



DATE: February 4, 2025
TO: Mayor and City Council
FROM: Director of Finance
SUBJECT: City of Hayward Budget: General Fund Budget Work Session

RECOMMENDATION

That City Council receives the presentation and overview of the updated General Fund fiscal outlook and potential strategies that could be implemented to assist in closing the projected structural deficit.

SUMMARY

Over the last several months, staff has updated the General Fund Long Range Model (model) to include both expenditure changes, and updated revenue projections since the time of adoption of the fiscal year (FY) 2024-2025 Operating Budget in June 2024.

The updated model reflects General Fund FY 2023-2024 year-end actuals, analysis of revenue trends and projections, and the impacts of recently approved employee labor contracts. With projected use of General Fund reserves over the next several upcoming fiscal years, this report also provides an overview of potential budget balancing strategies that could be explored to assist in achieving short-term and long-term fiscal sustainability.

BACKGROUND

On October 3, 2017¹, Management Partners (currently Baker Tilly) presented the Model to the City Council at a work session. The presentation provided a brief overview of the project objectives and key assumptions built into the Model. Management Partners provided a demonstration of the capabilities and flexibilities of the Model by running a variety of hypothetical scenarios to illustrate the long-term fiscal implication of policy decisions. Following the October 3, 2017, work session, the City held a fiscal sustainability work session on October 14, 2017², where the City Council was again presented with the Model, as well as strategies and options for revenue generation, cost shifting, expenditure controls, and changes

¹ [Hayward City Council Meeting October 3, 2017 \(www.legistar.com\)](http://www.legistar.com)

² [Hayward City Council Meeting October 14, 2017 \(www.legistar.com\)](http://www.legistar.com)

to service provisions to assist in closing the City's long-term structural budget gap. City Council supported exploration of options from all categories except for reductions to the provision of services. Several of the supported options were explored by staff and implemented, including increasing the City's real property transfer tax (RPTT), and transient occupancy tax (TOT).

In 2023, staff began working with Baker Tilly to update the Model by reviewing both revenue and expenditure assumptions to ensure congruence with current economic trends. On February 6, 2024³, staff held a budget work session with City Council to review the updated model and assumptions, including an overview of the City's fiscal outlook.

On October 29, 2024⁴, staff presented an informational report to the City Council Budget and Finance Committee with an overview of potential General Fund budget balancing strategies.

DISCUSSION

General Fund Year-End 2023-2024 Update (unaudited)

The City closed FY 2023- 2024 in September 2024. Staff continues to work with the City's external auditors to finalize the Annual Comprehensive Financial Report.

At the close of the fiscal year, the City projected revenues of \$217.1 million, and expenditures totaling \$216.2 million. As a result, the City ended the fiscal year building the General Fund Reserves by \$0.9 million. This is a significant improvement over what was projected during the FY 2023-2024 mid-year review process, which projected a use of General Fund Reserves in the amount of \$12.5 million. There are several factors contributing to the significant change in projection.

At the time of the mid-year review process, the City estimated that revenues for FY 2023-2024 would total \$210 million. Year-end revenues totaled \$217.1 million, a significant improvement over the previous projection. Key revenue sources driving the net increase of \$7.1 million were related to an increase in property tax of \$3.7 million, which includes new construction; and an increase in utility user tax (UUT) of \$3.4 million. The City continues to realize significant growth in this key revenue source.

Another component that impacted the change in projected year-end balance is related to how the City accounted for the \$8.6 million loan made to the Hayward Economic Development Corporation (HEDC). When the City issued the loan, it initially accounted for it as an operating expense rather than a loan receivable. Upon direction of the City's external auditors, the loan was reclassified and recorded as a loan receivable (asset), representing the amount of future economic benefits (i.e., cash inflows from loan repayments). While the loan receivable is considered an asset on the City's financial report, and will be paid back over time, the loan receivable is not available as cash on hand to pay for current operational expenses.

³ [Hayward City Council Meeting February 6, 2024 \(www.legistar.com\)](http://www.legistar.com)

⁴ [Hayward Council Budget and Finance Committee Meeting October 29, 2024 \(www.legistar.com\)](http://www.legistar.com)

At the start of FY 2023-2024, the City had a beginning balance of \$43.9 million. Based on year-end FY 2023-2024, the City is estimated to build the reserves by \$0.9 million, bringing the FY 2024 ending balance to \$44.9 million, or 20.8% reserve balance. Based on these estimates, the City met its reserve balance policy.

Forecast Updates Since FY 2024-2025 Adopted

While the City ended FY 2023-2024 in a net positive position, future years continue to project use of General Fund Reserves.

At the time of the FY 2024-2025 budget adoption, the City projected a beginning fund balance of \$29.4 million. Given the net positive year-end outcome of FY 2023-2024, resulting from improved revenue performance and the reclassification of the loan to the HEDC, the revised FY 2024-2025 beginning fund balance is \$44.9 million.

Five-Year Long Range Financial Model Updates:

Since the FY 2024-2025 budget adoption, the City’s financial outlook has changed due to a number of factors, including improved projected revenue, incorporation of approved employee labor contracts, and changes in the accounting of the HEDC loan.

Table 1: Five-Year General Fund Model Updated

GENERAL FUND FORECAST FY 2025 Revised \$ in thousands	FY 2024 Actuals (Unaudited)	FY 2025 Adopted Year 1	FY 2025 Revised Year 1	FY 2026 Forecast Year 2	FY 2027 Forecast Year 3	FY 2028 Forecast Year 4	FY 2029 Forecast Year 5
Revenues	\$217,093	\$216,360	\$220,062	\$226,668	\$229,769	\$235,701	\$241,546
ARPA (one-time revenue)			\$4,005				
Expenditures	\$216,154	\$218,168	\$227,348	\$232,876	\$238,696	\$242,595	\$248,643
Net Change in Reserve - Surplus / (Shortfall)	\$940	(\$1,808)	(\$3,281)	(\$6,208)	(\$8,928)	(\$6,894)	(\$7,098)
Beginning Balance	\$43,987	\$29,428	\$44,927	\$41,646	\$35,438	\$26,510	\$19,616
Ending Balance	\$44,927	\$27,620	\$41,646	\$35,438	\$26,510	\$19,616	\$12,517
Reserve Balance as % of Expenditures	20.8%	12.7%	18.3%	15.2%	11.1%	8.1%	5.0%

Significant Changes:

Revenue

In FY 2024, the City’s property tax revenue increased over the mid-year review projection due to a number of factors, including the increase in new construction coming online. Beginning in FY 2023 and continuing in FY 2024 the City’s utility user tax (UUT) continues to exceed estimated projections. Given the continued trending and analysis from the City’s tax consultant for UUT, the City has updated FY 2024-2025 and out-year revenue projections. Prior to FY 2023, UUT brought in an average of \$18 million annually. Beginning in FY 2023, the City received \$25.9 million in UUT revenue, and \$24.5 million in FY 2024. Moving forward, the City is projected to collect on average \$28.4 million annually over the next five years.

The FY 2024-2025 revised budget reflects a total revenue projection of \$224.1 million; an increase of \$3.7 million City tax revenue, and \$4.0 million in one-time revenue from ARPA to account for lost revenue during the pandemic

Expenditures

Additionally, the FY 2024-2025 revised budget incorporates ratified employee labor contracts, and changes in CalPERS costs related to the annually required contribution to the unfunded actuarial liability for all plans.

The FY 2024-2025 revised budget reflects total expenditures of \$227.3 million; an increase of \$9.1 million, which includes all approved employee labor contracts and changes to CalPERS annually required contributions.

Projected Fund Balance

Incorporating changes in revenue projections and updated expenditures, the FY 2024-2025 Revised budget projects a use of General Fund Reserves of \$3.3 million, with a projected ending balance of \$41.6 million, representing an 18.3% reserve balance.

While the City's financial outlook has seen notable improvement, projections still include continued projected use of General Fund Reserves, which will further diminish the reserve balance. The City remains committed to achieving long-term fiscal sustainability through a range of budget-balancing strategies, collaborative partnerships, and the continued leadership and direction of the City Council.

Budget Balancing Strategies

The City of Hayward is projecting a budgetary shortfall in the General Fund for FY 2024-2025 and beyond. While prior projections anticipated reliance on General Fund reserves to balance the operating budget over the last two fiscal years, the City has avoided drawing down reserves thanks to strong Council leadership and fiscal management. To address both short-term and long-term fiscal challenges, staff is evaluating best practices, industry standards, and innovative strategies, as well as revisiting measures implemented during past financial challenges, such as the Great Recession and the COVID-19 pandemic.

The budget balancing strategies discussed in this memo were presented and discussed with the City Council Budget and Finance Committee (Committee) in October 2024. The Committee provided feedback and support for a number presented General Fund budget balancing strategies that primarily fell under two primary categories, (1) revenue enhancements and (2) expenditure control and reductions.

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. There is also a consideration of potential one-time revenues that can be explored.

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, infrastructure maintenance, and other municipal 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.

Five (5) Potential Tax Considerations:

1. **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 15 percent (15%) 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*
2. **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 (14.5%). Executing the full tax could serve as a revenue generating strategy to assist with long-term fiscal sustainability. *Fiscal Impact Range: \$1 million - \$1.5 million*
3. **Half-Cent Sales Tax (Measure C/K1):** Half-Cent Sales can be transferred to the General Fund to defray operating expenses for provided services, such as public safety and maintenance services. The amount could vary based on available fund in conjunction in capital infrastructure funding needs. *Fiscal Impact Range: \$1 million - \$3 million*
4. **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. The City of Hayward is

potentially missing out on significant revenue, as many STR hosts currently operate without registration or tax remittance. *Fiscal Impact Range: \$0.4 million - \$0.6 million*

5. 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 City Council approval before consideration of placing a proposed tax adjustment on the voter ballot. *Fiscal Impact Range: \$1 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 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. The purpose of fees imposed by municipalities are intended to generate revenue to fund local services, cost recovery for services provided, and regulation. The City should consider a comprehensive review of its Master Fee Schedule.

Potential Fee Considerations: Additional analysis needed to calculate potential impacts.

Potential One-Time Revenues

The City of Hayward has a policy governing the use of one-time revenue. According to this policy, if the General Fund reserves fall below the 20 percent (20%) threshold of operating revenues, as outlined in the Reserves Policy, any one-time revenue must be allocated to replenish reserves until the required level is achieved. Current opportunities for one-time revenue proceeds may include the 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 million*

EXPENDITURE CONTROL AND REDUCTION

The City of Hayward has implemented varying cost reduction strategies in the past, which include common practices amongst municipalities. Some strategies to explore include:

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:

- Seeking potential operational efficiencies;
- Considering consolidation of services;
- Reducing capital project subsidies; and
- Identifying potential short-term personnel adjustments.

While expenditure reduction strategies can contribute to closing structural budget deficits, these types of strategies may also be at times challenging to implement; and, when not approached correctly could have significant impacts on services, staff retention/attraction and morale. It is an important tool to reset a prioritized approach to core and essential services that builds on staff collaboration and innovation.

Operational Efficiencies and Program Consolidation

Core 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 City 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 strategy to address the City's current fiscal position in the short-term, but could be implemented overtime to reduce projected structural deficits.

Program Evaluation

Staff will continue with efforts to regularly assess the effectiveness of programs and services to determine which can be scaled back or eliminated and assist in prioritizing spending and controlling costs. Evaluation of existing programs and services is a feasible approach that is a common practice of the City to address current financial shortfalls. This continued approach includes collaborating with departments to evaluate operating budgets at the programmatic level.

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

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, the City 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*

Personnel Costs Strategies

Personnel costs are the single largest annual expenditure in municipal government. As public service local government, it is expected that the largest cost of a city 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: \$3.6 million*

- Management of Use of 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.*

STRATEGIC ROADMAP

This is a routine operational item and does not relate to any of the priorities outlined in the Council's Strategic Roadmap.

FISCAL IMPACT

This is an informational report. Implementation of budget balancing strategies could positively impact the City's current and long-term fiscal position.

PUBLIC CONTACT

This staff report was posted in accordance with all requirements outlined in the Brown Act.

NEXT STEPS

During the budget work session staff will elicit City Council's feedback on specified strategies. City Council's feedback will be further explored in the consideration of drafting a staff recommendation for future City Council action tentatively scheduled for February 25, 2025.

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