal Impact Range: \$1.0 million - \$1.5 million

Short-Term Rental

Short-term rentals (STRs), such as those listed on platforms like Airbnb, VRBO, and others, have become increasingly popular as alternatives to traditional hotel accommodations. In some municipalities, including cities like Hayward, these rentals may be subject to the TOT. Short-term rental hosts may be required to register with the City or obtain a business license. Challenges may include tracking and enforcement of the collection of TOT from smaller, private rentals. Many cities have specific regulations that require STR hosts to register properties, comply with tax remittance guidelines, and ensure rentals meet certain health and safety standards. Non-compliance can result in penalties or the removal of properties from rental platforms. This potential revenue generating strategy would yield more time to explore the cost benefit analysis of regulatory compliance with revenue generation.

Fiscal Impact Range: Additional analysis needed to calculate potential impact.

Business License Tax

Business license tax is primarily a regulatory tax that allows cities to monitor and regulate businesses within their local jurisdiction prior to opening, and renewed annually. This potential revenue generating strategy would require support from subject matter experts and would yield a potential lengthy and labor-intensive process. Implementing adjustments to the business license tax requires affirmative voter approval. Additional analysis would be required, along with Council approval before consideration of placing a proposed tax adjustment on the voter ballot.

Fiscal Impact Range: \$1.0 million - \$1.5 million

Fees

Fees, on the other hand, are charges imposed on individuals or entities for specific services or privileges provided by the local government. Unlike taxes, which fund general operations, fees are typically designed to cover the cost of particular services such as building permits, garbage collection, recreation programs, or utility usage (water, sewer, etc.). Fees are often

one-time payments or charged as a user-specific service fee, meaning that the individual or business benefiting from the service is directly responsible for covering its cost.

Fees are charged by municipalities for various services provided. Fees include permit, utilities, licenses, developer impact fees, to name a few. The purpose of fees imposed by municipalities are intended to generate revenue to fund local services, cost recovery for services provided, and regulation. In reviewing potential other revenue generation strategies, the City, like other municipalities, can explore and review current or potential new fees.

Potential Fee Considerations:

Developer Impact Fees are designed to mitigate the impact of the new development and local infrastructure. The fees help ensure that the costs of the new growth are borne by the developers rather than existing residents. These fees are calculated via nexus studies that estimate the demand for public services generated by the development and land use type. Common types include Traffic, Public Facility, Parks and Recreation, Public Safety, and Water and Sewer Impact Fees. The City of Hayward currently has a Park Impact Fee adopted in December of 2019 and Traffic Impact Fee adopted in July of 2022.

Fiscal Impact Range: Additional resources needed to calculate potential impact.

Fees for Public Art

Fees for public art may be instituted through a framework that establishes collecting funds that will support public art projects. This can involve charging developers or businesses a fee specifically designated for the creation, installation, and maintenance of public art. The fee can be structured in various ways depending on the goals of the city, local regulations, and the scale of the art projects, including percentage of building permit or construction valuation, impact fees or voluntary contributions and endowments.

With interest in developing a public art program, establishing a public art fee could help defray potential impacts to the General Fund, while also providing a community benefit. While this fee may not have an impact on the current General Fund bottom line, identifying a potential funding source for a new program is essential to ensure sustainability and minimize continued expenditure growth in the General Fund.

Fiscal Impact Range: Additional analysis is needed to calculate potential impact.

Potential One-Time Revenues

The City of Hayward currently has a policy for the Use of One-Time Revenue. This policy states, if the City's General Fund is not within the policy noted in the Reserves Policy, which requires 20 percent of General Fund operating revenues, then any one-time revenue would be allocated to replenish reserves until the reserves policy requirement is met. Current opportunities for one-time revenue proceeds are the following:

Sales Proceeds from Caltrans Route 238 Properties

In 2016, the City acquired properties from Caltrans within and along the boundary of the City of Hayward. Since 2016, several properties have been sold for commercial and housing development. These funds have not been appropriated and remain in a separate account from the City's General Fund.

Fiscal Impact Range: \$5.0 million - \$7.0 million

American Rescue Plan Act (ARPA)

The City received federal stimulus funding, ARPA funding, in response to recovery efforts related to the pandemic. Under federal guidelines, all ARPA dollars must be either spent or obligated December 31, 2024. Any unobligated dollars could be appropriated to the General Fund to account for the calculated lost revenue experienced during the pandemic. While some funds were previously appropriated to the General Fund for this use, there remains capacity to appropriate additional ARPA dollars to account for lost revenue experienced during this economic downturn.

Fiscal Impact: \$3.6 million

Other potential revenue could include auditing existing revenue streams to ensure full compliance with existing regulations and taxes such as business license, TOT, UUT and cannabis operations. Ongoing community development including new housing, business, and retail establishments increase both property and sales tax long-term.

EXPENDITURE CONTROL AND REDUCTION

While the City of Hayward has implemented varying cost reduction strategies in the past, which include common practices amongst municipalities, not all strategies are the best solution for every organization. Some strategies to explore include: cost control and prioritization of spending (i.e. essential services and program evaluation).

Cost Control

Cost control strategies can assist in reducing structural budget deficits both in short-term and long-term approaches. Among the strategies contemplated in this report are:

- Working to identify potential short-term personnel reduction;
- Seeking potential operational efficiencies;
- Considering consolidation of services; and
- Reduction of capital project subsidies.

While expenditure reduction strategies can assist in closing structural budget deficits, these types of strategies may also be challenging to implement and could have significant impacts on services, staff retention/attraction and morale.

Personnel Costs Strategies

Personnel costs are the single largest annual expenditure in municipal government. As service organizations, it is expected that the largest cost of an organization is attributed to staff who provide services to the community. Some short-term personnel cost saving measures often implemented by local jurisdictions include the following:

Hiring Freezes: These short term “freezes” are one time cost saving measures for budgeted positions. Savings can positively impact the bottom line. While one time in nature, hiring freezes can impact service delivery. Given the operational needs of the organization, the duration of hiring freezes can negatively impact the City’s ability to maintain adequate service levels and have significant impact on staff morale depending on length of time for the “freeze”. For depiction, the potential fiscal impact is based on a three-month hiring freeze beyond what is already estimated in the City budgets for salary savings related to vacant positions that happen organically through attrition throughout the normal course of a year. Analysis of a hiring freeze policies should be considered to better understand potential service deliver impacts.

Fiscal Impact Range: \$3.6 million

Reduction in Overtime: Develop and institute policy related to overtime usage. While establishing an overtime policy may yield expenditure savings, there are potential challenges with this strategy, including maintaining staffing minimum staffing levels, service demands, impacts related to vacancies, and operational needs. Analysis of establishing an overtime policy should be explored to understand potential operational impacts and staff morale and retention.

Fiscal Impact Range: Additional analysis needed to calculate potential impacts.

Reduce General Fund Subsidy to Capital Projects

Institute an annual General Fund subsidy cap to fund capital projects as opposed to funding on as needed basis. The City can implement a maximum allowable annually to fund capital projects that rely on the General Fund as a primary funding source. Increase in leveraging other resources, such as federal, state, and local grant fund opportunities, and special revenue funds to capital needs.

While the capital infrastructure is vital to communities, organizations must recognize and live within its means before jeopardizing operational and service needs of the community. This may require prioritization or re-prioritization of capital projects each year based on funding availability and a reduction in support from the General Fund.

While reduction of General Fund support to capital projects can aid in balancing the General Fund, this strategy is not without flaws. The potential consequences and outcomes with the deferral of capital expenditure can negatively impact already aging infrastructure and vehicles replacement that allow the City to provide services to the community. Additionally, the deferment of capital expenditures to achieve immediate savings could have the potential to

cost more in the future, as the costs of construction, equipment, and supplies only increase over time. While this strategy may yield immediate positive impacts to the General Fund bottom line, the consequences of deferring capital expenses will not go without potential negative side effects and should be carefully considered before implementation.

Fiscal Impact Range: \$0.5 million to \$2 million

Prioritization of Spending

Essential Services

Operating costs for the General Fund are often tied to programs and services that serve communities. These programs often make up the core services that the City provides and range from public safety emergency response to building maintenance, library programming and financial reporting. A comprehensive approach to long-term sustainable fiscal planning would require an evaluation of those core services and a potential priority-based budgeting approach.

Priority based budgeting may help the organization allocate current resources based on priorities and goals rather than funding programs and departments at existing levels. This type of evaluation can be time consuming, data intensive, and require significant organizational change. While this may be an approach the City considers in the future, it is not a feasible strategies to address the City's current fiscal position.

Program Evaluation

Regular assessment of the effectiveness of programs and services to determine which can be scaled back or eliminated can assist in prioritizing spending and controlling costs. Evaluation of existing programs and services is a feasible approach to addressing current financial shortfalls. This approach would include collaborating with departments to evaluate operating budgets at the programmatic level.

In addition, evaluation of discretionary budgets is a strategy that can be implemented to defer or reduce discretionary purchases for a specified period of time. Examples of deferring or reducing discretionary purchases, include, but not limited to the following areas:

- Limit travel for conferences and trainings;
- Evaluate and reduce the need for consultant services;
- Review and reduce office supplies and materials; and
- Evaluate and reduce non-essential service levels.

While department operational needs vary from one another, it is important to evaluate programs and discretionary purchases with an equitable lens. Establishing clear definitions and criteria to evaluate programs and discretionary purchases will guide departments in the review and evaluation process. Whether a dollar reduction threshold is set, or a percent reduction is defined, this process can yield annual expenditure savings.

ECONOMIC IMPACT

There is no economic impact associated with this report as it is informational only.

FISCAL IMPACT

There is no fiscal impact associated with this report; however

PUBLIC CONTACT

The agenda for this item was posted in compliance with the California Brown Act.

NEXT STEPS

Staff will continue to evaluate the City’s General Fund and update the General Fund Model based on the FY 2024 outcomes and current market conditions. The strategies presented to the Committee will be provided to the full Council at an upcoming meeting for review and consideration.

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