May 28, 2025

Ms. Mayor and City Council,

As part of our annual efforts and pursuant to its charge from the City Council, 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. In a meeting on May 20, 2025, the Committee reviewed the most recent revised fiscal year 2025-26 budget and projections, as prepared and presented by Interim Finance Director Michael Szczech and his staff under the guidance of City Administrator Rosanna Bayon Moore.

From the May 20 presentation, we believe that the City's understanding of its financial position, as in previous years, is very thorough and well communicated. The Interim 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 24-25 Results and FY 25-26 Budget

The City continues to maintain a strong financial condition, although recent allocations within the Facilities Capital Fund for additional costs related to the Community Pool project have significantly reduced the City's flexibility to undertake future capital projects, both planned and unanticipated. Property tax-related revenue (including the Municipal Services Special Tax ("Parcel Tax") and Real Property Transfer Tax ("Transfer Tax") revenue), which generally makes up in excess of 60% of the City's revenue, has been bolstered by the strong residential 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 revenues across several categories and lower expenditures helped the City achieve a projected budget surplus of approximately $3.6 million for FY 24-25 before capital transfers.

The Committee supports the proposed uses of the FY 24-25 surplus: transferring $850,000 to the Equipment Replacement Fund and retaining a higher balance in the General Fund to cover higher operating expenses, new initiatives and facilities capital projects budgeted for FY 25-26. This is consistent with both recent City practice and the Committee's recommendations in prior years.

The proposed budget for FY 25-26 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.

The proposed FY 25-26 budget shows expense growth in excess of revenue growth. Overall revenues are essentially flat, while expenditures and operating transfers out are expected to grow by 7% due to higher personnel costs and a combination of one-time and cyclical costs. In addition, the proposed budget shows a number of capital projects, including the completion of the Community Pool and the dispatch center relocation, that will essentially deplete the Facilities Capital Fund in the coming fiscal year. The Community Pool project has required approximately $5.4 million to be drawn from the Facilities Capital Fund (approximately 50% of this year's beginning fund balance). This will restrict the City's ability take on new capital projects absent revenue growth in excess of the amounts planned in the budget and long-term forecast. While the City may have flexibility to defer some projects for the short and intermediate terms, deferral will inevitably result in higher overall costs to complete the project given inflation and extension of wear / useful life .

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. It should be noted, however, that the current long-term projections now show the General Fund balance dipping to as low as 15% in several of the next nine years. This is a change from the prior year which showed the General Fund consistently at 18% or above. In addition, the long-term projections assume only minor transfers to the Facilities Capital Fund after FY 24-25. This lack of funding for facilities capital projects is addressed later in the report but the Committee wants to note here that achieving the General Fund balances in the long-term projections is at risk due to this lack of funds.

- The long-term forecast assumes a 3.3% increase in property tax revenue for FY 25-26 and then 4.9% annually for the remaining term of the forecast. While the 4.9% is the same as the 15 year average growth rate, this number may be aggressive. Reaching this number requires the continued sale of homes with comparatively low assessed valuation due to Proposition 13 and the number of such homes is presumably decreasing. As noted in the May 20 presentation, the amounts that Sales Price has exceeded the Assessed Valuation has declined from 119% to 83% over the last four years and further deterioration in the ratio will make it difficult to reach the 4.9% growth projection.

- As in prior years, the projections continue to show that the long-term financial health of the City is heavily dependent on property-related taxes, including the collection of the Parcel Tax, robust Transfer Tax revenue and growth in assessed property values. The long-term projections assume that the Parcel Tax continues with a standard CPI adjustment each year, and the Committee supports this approach. The Committee supports continued careful review of property-tax-related revenue projections, given the City's reliance on these revenue sources.

- 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 26-27 to mitigate the increase in pension expenses and show that the Fund will be exhausted in FY 28-29.

- The long-term projections assume that salaries and benefits grow by 3.25% in FY 25-26 and then 3.0% annually thereafter. This increase will be significantly impacted by the results of the current and future labor negotiations. In addition, the Committee notes that the budget includes an operating subsidy for the pool of $400,000 for FY 25-26 and $200,000 per year thereafter. While the City intends to operate the pool on a revenue-neutral basis, the City has taken this conservative budgeting approach since the actual operating performance is not yet known. While the Committee supports this approach, there is also the risk that actual costs could exceed these numbers.

- As discussed throughout this letter, the Facilities Capital Fund will be essentially depleted in FY 25-26.

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 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 both the increased Transfer Tax revenue in the 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 long-term 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 made for funding facilities maintenance, significant issues remain for the Facilities Capital Fund, including the following infrastructure needs:

- **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 or based on outdated analyses at this point. Much more work remains to be done to more comprehensively detail and quantify the City's 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 $80 million) is well beyond the City's current funding capacity. The Committee continues to believe that continued 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. The Committee supports that the FY 25-26 budget allocates funds to preliminarily 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. While the City's assessment is ongoing, priority projects estimated at $1.7 million have been identified and potential costs are expected to be much higher. These amounts are not fully included in the Facilities Capital Fund and underscores that inadequate funds are available to cover the costs associated with stormwater management requirements. The first FY 25-26 budget for the Facilities Capital Fund does include $400,000 to address certain 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 60 – 69 is in the "Fair" category), 67 in 2019, 65 in 2022, and 63 in 2023 in and 2024. An estimated $700,000 in additional annual spending above recent levels would be required to improve the PCI to 71 and reach the "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.

The long-term projections reflect that the Facilities Capital Fund will be essentially depleted after FY 25-26 given the significant outlays in the upcoming year for the Community Pool and other projects. While certain major capital projects may be funded through debt financing, this will not be feasible for all capital projects. The Facilities Capital Fund, as presented, is therefore inadequately capitalized for the duration of the 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 broad-based 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 25-26 budget and long-term projections assume only two full-time additions for replacing 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 20 presentation that the City has very limited ability, both currently and during the window of the long-term projections, to absorb future cost increases due to inflation, contract negotiations, new State mandates or the need to increase staff to provide the services that the City residents expect. The community's approval of Measure F in February 2024, which renewed the Parcel Tax for 12 years with an initial 20% increase starting in FY25-26, will provide necessary stability and some additional funds to the City's revenue stream.

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, as well as to respond to both 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 to the City. Staff and Council. The Committee believes that increasing the Transfer Tax continues to be the most broad-based and sustainable source for material additional revenue during the window of the 10-year projections

The Committee appreciates the opportunity to serve the City and is especially appreciative of the work of the Interim 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 addresses 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,

Frank Ryan

Budget Advisory and Financial Planning Committee

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