



**CITY OF PACIFICA
COUNCIL AGENDA SUMMARY REPORT**

4/11/2022

SUBJECT:

Fiscal Year 2022-23 Budget Planning Process, Timeline, Long-Term Financial Forecast, and Narrative Budget Report

RECOMMENDED ACTION:

Accept the report, consider and discuss budget strategies recommended by the City Manager and provide feedback and additional policy direction for the preparation of the FY 2022-23 Budget.

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BACKGROUND:

Each year, the City of Pacifica adopts an annual operating budget that reflects the planned activities for the next fiscal year based on the best information available to the City Council and staff at the time of adoption. This narrative report is not intended to provide detailed budgetary numbers for FY2022-23. The next step in the budget process will be a more detailed General Fund budget presentation and subsequent budget public hearings and budget adoption. This report provides Council with the general outline of the budget development process, including timeline, methodology, long-term financial forecast, and strategic priorities for the upcoming year.

Budget Calendar

The annual budget cycle begins each year with the development of budget instructions, including policy directives and a budget calendar in January, and is completed with the budget adoption by the City Council in June of each year. A summary of the tentative budget schedule is as follows:

| PUBLIC MEETING | | BUDGET STEP | TIME FRAME |
|----------------|---|---|----------------------------------|
| 1 | ✓ | FY 2020-21 Mid-Year Budget Review to Council | March 14, 2022 |
| 2 | ✓ | Council Workshops: FY2022-23 Goal and Priority Setting | March 25, 2022 March 26, 2022 |
| 3 | ✓ | Budget Session 1: Budget Methodology, Budget Calendar, Long-Term Financial Outlook and FY 2022-23 Strategic Priorities | April 11, 2022 |
| 4 | | Budget Session 2: FY 2022-23 Base Budget and FY 2022-27 CIP Budget Review | May 9, 2022 |
| 4 | | Planning Commission: Review of the Proposed FY2022-27 CIP Plan for Conformity with General Plan | May 16, 2022 |
| 6 | | Budget Session 3: City Council Review and Approval of Proposed FY 2022-23 Budget Recommendations | June 13, 2022 |
| 7 | | City Council Budget Hearing: and Formal Adoption of the FY 2022-23 Operating and Capital Budget | June 27, 2022 |

This year's budget cycle launched in March with the Council's mid-year review of the FY2021-22 Budget. At that time, the Council reviewed revenues and expenditures and made adjustments that will be factored in developing the FY 2022-23 Base Budget to be presented on May 9.

This report provides the City Council an opportunity to review and discuss the budget strategies recommendations from the City Manager to help guide the development of the proposed Budget for the Fiscal Year 2022-23. This report is referred to as a "Narrative" Budget Report because it conveys in a narrative format guiding strategies for budget development that, if supported by the City Council, will inform the City Manager's recommendations to the Council for the FY 2022-23 budget. Although the Council is not being asked to vote on the recommendations included in this report, staff will track the Council's discussion and questions, which will be helpful to the budget preparation of the proposed FY2022-23 Budget for the Council's future consideration to bring it to adoption in June 2022.

Budget Methodology

The Adopted Budget is achieved after an inclusive and interactive budget development process. Any budget process aims to reach a balanced and sustainable budget. Last year, staff modified the City's standard budget process to apply a modified zero-based budget methodology to prepare the baseline budget. The modified zero-based Budget is a systematic financial management strategy commonly used by local governments which helps achieve more cost-effective delivery of public services.

The Base Budget reflects the current level of services and operations. The Base Budget is not an exact duplication of the prior year's adopted Budget because of actions that the Council may have taken or provided direction that modified the Budget over the course of the year and, most importantly, because of the FY2022-23 Budget assumptions used to develop the base budget.

Although the preliminary Base Budget estimates are being used in the Long-term Financial Forecast, staff will present the complete Base Budget at the next Budget Study session, including the detailed revenue and expenditures assumptions that reflect the current economic conditions and existing service level.

Once the Base Budget is developed, each department will be given an opportunity to request prioritized program changes for service enhancements or reductions to identify any necessary or desirable service increase or reduction options, which combined will reach a balanced and sustainable budget. The City Manager will review department requests and formulate a packaged budget recommendation of service-level changes for the Council's consideration.

These recommendations for service changes will be based on many factors, including the Council's strategic vision, staffing capacity, and potential impact on the overall City operation and services provided to the Community.

The final budget document will incorporate the City Manager's recommendations and the priorities of the City Council. Throughout the upcoming budget session meetings, Council will have an opportunity to review and consider budget options and provide direction to staff regarding any changes.

The City's budget goals are to achieve a balanced budget with operating revenue equal to or greater than operating expenditures, including reimbursements from other funds for services, including debt service. Under this policy, it is allowable for total expenditures to exceed revenue in a given year to fund capital improvement plan projects or other "one-time" non-recurring expenditures.

Ultimately, the City's financial position and the resources in each fund will determine the level of services and the projects that the City will be able to deliver to the Community in the upcoming fiscal year. Therefore, these services and projects are included in the adopted annual Budget.

Long-Term Financial Forecast

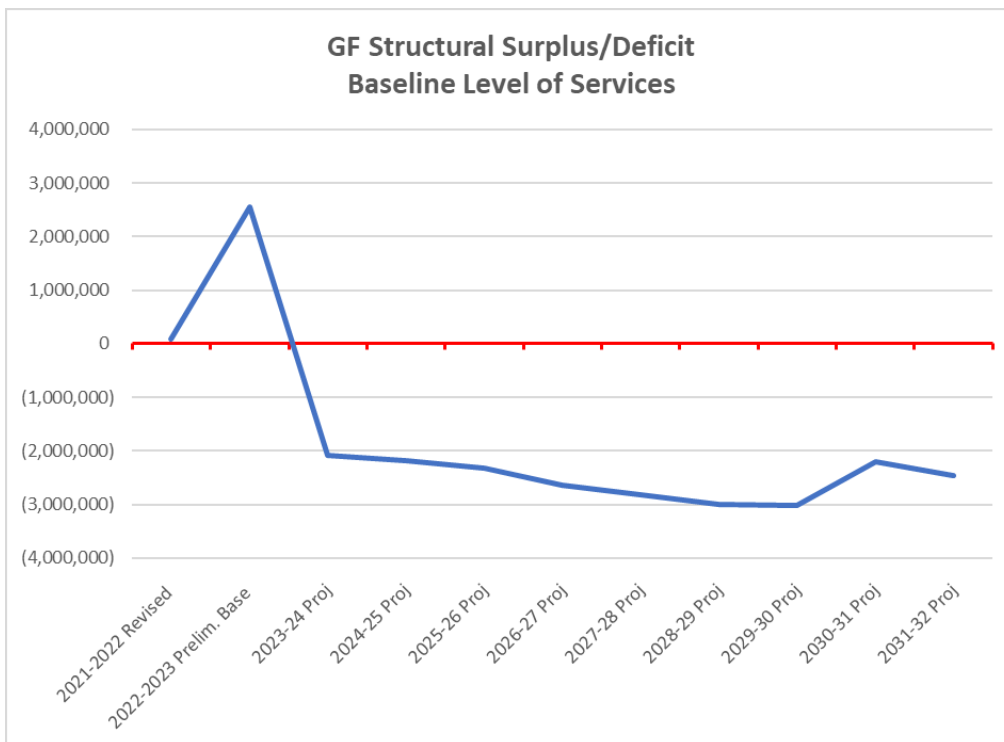
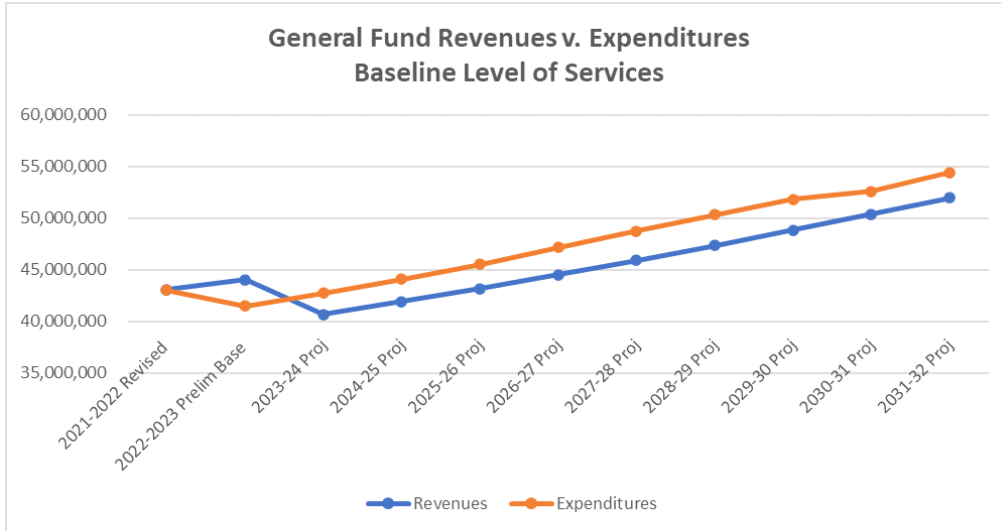
This report also presents the Long-Term Financial Forecast for 2022-23 that was originally presented to the Council in context of the fiscal sustainability analysis as part of the Vision 2025 & Beyond project on February 14, 2022. After completing the mid-year budget review, the Finance staff refined the preliminary 10-year Financial Forecast. Staff will further fine-tune and refine the FY 2022-23 Base Budget before the next Budget session, but this financial forecast provides a general overview of the City's long-term fiscal challenges at the current Base Budget level.

The forecast considers current revenue and expenditure trends at the mid-year mark projected forward. It also adjusts for PERS Retirement and Year 2 labor union MOU expenses, removes limited-term positions in the Budget, assumes annual debt service for the Civic Center Renovation project, does *not* assume any ongoing General Fund contribution towards the capital improvement program, and reflects a 14% increase in PERS unfunded liability from the prior year. This forecast only projects forward the current level of services and does not take into account any potential revenue measures, service enhancements, or reductions that may be reflected in the final FY2022-23 Budget once it is developed and adopted.

With these preliminary updates, the City's Operating Budget covering ongoing services to the Community will remain in balance during the current fiscal year and the upcoming 2022-23 fiscal year. This is in part due to the availability of American Recovery Plan Act (ARPA) funds that offset losses of City revenues during the Covid pandemic plus the payment of In Lieu Vehicle License Fees from the State. However, these funds will be spent by the end of 2024 and will result in an ongoing structural financial deficit in future years.

Projected Financial Deficit Starting in 2023-24 Fiscal Year

The structural deficit exists when the ongoing operating expenditures consistently exceed the ongoing operating revenues. Starting in the third year of the financial forecast, the City will experience a shortfall in funds to maintain the current level of City Services. This shortfall is projected to be \$2.1 Million in 2023-24, growing to \$2.2 million the following year (2024-25) and reaching \$3 Million in FY 2029-30, as summarized in the charts and table below.



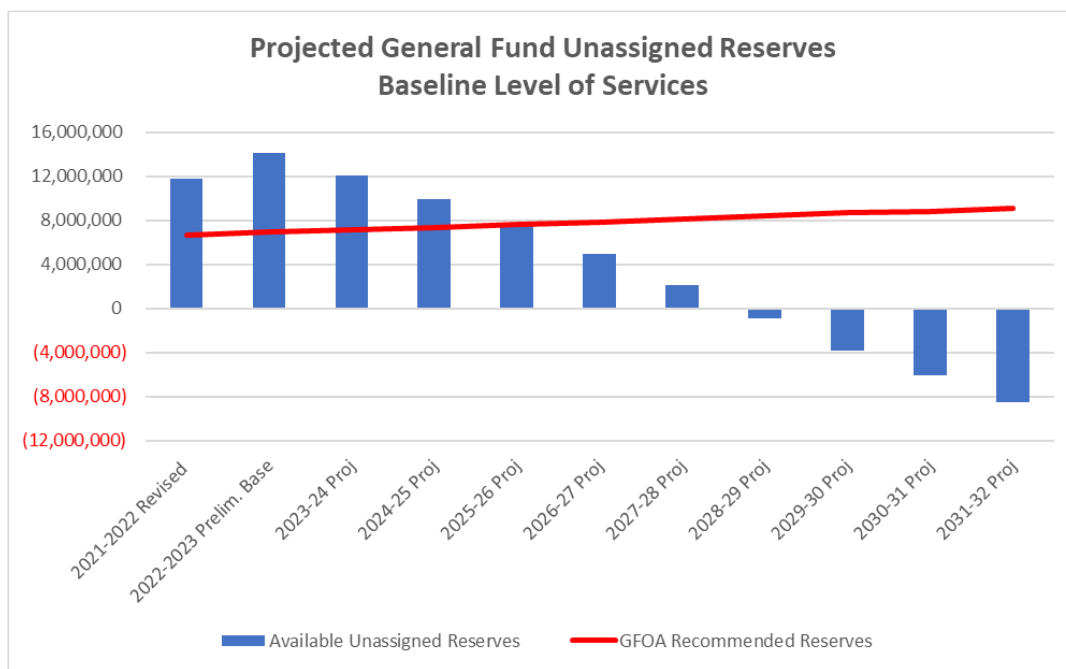
| <u>Fiscal Year</u> | <u>Projected Deficit</u> |
|---------------------------|---------------------------------|
| 2023-24 | (2,089,659) |
| 2024-25 | (2,183,836) |
| 2025-26 | (2,325,502) |
| 2026-27 | (2,634,432) |
| 2027-28 | (2,814,438) |
| 2028-29 | (2,989,050) |
| 2029-30 | (3,013,334) |
| 2030-31 | (2,209,028) |
| 2031-32 | (2,452,243) |

Budget Deficit Impact on General Fund Reserves in Future Years

If the structural budget deficit beginning in the 2023-24 fiscal year remains unaddressed, the City's unassigned General Fund Reserves will continue to shrink and by FY2026-27 will fall below the Government Finance Officers Association (GFOA) recommendation for government entities of no less than two months of regular general fund operating expenditures. At the same pace, by the FY2028-29, the entire unassigned fund balance would be wiped out.

Maintaining sufficient reserves is necessary for fiscal and operational sustainability, which becomes especially critical in the current uncertain economic situation. Therefore, staff always strives to go above the minimum recommendation for the General Fund's undesignated fund balance. The prospect of it falling below the minimum threshold guidelines presents a significant challenge to maintaining the City's operations and is not sustainable.

The scenario in the chart below is being presented for illustrative purposes only, as the City will be adopting a balanced Budget each year. Therefore, services would have to be dramatically reduced and/or reimagined to balance the Budget if the City's revenue base remains the same.



City Council Annual Goal-setting

On March 25-26, City Council held an annual goal-setting workshop, which allowed the Council to hear directly from community members to gain additional insight into the Community's priorities for budget allocation of resources over the next year and beyond.

At the meeting, the Council reaffirmed previously adopted goals and identified 13 priorities for the upcoming year, as discussed in the Goals and Priorities agenda item tonight.

As part of the separate Goals and Priorities agenda item tonight, the City Council is being asked to adopt their goals and priorities for FY2022-23, which will provide staff with direction on incorporating the City Council-adopted goals and priorities into the budget-development process. Although the goals are long-term and many of the priorities are multi-year projects, the City Manager's recommended budget strategies will help make progress towards achieving results in the upcoming year.

Recommended Budget Strategies and Next Steps

The Council's input on the following recommended budget strategies will help guide the development of budget recommendations for FY2022-23 that achieve the Council's goals and priorities and continue providing exceptional City services to the Pacifica community. This year's recommended strategies are organized and presented within the framework of the City Council's Goals, as well as referencing specific Council priorities where relevant.

➤ **Council Goal: *Fiscal Sustainability***

Includes investing in economic development to increase revenues, funding a reserve/emergency fund, and being well prepared for grant opportunities.

Recommended Budget Strategies:

- **Strategy #1: Fully fund Vision 2025 & Beyond Strategic Financial Sustainability Study.**

This study is critical to understanding the City's long-term financial sustainability challenges and to identify strategies to address them. It also includes a robust public engagement component. Staff is working to identify any additional funding necessary to complete the multiple components of this study beyond the \$100,000 currently budgeted and will recommend additional funding in the FY2022-23 Budget.

- **Strategy #2: Utilization of American Rescue Plan Act Funding.**

The current FY 2021-22 Budget includes utilization of the first tranche of ARPA funds, which includes a portion of these funds allocated to offset unprecedented revenue losses resulting from COVID-19 and addressing increased operational needs in compliance with Treasury Guidelines for qualified uses. The FY 2022-23 Budget will also require a detailed analysis of the remaining unused portion of ARPA funds from the prior year and policy discussion for appropriate use considerations of the new tranche of ARPA funds potentially to be spread over the qualifying period through December 31, 2024. Staff will include a more detailed memo regarding current ARPA funding utilization, and future recommended uses at the May 9 budget session.

- **Strategy #3: Returned ERAF and VLF In-lieu Funding Uncertainties.**

The City Council has previously been briefed about the VLF In-lieu revenue shortfall and uncertainties about if/how the state will keep the City whole. A resolution to this significant funding uncertainty is being worked on currently between the cities/county and the state. Returned ERAF funding is critical to the City's one-time funding allocations, such as the Disaster Accounting Fund. And VLF In-lieu revenue is relied on as an ongoing guaranteed revenue source that funds General Fund essential services. Staff will be working on and monitoring potential resolutions to this uncertainty throughout the spring and will include information and recommendations in the Budget as more details become known.

- **Strategy #4: Continue to replenish the City's Reserve Funds.**

Prior to FY2018-19, the Council approved revisions to the City's Reserves Policy and began funding Reserves. The Reserves Policy states:

"...the City has established certain financial reserves to protect the City against unexpected interruptions in revenues, the vulnerability of State actions, adverse economic conditions, unpredictable one-time costs, and exposure to natural disasters and emergencies."

Due to the decline of the City's revenues because of the pandemic, the City had to utilize reserves to continue funding essential city services and programs. Given the anticipated structural deficit in future years, the City

Manager recommends continuing to replenish reserves.

- **Strategy #5: Develop and implement a funding policy for Unfunded Pension and OPEB obligations.**

The City's long-term unfunded obligations have been growing considerably year after year. In 2019 the City established the irrevocable Section 115 Trust with Public Agency Retirement Services (PARS) to start prefunding these obligations, and the Council approved the initial contribution of \$200,000. However, the COVID-19 pandemic caused some delays in making this transfer. In 2021 the City made an initial contribution to account for FY 2020-21 and FY 2021-22. However, the City is still behind in addressing this issue systematically, compared to many other Bay Area cities that started prefunding these obligations more than a decade ago. The strategy would include developing the funding policy to identify funding goals and annual contributions to accumulate sufficient assets to finance the retiree healthcare benefits and pension obligations and account for a higher discount rate of return to reduce the book value of the unfunded liabilities. The funding policy should be transparent, reasonable, and flexible considering the City's challenging financial situation, but also consistent and should demonstrate fiscal discipline, commitment, and prudent financial management practices.

- **Council Goal: *An Engaged Community***

Includes creating opportunities to expand public participation, increase communication, and build community post-COVID.

Recommended Budget Strategies:

- **Strategy #6: Identify specific components of Council Priority Projects that will require increased funding for enhanced public engagement and communication strategies.**

Major Council Priority Projects that are not emergency infrastructure repair or maintenance projects are good candidates to design and implement enhanced public engagement strategies. Recent examples include the Home For All sessions, Plan Pacifica, City Tree Program Evaluation Part 1, and the Beach Boulevard Infrastructure Resiliency Project. Enhanced public engagement costs more and takes more time. Numerous Council Priorities for FY2022-23 will benefit from enhanced public engagement, such as the Housing Element Update, City Tree Program Evaluation Part 2, Quarry Site Specific Plan, and Vision 2025 & Beyond, and potentially others. Staff will identify public engagement funding related to each of these efforts and include recommendations in the Budget.

- **Council Goal: *Stewardship of City Infrastructure***

Includes repairing/replacing outdated city facilities, improving streets, stormwater, and wastewater infrastructure, and responding to impacts of sea-level rise and other effects of climate change.

Recommended Budget Strategies:

- **Strategy #7: Funding for the Capital Improvement Program**

Staff will identify a variety of potential one-time funding sources, such as State and Federal grant opportunities, unassigned General Fund Balance, and Impact Fee revenue sources to help fund critical infrastructure projects and other one-time priorities. Construction bids for the Civic Center project are currently being evaluated, and the project likely will require additional funding to achieve the Council's vision for this critical facility.

- **Council Goal: *A Healthy and Compassionate Community***
Includes addressing affordable housing and mental health services, exploring and implementing strategies related to homelessness, and supporting community services for all ages.

Recommended Budget Strategies:

There are no specific budget strategies recommended related to this goal other than the operating and project budgets necessary to carry out the completion of the Housing Element Update, the Council conversation with the Community about homelessness, and other core City services and programs that support this goal.

- **Council Goal: *Environmental Sustainability***
Includes stewardship of parks, urban forests, and open space, preserving hillsides and beaches, and adaptation to climate change.

Recommended Budget Strategies:

There are no specific budget strategies recommended related to this goal other than the operating and project budgets and grant opportunities necessary to carry out the completion of the Climate Action Plan Update, the City Tree Program Evaluation Part 2, and other Capital Improvement Projects related to solar and electric vehicle charging stations.

- **Council Goal: *A Strong City Workforce***
Includes strategies to address employee retention and attraction, work-life balance, engaging staff in decision-making, and celebrating and recognizing staff.

Recommended Budget Strategies:

- **Strategy #8: Fund limited-term positions, position reclassifications, and technology improvements to successfully deliver the City's workplan.**

As discussed during the City Council goal-setting sessions, the organization is severely understaffed and is carrying a heavy workload. Successful recruitments are an increasing public sector challenge. To confront these challenges and deliver effective and sustainable services, this recommendation entails identifying several limited-term positions, reclassifications, and other technology improvements to assist the conduct of business, along with funding source recommendations. Staff will include a detailed memo regarding these recommendations at the May 9 budget session.

- **Council Goal: *Maintaining a Safe Community***
Includes supporting our first responders (police, fire, public works), responding to emergencies, protecting people, property, and businesses, and engaging in emergency preparedness community outreach, public education, and prevention activities.

Recommended Budget Strategies:

There are no specific budget strategies recommended for this goal other than the operating and project budgets and grant opportunities necessary to carry out the programs and services that deliver the essential safety services envisioned in this goal. Financial strategies to ensure adequate resources, coverage and response times for public health and safety and other emergencies are interrelated with the above goals of Fiscal Sustainability, Stewardship of City Infrastructure, and a Strong City Workforce.

To develop a balanced and sustainable budget, staff will further define the strategies above to bring back at future budget sessions. Staff is seeking Council feedback on the budget strategies recommendations. Council's feedback will be integrated into a specific work plan for the upcoming year.

FISCAL IMPACT:

There is no action or fiscal impact associated with this item. This is an informational presentation seeking Council input to help guide further development of budget recommendations. As reflected in the budget calendar above, staff will be bringing forward the FY 2022-23 Base Budget and more specific budget strategies, policy options, and service change recommendations (if necessary) at future meetings.

ORIGINATED BY:

City Manager's Office

ATTACHMENT LIST:

Attachment 1 - LONG TERM FINANCIAL FORECAST (PDF)