



May 9, 2017

Honorable Mayor and Members of the City Council:

Like most cities throughout the nation, Hayward has been forced to deal with the lingering impacts of the Great Recession that started in December 2007 and lasted until June 2009. Nevertheless, due to prudent and difficult policy decisions, continued support from the City's dedicated employees and the Hayward community, and assistance from a recovering economy, the City of Hayward has continued to provide quality services and has worked to invest in its future. Thus, with great appreciation for all involved, I respectfully submit to you for your consideration the City Manager's Proposed fiscal year (FY) 2018 Operating Budget; a budget built on the priorities of providing a Safe, Clean, Green, and Thriving community and my first as Hayward's new City Manager.

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, primarily relating to the rising costs of labor. This budget is largely a status quo fiscal plan with limited growth in necessary areas and is "balanced" with the assumed use of \$10.4 million of the General Fund Reserve (unless the Council adopts one-time balancing measures to prevent the use of reserves as part of the final adopted budget). Nevertheless, the structural gap continues to grow in future years absent additional cost cutting measures and expanded or increased sources of revenue. As such, the City is collaborating with a consulting firm, Management Partners, to develop an enhanced and refined forecasting model that will allow for the quick modification of key cost and revenue drivers and the testing of measures to achieve fiscal sustainability. This model is expected to be completed in the next few months and we anticipate that it will continue to show an increasing structural deficit. Additionally, Management Partners will prepare a report that includes an analysis and recommendations of measures the Council can consider to reduce or eliminate the General Fund structural deficit over the coming fiscal years. This report will present various combinations of recommended strategies that will include revenue-generation, expenditure control shifts, service delivery model options, and if necessary, the impacts service reduction and ways to do so that will be the least impactful to the Hayward community. Deliberation of these various options and discussion of a strategy to eliminate the General Fund structural deficit will be the focus of the upcoming Council retreat in the fall of 2017. Because this is an ongoing effort, I did not ask departments to propose service reductions or other cuts to balance the FY2018 budget as we undertake this review.

Achieving progress during the Great Recession and the subsequent period of slow low 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 recent phased in lowering of CalPERS discount rate to 7% and modification to their 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.

As we struggle to address and resolve this 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.

The next two months will include several Council budget work sessions (including a special all-day Saturday work session on May 20, 2017) and a public hearing on June 20. This Public Hearing will allow City Council, employees, and the public an opportunity to review and comment on the proposed FY 2018 funding levels for City programs and services and to understand the alternatives and their respective impacts prior to Council adopting the budget on that date.

A continuing challenge to balance...

While the FY 2018 General Fund budget is balanced with the reluctant use of General Fund Reserve, achieving even this delicate balance is the result of some difficult choices, which the Council may choose to modify as we go through the public review of the budget over the next two months. For example, while the City is committed to paying down its unfunded liabilities, the FY 2018 budget proposes funding the pay as you go portion of \$2.9 million and additional \$1.0 million towards the annually required contribution (ARC) amount for retiree healthcare (OPEB) contributions totaling \$3.9 million in FY 2018. Additionally, while the budget does not contain expenditure reductions, it maintains current service levels and includes very limited growth in necessary areas such as minimal staffing increases for the new Library and Community Learning Facility (scheduled to open January 2018). Given these facts, the City is still struggling to meet the rising costs of doing business and the proposed budget requires a use of \$10.4 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 in annual 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, 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 approved for 20 years by 67.4% of the voters in June 2016 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 200,000 jobs per month since early 2010 and California job growth leads the nation. California added 19,300 jobs in March 2017; 2.1% greater than the year prior. State

unemployment is down to 4.9% and the economy is being driven by increases in construction, healthcare, and consumer spending. East Bay unemployment was 4.1% as of January 2017 and continues to remain lower than the State average. Further helping local revenues is a 3.5% surge in consumer spending over the 2016 calendar year.

Nevertheless, despite these encouraging signs, the economy is on the 8th 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 against 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 further work towards measures that will achieve long-term fiscal sustainability and 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 factor 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 2018 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 discussed with Council this spring. The City continues to work towards a Safe, Clean, Green, and Thriving community and these initiatives will help to ensure that Hayward is not only a fun 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 proposed at 657.8 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 2003; in FY 2018 884.1 positions are being 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 gap and exponentially increase unfunded liabilities for CalPERS (retirement) and OPEB (retiree medical benefits). Thus, the current budget before you has

extremely limited staffing growth; mainly only to support the new Library facility. The City will continue to be strategic in its staffing decisions as it looks towards fiscal sustainability.

The table below demonstrates three scenarios to provide information on the City's efforts to balance the Operating Budget while still addressing critical needs and funding the City's liabilities. The amount in the column **(A)** represents what total General Fund expenditures would be if the City proposed to fund all department budget requests initially submitted for FY2018, required salary and benefit cost increases, and fully funded the OPEB ARC. Column **(B)** represents General Fund expenditures as winnowed down by the City Manager and Finance Director to reflect the "status quo" budget directive, required salary and benefit cost increases, and a fully funded OPEB ARC and Column **(C)** represents General Fund expenditures as proposed with only expenses that staff determined maintain current service provision and fund vital capital needs and this amount budgets OPEB only at the pay-go amount and an additional contribution of \$1 million towards the unfunded liability.

Expenditures (in 1,000's)	(A)	(B)	(C)
	FY 2018 Department Identified Needs & Fully Funded OPEB ARC	FY 2018 Fully Funded OPEB ARC	FY 2018 Proposed
2018 Baseline	\$ 154,017	\$ 154,017	\$ 154,017
Required adjustments to baseline*	1,300	1,300	1,300
Departmental Requests	2,150	-	1,029
Contribution to OPEB**	10,268	10,268	1,000
Total General Fund	167,735	165,585	157,346
Projected Use Of General Fund Reserves	(20,815)	(18,665)	(10,426)

* Includes adjustments to costs the City can not effect change ie. contractually obligated increases to bargained agreements, adjustments to the cost of benefits, contributions to PERS, amounts to which the City is otherwise contractually obligated to pay in FY 2018.

** excludes the "Pay-go" amount which is currently included in the 2018 Baseline amount although it is a component of the ARC

We are presenting this information to the Council and the public in an attempt to better explain the true financial gap that the City faces in FY 2018. The longer the City waits to fund its OPEB liability, the more expensive this proposition becomes in the future, creating more significant pressures on the City's ability to fund critical services and to fund these retirement benefits that have been promised to employees. Staff is continuing to look for one time cost saving measures to decrease or eliminate the need for a use of General Fund Reserves and will be providing them to Council as we proceed through the FY 2018 budget process; however, these one-time measures will not eliminate the structural gap that exists in future fiscal years.

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, this budget again proposes to use some General Fund Reserve. We continue to make remarkable progress in our elusive quest for fiscal sustainability, but as previously stated, work remains. Thus, we will be working with Management Partners to not only create an enhanced and refined financial model, but will also be collaborating with them and all departments to identify operational efficiencies which can be implemented. As strategies are developed and refined, they will be discussed with Council so as to ensure alignment with goals and priorities. 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 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. It is better to act now when our actions will have greater impact and not need to be so severe than risk fiscal insolvency and have 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 foreseeable future absent substantive action.

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 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 of our elected officials, our executives and unrepresented employees, and our multiple bargaining groups that the City is able to close the annual operating deficit even to the delicate 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 2018, 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, but 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 an organization in service to our community.

Sincerely,



Kelly McAdoo
City Manager
ICMA-CM

Attachment: FY 2018 Budget Overview