

May 30, 2024

Ms. Mayor and City Council,

As part of our annual efforts, the Budget Advisory and Financial Planning Committee (the “Committee”) has completed its review of financial projections in the City budget and whether they provide a sustainable long-term financial future for the City. The Committee reviewed the most recent revised fiscal year 2024-25 budget and projections, as prepared by Finance Director Michael Szczech and his staff under the guidance of City Administrator Rosanna Bayon Moore, and as presented to the Committee on May 14, 2024.

From the May 14 presentation, we believe that the City’s understanding of its financial position, as in previous years, is very thorough and well communicated. The Finance Director presented the projected financial results for the current fiscal year as well as projections for the upcoming budget year. The presentation included all material revenue sources and expense categories, and discussed potential revenue risks, projected pension costs in detail, Other Post-Employment Benefits (OPEB) funding, equipment replacement, facilities maintenance, and facilities capital projects. Overall, we believe the assumptions used, and the results presented, to be well-founded and consistent with past practices.

FY 23-24 Results and FY 24-25 Budget

The City continues to maintain a strong financial condition and weathered the financial impacts of the Covid-19 impact admirably. Property tax-related revenue (including the Municipal Services Special Tax (“Parcel Tax”) and Real Property Transfer Tax (“Transfer Tax”) revenue), which generally makes up approximately two-thirds of the City’s revenue, has been bolstered by the strong real estate market during and following the pandemic, even when accounting for the downward trend following the FY 20-21 peak and the current economic climate. In addition, other material revenue categories have rebounded and now equal or exceed their pre-pandemic levels. The combination of higher-than-expected Transfer Tax revenues and lower expenditures due to deferred projects helped the City achieve a projected budget surplus of approximately \$2.9 million for FY 23-24.

The Committee supports the proposed uses of the FY 23-24 surplus, which include transfers of \$800,000 to the Equipment Replacement Fund and retaining approximately \$2 million of the surplus in the General Fund to cover higher operating expenses, new initiatives and facilities capital projects budgeted for FY 24-25. This is consistent with both recent City practice and the Committee’s recommendations in prior years.

The proposed budget for FY 24-25 reflects the City's continued commitment to conservative budgeting and financial discipline. This approach ensures that the City can continue to provide high quality public services, replace aging equipment, and address infrastructure repairs, while retaining a strong General Fund. Further, the City continues to fund reserves to handle potential increases in pension and retiree health care liabilities and can accommodate those costs without impacting services.

Long-term Planning

As discussed in our prior reports, the Committee believes the objective of long-term financial planning for the City is to enable it 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 (including infrastructure needs) are set aside on a current basis. In short, current citizens should pay for the current costs of running the City and not defer those costs to future citizens.

In reviewing the City's long-term projections, the Committee notes the following:

- The financial projections continue to seek to maintain, over the long term, an 18% General Fund balance, which the Committee thinks is a prudent goal.
- The City has taken a conservative approach in budgeting for Transfer Tax revenues given their historic volatility. Projected Transfer Tax revenue is set at \$3.8 million for FY 24-25 and beyond, a modest increase from the \$3.4 million budgeted in FY 23-24 and a decrease from the actual \$4.5 million in receipts projected for FY 23-24. While this conservative approach is consistent with prior years, the Committee believes that recent history has shown this to be too conservative and recommends that the amount be increased, for both FY 24-25 and the long-term projections, to \$4.2 million, a figure the Committee believes is reasonable based on the data for the last ten years. The Committee recommends that this increase, and also any actual Transfer Tax revenue collected in excess of the budgeted amount, be used to fund the Facilities Capital Fund and not be used to fund increased operating expenses given the year-to-year volatility of Transfer Tax revenue.
- Pension expenses are projected to increase substantially over the next decade, as has been anticipated for some time. While these increased expenses are fully met in the long-range projections (due to the City's active management and prior funding of the of the Public Agency Retirement Services Fund), the extreme volatility of the financial markets still presents risks to the extent that investment returns fail to achieve expected returns in the long run. The long-term projections assume the use of funds from the Pension Rate Stabilization Fund starting in FY 25-26 to mitigate the increase in pension expenses.

- As in prior years, the projections continue to show that the long-term financial health of the City is dependent on property-related taxes, including the collection of the Parcel Tax. The projections assume that the Parcel Tax continues with a standard CPI adjustment each year, and the Committee supports this approach.
- The Committee notes that the budget includes an operating subsidy for the pool of \$400,000 for FY 24-25 and \$200,000 per year thereafter in the long-term projections. While the intent of the City is to operate the pool on a revenue-neutral basis, actual operating performance is not yet known, and therefore the City has taken this conservative budgeting approach, which the Committee supports.

Over the past decade, the City has done an excellent job planning for and controlling future costs of retirement commitments and equipment replacement. Below, the Committee highlights future needs that it believes require further attention now, followed by revenue considerations to address those needs.

Infrastructure Needs

As the Council is aware, quantifying and planning for the future costs associated with the City's facilities, streets, and sidewalks – broadly, its infrastructure – have been and continue to be a focus of this Committee. The City staff have done an admirable job over the past several years in identifying these costs, especially for Facilities Maintenance and Equipment Replacement. Work remains to be done, however, in quantifying costs and allocating funding for major Facilities Capital projects, most notably for the City buildings in the City Center, including public safety.

The Facilities Maintenance Fund is now separated into two funds: one focused on regular repairs and maintenance (Facilities Maintenance Fund), and the other for major capital projects and improvements (Facilities Capital Fund). Due primarily to the overall trend in increased Transfer Tax revenue in the current and recent years, and the growth in assessed property values, the City is now able to fund its facilities maintenance costs over the term of the projections. This contrasts with the practice in earlier years, in which contributions to the Facilities Maintenance Fund were generally not budgeted, and transfers would only be made to that Fund if and when budget surpluses were achieved. Despite the notable progress being made, the following infrastructure needs remain:

- **Aging Buildings.** The Facilities Capital Fund projections include estimates for major capital projects to address the necessary replacement or renovation of aging buildings and parks to meet current standards and to improve operating capacity and efficiency. Staff has done a commendable job in identifying necessary renovations in the buildings and parks, but many

numbers are rough estimates at this point. Much more work remains to be done to more comprehensively detail and quantify our capital needs and to provide sufficient information for the Council to weigh strategic priorities. Nonetheless, based on existing information, the cost of such infrastructure needs (preliminarily estimated to be in excess of \$83 million) is well beyond the City's current funding capacity. The Committee continues to believe that further quantification, prioritization, and planning for these capital projects is of high importance given the high cost for some of these projects, as well as the long lead time to identify funding and to implement these initiatives. We understand and approve that the budget allocates funds to assess the potential costs for capital projects related to the buildings in the Civic Center.

- **Stormwater Management/Storm Drain Infrastructure Needs.** The Regional Water Quality Control Board regulates local jurisdictions' stormwater management and has imposed new requirements on cities, including Piedmont, to control stormwater runoff. Currently, cities are being required to inventory their storm drain infrastructure and project the cost of improvements to meet new standards. At present, no State funding sources are available to cover the potential costs, which are likely to be significant. The City's assessment is ongoing. Priority projects estimated at \$1.7 million have been identified and are included in the Facilities Capital Fund program. The first project is slated to be completed in FY 24-25 for the amount of \$330,000 and will address areas of known need where there has been flooding and/or failure of the storm drain infrastructure.
- **Road Conditions.** While the City has made efforts to step up its repaving activity and improve its roadways in recent years, the condition of Piedmont's roads has not improved since 2017. Piedmont's overall Pavement Conditions Index (PCI) was 64 in 2017 (where a score of 50 – 69 is in the "Good" category), 67 in 2019, 65 in 2022, 63 in 2023, and is now estimated to be 61. An estimated \$700,000 in additional annual spending above recent levels would be required to improve the PCI to 71 and reach the "Very Good" category. The long-range projections do not include any additional annual amounts for paving beyond the dedicated street improvement funding sources (Measures BB & F, gas tax revenue and SB1) that the City has historically utilized to maintain its streets.

Regarding the adequacy of the Facilities Capital Fund, the Committee notes that achieving the target 18% General Fund balance in the long-term projections can only be achieved by eliminating transfers to the Facilities Capital Fund after FY 23-24, and the long-term projections therefore reflect a Facilities Capital Fund that will be depleted after FY 26-27. While certain major capital projects may be funded through debt financing, this will not be feasible for all capital projects and the Facilities Capital Fund, as presented, is therefore inadequately capitalized for the duration of the 10-year projections. This projected underfunding is not realistic

since there will undoubtedly be necessary replacement expenditures after FY 25-26. The Committee does recognize, however, that this funding shortfall may be alleviated to some degree if revenues, such as Transfer Tax revenue, come in higher than projected or if the City develops incremental or new tax sources.

Staffing Needs

The City's staffing levels, along with the City's population, have held largely steady over the past two decades and the FY 24-25 budget and long term projections assume only additions for dispatch staff and part-time positions. However, the provision of services is becoming increasingly complex due to a combination of factors including changing technologies and increasing requirements for local jurisdictions to address state and regional requirements and challenges. The City currently has staffing studies underway that may identify the need for additions to staffing levels and funding will need to be identified for these additions.

Revenue Considerations

It is clear from our discussions and the May 14 presentation that the City has limited ability to absorb future cost increases due to inflation, new State mandates or the need to increase staff to provide the services that the residents of the City expect. The recent approval of Measure F in February 2024, which renewed the Parcel Tax for 12 years with an initial 20% increase, provides necessary stability and some additional funds to the City's revenue stream starting in FY 25-26.

Even with the renewal of the Parcel Tax, the Committee believes that the City will likely need additional revenue in the future to fund known capital projects, increasing public expectations for higher services and unplanned cost increases. Prior Committee reports, including its October 3, 2023 report on the Parcel Tax, identified the need for and examined potential additional revenue sources, including an increase in the Transfer Tax, that may be useful when that need arises. The Committee believes that increasing the Transfer Tax continues to be the most broad-based and sustainable source for material additional revenue.

The Committee appreciates the opportunity to serve the City and is especially appreciative of the work of the Finance Director in providing such a complete and thorough long-term financial plan, as well as the work of the Public Works Director in identifying and quantifying the City's facilities needs reflected in the long-term projections. The Committee believes the City is well positioned to address this next fiscal year but cautions that the City is likely to face challenges as it becomes necessary to address the City's increasing service needs and capital projects, especially for its ever-aging facilities.

Please let us know if you have any questions or would like any additional analysis.

Thank you,



Budget Advisory and Financial Planning Committee

Frank Ryan, Chair
Murat Bozkurt
Andrew Flynn
David Kimball
Robert McBain
Paul Raskin
Vanessa Washington
Alice Cho (alternate)