



May 3, 2016

Honorable Mayor and Members of the City Council:

As a result of prudent and difficult policy decisions, support from the City's dedicated employees and the Hayward community, and assistance from a recovering economy, the City of Hayward is better positioned than it has been in recent years to continue providing quality services and investing in our future. It is with appreciation for all involved that I respectfully submit to you for your consideration the City Manager's Proposed fiscal year (FY) 2017 Operating Budget.

The bold steps taken over the last several years by Council have substantially decreased the \$30 million General Fund deficit originally projected in 2011. While the City has made great strides in establishing fiscal sustainability, we do continue to struggle with a structural gap driven by increasing costs of operation, primarily the cost of labor. This budget is balanced with the assumed use of \$4.5 million of the General Fund Reserve. The structural gap grows in future years absent additional cost cutting measures or expanded or increased sources of revenue.

Achieving progress during this recent time of fiscal adversity is a testament to the grit and dedication of City employees and City Council. Hayward has seen positive economic improvement in many of its key General Fund revenues, such as Property Tax. At the same time, we continue to experience an astronomical rise in employee benefit costs, particularly pension and healthcare costs.

As we struggle to address and resolve this reoccurring structural deficit, we must also address staffing needs throughout the organization to manage the workload. Our deferred infrastructure and capital needs, along with our unfunded liabilities like CalPERS, must be accommodated in our short and long-range financial planning.

The next two months will include several Council budget work sessions (including a special all-day Saturday work session on May 21, 2016) and a public hearing on June 21. This Public Hearing will allow City Council, employees, and the public an opportunity to review and comment on the proposed FY 2017 funding levels for City programs and services; and to understand the alternatives and their respective impacts prior to Council adopting the budget on June 28, 2016.

A challenge to balance...

While the FY 2017 General Fund budget is balanced with the reluctant use of the General Fund Reserve, achieving even this tenuous balance is the result of some difficult choices and assumptions. For example, while the proposed budget allocates funding toward the City's Retiree Medical liabilities, it is at a lower level than originally intended and does not allocate funding toward the unfunded liability component of this benefit. The budget does not contain any service or resource reductions; however, it just barely maintains current service levels – even with minimal resource increases. The intent of the budget balancing decisions these last six years has been to allow time to work toward a budget that is structurally balanced while maintaining service levels to

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the community. Both Council and staff are committed to continuing the evolution of a long-term plan to permanently address our unfunded liabilities and pressing capital needs.

The voters of Hayward have been instrumental in helping us cope with the challenge of maintaining service levels in a resource-constrained environment. “Measure A”, passed in June 2009, generates about \$16.5 million in annual Utility Users Tax funds, which have allowed us to maintain staffing levels in public safety, as well as other critical City services. However, it remains imperative that we recognize that should the Hayward voters choose not to renew the Utility Users Tax before it expires in 2019, we will have an enormous and unsurmountable financial gap.

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, both Fire and Police. We did that while maintaining other essential services, albeit with a reduced staff, and while adding police services such as bike patrols in the Downtown and on Tennyson Ave. We will be able to continue doing this even with the unanticipated enormous increases in employee benefit costs affecting us now and into the future; all thanks to Measure A revenue.

The more recently approved “Measure C” will generate about \$13.5 million a year for the next twenty years 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 roads, as well as providing funding for increased police and maintenance services.

Several other courageous cities in California have been dealing with the same issues created by the unprecedented and unpredicted economic recession, layered with an unimaginable growth in employee benefit costs. In many cases, the progressive stages of meeting the financial challenge have been all too similar:

- (1) reduce over-all operating costs and stretch existing dollars;
- (2) increase the employees’ share of benefit costs while retaining and attracting quality employees, and protecting robust benefits for employee attraction and retention – or reducing benefits to employees overall;
- (3) explore innovative ways to fund and construct service delivery models; and
- (4) reduce or eliminate services.

We have accomplished all possibilities in step one. We are continuously working, and making gradual progress, on step two to protect our benefit package while asking employees to share more of the cost. We are midway into step three. And, even in FY 2017, we continue to struggle to avoid step four – although it is quite possible we will need to take this step soon if Measure A is not renewed, another major recession occurs, or we cannot get “ends to meet” and eliminate our ongoing structural deficit.

The City of Hayward has long prided itself in 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. 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 2017 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 need for increased staffing resources to meet service demands...

Staffing resources over the last twelve years have shrunk by twenty percent in the General Fund from a high in FY 2003 of 773 General Fund positions and total citywide staffing (inclusive of all operating funds) of 937. 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 increase. As might be expected, we are a victim of our own success: the more we do, the more 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.

In order to prevent total employee burn-out and to meet essential service delivery demands, this budget includes limited additional staffing resources in sensitive areas. If we do not take the risk to add this staff now, the only other alternative is to eliminate some service areas in order to protect other, more critical areas. Adding positions is a difficult decision given our budget challenges and the rising cost of employee benefits; however, it is absolutely necessary to address expanding workload and increasing service level expectations. In addition, we want to honor our labor agreements and to be judicious and transparent about our analysis of what work needs to be done in-house and what needs to be contracted out. A high-performing organization runs most effectively on a delicate balance of these factors based on sound analysis of the applicable finances and needs of the organization.

A slowly recovering budget...

Last year, I indicated that I could no longer recommend use of the reserves to balance the budget; and yet, this budget proposes to use some General Fund Reserve. We are making remarkable progress in our elusive quest for fiscal sustainability: City employees have assumed a greater burden of their benefit costs; Council has adopted key financial policies to provide the framework for stability; and Council has also focused on managing the City's benefit liabilities. Council has also provided clear priorities that allow me to manage the organization's limited resources in a focused and highly productive manner. However, 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 2019.

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. 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 at least the next six to ten years. At that point, we will begin to see some recognizable benefit from the changes in the CalPERS system.

While CalPERS has finally implemented long-overdue policies and procedures that help stabilize the fund and provide it with a more positive and less volatile future, these changes continue to heavily impact the members of the system, driving our costs up higher and faster than we could possibly have predicted. In the future, these changes will benefit everyone. In the near term, they create an almost unmanageable financial burden for member organizations like the City of Hayward. Healthcare costs also show no sign of slowing and continue to rise at a double digit rate.

In this struggle to resolve our structural deficit and meet the demands of the future, I am compelled to recognize and be thankful for the leadership and courage of our Mayor and Council. The decisions you all have had to make over the last seven 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 of our elected officials, our executives and unrepresented

employees, and our multiple bargaining groups that the City is able to close the structural deficit even to the tenuous degree reflected in this budget.

I look to a bright future for all of us as we make more progress toward fiscal stability in FY 2017, as well as continuing to improve in the quality of services we deliver to Hayward residents and businesses. Hayward is a wonderful community that understands and honors the value of culture, race, and lifestyle diversity. Our municipal organization is one of "family", despite our immediate differences; one that has shown its grit and mettle over the last tough years; and one that looks to the future with maturity and strength. Thank you for the honor and the privilege of being your City Manager and leading such an organization in service to our community.

Sincerely,

A handwritten signature in black ink, appearing to read 'Fran David', with a stylized flourish at the end.

Fran David
City Manager
ICMA-CM

Attachment: FY 2017 Budget Overview