

May 21, 2018

Mr. Mayor and City Council,

As part of our annual efforts, the Budget Advisory and Financial Planning Committee (the "Committee") has completed a brief review of the most recent projections as prepared by Michael Szczech and his staff under the guidance of Paul Benoit. With the new City Finance Director on board and taking a fresh look, the projections are more robust and thorough than they have been in prior years which provides a great level of comfort for us.

Overall, we believe the assumptions used, and the results presented, to be reasonable and more complete than past practices, which has proven to be conservative. Given the age of the current real estate cycle, the Committee feels it is important to maintain the conservative nature. As in prior years, the projections show that the long-term financial health of the City is dependent on the Municipal Services Parcel Tax ("MSPT").

As you know, the Committee feels the objective of long term financial planning for the City is to take steps to ensure that current services are being paid for in the current year, to the extent possible, and that funds for known future requirements (retirement commitments and facilities/road maintenance) are set aside on a current basis. Although it has been recent practice, due to revenue limitations and not fully quantified liabilities, to underfund certain longer term liabilities such as pension costs, Other Post Employment Benefits ("OPEB") and the Facilities Maintenance Fund, the City has taken very commendable steps this year to set aside additional funds to address many of these underfunded liabilities. These steps include: a more thorough analysis of OPEB requirements as compared to the Police and Fire Pension Fund overfunding; a detailed actuarial analysis of future active employee pension costs, negotiating lower retiree healthcare costs for future employees, and the creation and funding of a new Section 115 Pension Trust. Combined with prior years efforts to ameliorate the growth of pension costs with new lower tiers and employee sharing, the City has really done an excellent job of planning for and controlling future costs – especially as compared to where we were sitting just 7-8 years ago.

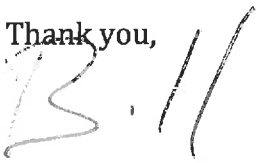
We believe that with the recent increase in the MSPT, the new (and continued) funding of the Section 115 Trust, the planned dedication of the overfunded Police and Fire Pension Fund to OPEB underfunded liability, and the side fund debt

retirement in 2020, which frees up \$1.3 million in annual debt service, the City will be better positioned to meet its obligations beginning after 2020 and into the future.

As positive as the situation looks, the Committee reminds the Council that the current economic recovery – especially as it impacts Bay Area housing prices – is very long in the tooth, and it is important to continue with conservative property tax and transfer tax assumptions. The Committee also wants to remind council that until the completion of a long-term facilities maintenance plan (including streets, sidewalks, and parks) and the associated long-term costs are better understood, the City will be constrained in its ability to prioritize facility capital repair/ replacement projects. We believe this to be a very high priority. The City will always have more needs and wants than funds and an agreed upon capital plan will allow the Council to prioritize its needs and better utilize its scarce resources

The Committee appreciates the opportunity to serve the City and is especially appreciative of the work of the new Finance Director in providing such a complete and thorough long term financial plan. Please let us know if you have any questions or would like any additional analysis.

Thank you,



Bill Hosler

Chair of the Budget Advisory and Financial Planning Committee