



DATE: January 15, 2020

TO: Council Budget and Finance Committee

FROM: Director of Finance

SUBJECT: Update to General Fund Long-Term Outlook

RECOMMENDATION

That the Council Budget and Finance Committee receives an update and provides comments on the City's General Fund Long Range Financial Model.

SUMMARY

This report provides an update of the City's General Fund Long Range Financial Model (Model). This update includes the latest revenue and expenditure projections and shows the impact to the City's long-term financial outlook.

BACKGROUND

For several years, the City utilized a General Fund Ten-Year Plan Model previously developed in-house as a tool to understand the long-range financial implications of policy decisions. In early 2017, the City engaged Management Partners to develop a more comprehensive and agile financial model, which was presented to Council during a special work session in October 2017¹. That October presentation included a demonstration of the capabilities of the Model, as well as Council participation in discussing a variety of hypothetical scenarios to illustrate the long-term fiscal implications. This Model has been updated in subsequent years to simulate the long-term financial forecast using the latest revenue and expenditure figures.

DISCUSSION

At the time of adoption, the FY 2020 Operating Budget projected a net positive position at fiscal year end and increase to General Fund Reserves of \$0.3 million. The Model projected that General Fund reserves would remain above the City's 20% of budgeted General Fund expenditures until the end of FY 2022, at which time it would dip to a projected 15.9%. Table 1 below provides a summary of the General Fund Five-Year fund balance projection as of May 2019.

¹ City of Hayward City Council Meeting on October 17, 2017

<https://hayward.legistar.com/MeetingDetail.aspx?ID=568550&GUID=6855A6D8-73F8-422D-8F2B-D5E1FE091927&Options=info&Search=>

TABLE 1: FY 2020 GENERAL FUND FIVE-YEAR FORECAST ENDING FUND BALANCE PROJECTIONS

GENERAL FUND FORECAST - FY 2020					
ADOPTED <i>in thousands</i>	FY 2020 Year 1	FY 2021 Year 2	FY 2022 Year 3	FY 2023 Year 4	FY 2024 Year 5
Revenues	\$172,439	\$176,677	\$183,050	\$189,391	\$194,841
Expenditures	172,103	180,150	189,822	195,867	202,111
Net Change in Reserve - Surplus / (Shortfall)	336	(3,473)	(6,772)	(6,476)	(7,270)
Beginning Balance	\$40,146	\$40,481	\$37,009	\$30,236	\$23,761
<i>Net Change in Reserve - Surplus / (Shortfall)</i>	336	(3,473)	(6,772)	(6,476)	(7,270)
Ending Balance	\$40,481	\$37,009	\$30,236	\$23,761	\$16,491
Target to maintain 20% GF Reserves in Operating Expenses	\$34,421	\$36,030	\$37,964	\$39,173	\$40,422
General Fund Reserve Level as % of Total Expenses	23.5%	20.5%	15.9%	12.1%	8.2%
Amount Above or (Below) Target 20%	\$6,061	\$979	(\$7,729)	(\$15,413)	(\$23,932)
Percentage Above or (Below) Target 20%	17.6%	2.7%	(20.36%)	(39.34%)	(59.20%)

Recent Fiscal Changes to the General Fund

Since the adoption of the FY 2020 Operating Budget, a number of additional appropriations have been approved by Council to support emerging needs. The additional appropriations decrease the City's General Fund net position, and results in the projected use of \$4.5 million of the General Fund reserve in order to balance the budget. Nearly this entire amount relates to the funding of the demolition of the City Center site². These expenses are considered one time in nature and the City expects to recover all costs associated with demolition upon development of the former City Center site.

The other significant change in General Fund reserves between the May 2019 budget adoption and the amounts shown in Table 2 is the "Beginning Balance" amount in FY 2020. The "Beginning Balance" is \$36.9 million as compared to the initial projected amount shown in Table 1 of \$40.1 million. This change reflects the one-time expense of \$2 million to purchase the City Center site. The additional \$1.2 million dollar difference is mostly related to unbudgeted personnel expenses.

Table 2 below shows the most recent revenue and expenditure projections through the end of the fiscal year. The projection also includes the previously approved additional appropriations, including the expenditures associated with the demolition of City Center. The

² City of Hayward City Council Meeting on December 3, 2019

<https://hayward.legistar.com/LegislationDetail.aspx?ID=4263965&GUID=635A7662-752A-43D6-BC31-328887055949&Options=&Search=>

Model projects the City's General Fund reserve levels will fall below the City's 20% policy level to 18.1% at the close of FY 2020, and depletion of the City's General Fund reserve by FY 2023.

TABLE 2: JANUARY 2020 UPDATED GENERAL FUND FIVE-YEAR PROJECTIONS

GENERAL FUND FORECAST - UPDATED <i>in thousands</i>	FY 2020 Year 1	FY 2021 Year 2	FY 2022 Year 3	FY 2023 Year 4	FY 2024 Year 5
Revenues	\$172,189	\$173,428	\$176,140	\$181,648	\$187,373
Expenditures	176,952	180,628	190,308	196,441	202,858
Net Change in Reserve - Surplus / (Shortfall)	(4,763)	(7,200)	(14,168)	(14,793)	(15,485)
Beginning Balance	\$36,877	\$32,114	\$24,914	\$10,747	(4,047)
<i>Net Change in Reserve - Surplus / (Shortfall)</i>	<i>(4,763)</i>	<i>(7,200)</i>	<i>(14,168)</i>	<i>(14,793)</i>	<i>(15,485)</i>
Ending Balance	\$32,114	\$24,914	\$10,747	(4,047)	(19,531)
Target to maintain 20% GF Reserves in Operating Expenses	\$35,390	\$36,126	\$38,062	\$39,288	\$40,572
General Fund Reserve Level as % of Total Expenses	18.1%	13.8%	5.6%	(2.1%)	(9.6%)
Amount Above or (Below) Target 20%	(\$3,276)	(\$11,211)	(\$27,315)	(\$43,335)	(\$60,103)
Percentage Above or (Below) Target 20%	(0.93%)	(31.0%)	(71.8%)	(110.3%)	(148.1%)

The updated Model (Attachment II) provides a snapshot of the City's long-term outlook. The City faces the continuing challenges of rising CalPERS rates, unfunded accrued liabilities, and structural deficits that have a significant impact on the projected expenditures in future years.

Attachment III provides an overview of key revenue and expenditure assumptions included in this update to the Model. A summary of these changes is below:

- Property tax projections assume a flattening of revenues through FY 2024
- Increased RPTT revenue from the passage of Measure T;
- Recession scenario beginning in FY 2021;
- Sales tax is projected to be flat for FY 2020, and contract in FY 2021
- Cannabis tax revenue for FY 2020 shows no tax as no businesses have made it through the entitlement process. Future revenues are estimated at \$250,000 for FY 2021, growing to \$500,000 per year by FY 2030.

It should be noted that the projected property tax revenue does not include increases to property tax expected from future developments. Property tax projections are expected to improve as the Route 238 properties are developed. Staff will adjust projections accordingly as development timelines become clearer and the value of the properties can be more accurately projected.

Council Supported Fiscal Strategies - Long-Term Financial Outlook:

In October 2017, City Council held a Fiscal Sustainability work session, where staff unveiled the updated Model, and Council discussed various options in four categories to address the City's structural budget deficit, which included (1) revenue generating options, (2) cost shifting options, (3) expenditure control options, and (4) changes in provision of services that Council could implement to assist in closing the City's long-term structural budget gap.

Table 3 is a summary of Council supported strategies at the October 2017 fiscal sustainability work session. A status of each strategy is included to provide the Committee with an update on strategies that have yet to be implemented and may be reviewed and recommended for the full Council's consideration, to assist with closing the project structural budget gap.

TABLE 3: FISCAL SUSTAINABILITY STRATEGIES (OCTOBER 2017)

Council Supported Fiscal Sustainability Strategies	Status
Revenue Generation Strategies:	
Real Property Transfer Tax (RPTT): \$8.5 per \$1,000 (Place ballot in 2018)	Complete - Voters' passed Measure T in November 2018.
Cannabis Tax Revenue	Complete - While the City has not realized revenue from the source, the voters have approved a cannabis tax.
Transient Occupancy Tax (TOT) @ 12% - Projected annual revenue to \$1,200,000 with new hotels	Option considered viable by staff; however, formal action from Council is necessary prior to further pursuing the option.
Business License Tax (BLT) (Up from \$19.06-\$26.02 per capita- Projected annual revenue from \$2.9M to \$4.0M	Option considered viable by staff; however, formal action from Council is necessary prior to further pursuing the option.
Expenditure Controls/Cost Shifts:	
In partnership with and through the collective bargaining process with our employee groups identify potential cost saving strategies related to wages, benefits, and working conditions	Complete.
Update Cost Allocation Plan	Staff is finalizing an update to the cost allocation plan; however, the impact to the General Fund is not significant.
Service Delivery Changes:	
Prioritized Use of Measure C Revenue after projects completed	Ongoing – This strategy is reviewed and discussed annually during the City's budget process.
Fleet Utilization Improvements (5% fleet removal) (\$39,675 annual maintenance + \$82,300 replacement cost)	In Progress - Fleet Utilization Study currently underway.

While long-term financial projections show a significant continued structural deficit despite the successful passage of Measure T and the additional revenues it is expected to generate, there are two remaining supported strategies that can be deployed to positively impact the long-term fiscal health of the City. Staff is requesting feedback and confirmation from the Committee of prior Council direction on the remaining two revenue strategies: an increase to the City's TOT and/or an overhaul of the City's Business License Tax Ordinance (changes proposed would be to the level that would require voter approval to achieve the impact to revenues shown above) to the full Council. Analysis of additional strategies and updates to the Model will be provided to Council on an ongoing basis for their continued policy leadership in helping to ensure fiscal sustainability for the City while ensuring the highest level of service availability to the Hayward community.

The City of Hayward's TOT rate of 8.5 percent is the twelfth lowest among sixteen Bay Area cities of 100,000 or more residents, according to analysis provided by Management Partners for the October 2017 work session. Staff analysis performed in 2018 estimated that an increase in TOT to a new rate of 12.0 percent would generate an additional \$986,000 annually.³ Assuming the passage of a ballot measure in 2020, the Model estimates that a 12.0 percent TOT rate will generate an additional \$519,240 million in FY 2021 and an average of \$859,900 annually through FY 2030.

Based on FY 2015 actual financial data, Hayward's per capita business license tax ranks 13 out of the 16 Bay Area cities with populations greater than 100,000. While this data has not been updated since, it is highly unlikely that Hayward would have gone higher on the list. The City's ordinance has not been significantly updated and both rates and categories are outdated and no longer accurately reflect the categories of businesses which operate in the community.

At this time, staff is seeking the Committee's direction as to whether it would recommend the presentation of either or both strategies to the full Council for consideration to place on the November 2020 ballot. Based on previous Council direction to potentially place the TOT increase on the November 2020 ballot, staff has solicited a survey proposal (Attachment IV) from the consultant used by City for the successful effort to pass Measure T in 2018. If the Committee is supportive of moving forward, staff would proceed with preliminary polling in March and would return to the Committee for further direction later in the spring.

ECONOMIC IMPACT

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

FISCAL IMPACT

³ City of Hayward City Council Meeting on July 17, 2018

<https://hayward.legistar.com/LegislationDetail.aspx?ID=3553050&GUID=5504B467-533C-4C23-9243-448F969C92EB&Options=&Search=>

There is no fiscal impact associated with this report; however, staff will continue to refine and update the General Fund Long Range Financial Model as economic factors change.

PUBLIC CONTACT

The Model has been presented at numerous public meetings beginning in October 2017.

NEXT STEPS

Upon direction and recommendation from the Committee, staff will present to the full Council potential long-term financial strategies that may be employed to help the City achieve long-term fiscal sustainability.

Prepared by: Rick Rivera, Management Analyst I
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Recommended by: Dustin Claussen, Director of Finance

Approved by:

A handwritten signature in black ink, appearing to read 'K. McAdoo', is written over a horizontal line.

Kelly McAdoo, City Manager