



June 2020

Honorable Mayor and Members of the City Council:

I present this FY 2021 budget to you under vastly different circumstances than we all imagined just a few short months ago. I am grateful to our Finance Department team for their flexibility and ability to pivot quickly this spring to change all prior assumptions regarding next year's budget. This budget presents some difficult choices and mostly one-time solutions to what are unprecedented circumstances.

The City, as with many other agencies both large and small, is facing a tremendous challenge in FY 2021. The impacts of the COVID-19 pandemic are not entirely known, but what is known is that there have been a historic number of unemployment claims and entire industries have, at least temporarily, shut down. This will likely result in a continued economic downturn and ultimately a recession that will make the City's financial outlook even more tenuous. It is my hope, and assuredly the hope of Council, that this is a very brief and shallow downturn. Given that the local and national economies have seen historic growth and have not seen a recession period in over 10 years, it is hard to think that this will not be the case in the near term. The real question is how deep it will go and how long it will last. As you are all aware, the City took immediate action this spring to reduce and control expenses. The proposal put forth in this document continues and expands upon many of these strategies. I am committed to stabilizing the City's fiscal position after a significant use of reserves in FY 2020 to sustain the community and organization through the pandemic and during the State's and County's shelter in place order. While the proposal presented in this document does include a relatively small use of reserves, it is my hope that the economic impacts faced by the City will not be as severe as expected.

The City's General Fund entered FY 2020 with reserves of \$36.9 million; this amount equated to approximately 19.7% of budgeted expenditures in the General Fund. During the final months of FY 2020, however, the City is projecting to use approximately \$11.8 million in reserves due to reductions in many key revenue sources while continuing to provide services to the community and organizational stability. During the Great Recession of 2008-2011, the City was able to weather the storm while maintaining a high level and quality of services, through organizational strength, partnerships with our employee groups, and innovation. While there are few remaining visible signs of the Great Recession, the City still struggles with a minor structural budget gap. Closing this gap has been challenging year after year as the City works to reduce its unfunded liabilities, meet ongoing service demands, address its capital needs, and appropriately address emerging needs. While slowing a bit, Hayward had continued 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 considerable growth in employee benefit costs, particularly pension and post-employment healthcare costs. The phased in lowering of the CalPERS discount rate to 7% and modifications to the mortality and investment risk assumptions only exacerbate the already steep growth in retirement benefit costs for cities. Further negative cost impacts based on recent performance of the pension fund are anticipated in the coming fiscal years. The City is also working to address emerging needs that were not previously a significant part of our operations such as the increasing demands on the organization and community to serve and support our increasing homeless



population and addressing the housing crisis. While there are some resources available from outside funding sources, this funding is not nearly enough to entirely address the additional need.

This budget is being proposed with strategic reductions in areas of personnel expenses and community programs. While these strategies have allowed us to narrow the structural budget gap, the City projects a shortfall of approximately \$1.2 million. This budget is "balanced" with the assumed use of \$1.2 million of the General Fund Reserves. Last year's initial FY 2020 proposed budget identified building General Fund reserves by \$0.9 million. We instead anticipate ending FY 2020 with a use of \$11.8 million of General Fund reserves.

Future years continue to project significant structural budget gaps, primarily attributed to current economic uncertainty. As we continue to work 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 emerging needs in our community. Our deferred infrastructure and capital needs, along with our unfunded liabilities like CalPERS and Other Post Employment Benefits (OPEB/Retiree Medical), must also be accommodated in both our short and long-range financial planning.

**A continuing challenge to balance...**

While the FY 2021 General Fund budget is balanced with the reluctant use of a small amount 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 2021 proposed budget includes funding our annually required contribution (ARC) amount for retiree healthcare (OPEB) contributions but not at the level originally anticipated or necessary to manage the City's long term liabilities. The FY 2021 ARC is estimated at \$8.5 million yet this budget only proposes to fund \$4.5 million of this amount, \$3.5 million toward the pay as you go portion (benefits being paid out to current retirees) and an additional \$1 million towards the unfunded liability amount. Council has provided clear intent to fund the OPEB ARC by phasing it in over the next five fiscal years and the City still intends to phase in full funding of the ARC annually by FY 2022 of the long range financial forecast.

Additionally, this budget contains a number of expenditure reductions, which may impact service levels to the community.

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 that are entirely locally controlled. This has allowed us to maintain staffing levels in public safety, as well as other critical City services. Absent re-approval in 2016, 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% local sales tax add-on, was approved for 20 years by 67.4% of the voters in June 2014. This has generated approximately \$15.4 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.

In the November 2018 election, the voters of Hayward again expressed their support for preserving City services by approving Measure T, which increased the City's Real Property Transfer Tax with a positive impact on the General Fund estimated between \$5.5 and \$7.0 million annually. This increase will allow the City to maintain services and work towards addressing the demands of the developing Hayward community.

We wouldn't be able to weather the impacts of the current economic climate without these locally approved revenue measures. The impacts of the COVID-19 pandemic have severely impacted many industries, resulting in an unprecedented number of unemployment claims. Recently released, the nation as a whole currently has a 13.3% unemployment rate, presenting 21.0 million unemployed persons. As of April 2020, California has a current unemployment rate of 16.1%; representing almost 3.0 million unemployed persons. Alameda County unemployment was at 14.1% as of April 2020.

While no economist can definitively predict the depth or length of the expected recession, many expect it to last through FY 2021, albeit forecasters predict one less severe than the Great Recession. Additionally, the current political climate produces much uncertainty and anxiety for California as current Federal policies are often diametrically opposed to the core values and beliefs this State has supported.

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. The current financial situation is forcing the City to again make some very tough decisions, including negotiated employee concessions, a significant hiring freeze, reductions in supplies and services, proposed program service reductions, and a deferral of contributions to unfunded liabilities and capital contributions. We have also relied on strong partnerships with our employees who have continued to contribute more towards the costs of their benefits to allow the City to preserve vital services for our community. I am grateful to the employee groups that have stepped up to provide concessions that will help us work to balance our FY 2021 budget. Through it all, I know that this organization will continue 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.

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

Staffing resources in the General Fund are proposed at 658.6 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 2021, 892.8 total citywide positions are proposed.

We must continue to be mindful that increases to staffing absent additional funding sources only widens the structural budget gap and exponentially increases unfunded liabilities for CalPERS (retirement) and OPEB (retiree medical benefits). The proposed budget includes a

decrease in staffing, primarily related to program reductions. 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, the City has been effective in implementing strategies to avoid the ongoing use of General Fund reserves to fund operations. FY 2020 is projecting a significant use of General Fund reserves. It will take the City time to rebuild and restore adequate reserves to provide stability should another catastrophic event take place, presenting an immediate need for funds to stabilize the community. I am confident that, through the continued partnership between staff and Council, we can weather this storm and work back to a place of consistently building towards adequate reserves. 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 an October 2017 work session. In FY 2019, the City worked to implement many of the strategies Council identified to improve fiscal sustainability including successful labor negotiations with all labor groups to achieve annual savings over projected amounts, going to the voters to ask for an increase in the City's Real Property Tax Rate from \$4.50/\$1,000 of valuation to \$8.50/\$1,000 of valuation, and an update to the City's cost allocation plan. We will continue our work to implement additional balancing strategies and work 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.

If we cannot resolve our structural gap over the long-term, future budgets must contain recommendations for service reductions even as the economy improves. It is better to act now when our actions will have greater impact and will not need to be as severe. We need to take these steps long 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 through the COVID-19 pandemic 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 balance the budget in a variety of ways.

I look to a bright future for all of us as we recover and work our way back toward fiscal stability in FY 2021, as well as continuing to provide core 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 through 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 2021 Budget Overview