



Item No. 1 Town of Atherton

CITY COUNCIL STAFF REPORT – STUDY SESSION

TO: HONORABLE MAYOR AND CITY COUNCIL

**FROM: GEORGE RODERICKS, CITY MANAGER
ROBERT BARRON III, FINANCE DIRECTOR**

DATE: MARCH 1, 2023

SUBJECT: FY 2023/24 BUDGET KICK-OFF AND OVERVIEW

RECOMMENDATION

Review and Discuss.

BACKGROUND

The Budget Kick-Off Meeting is the first meeting in the FY 2023/24 Budget cycle. The Kick-Off Meeting is a high-level overview of the Budget and provides an orientation not only for the Council but community participants as well. The Overview is not intended as a detailed discussion; instead, it focuses on a recap of the current Fiscal Year, current priorities, and identifies some of the Preliminary Budget Assumptions and introduces the 5-year Forecast.

The Annual Budget serves as one of the most important policy documents of the City Council. It aligns the Town's annual revenues with Goals and Objectives for the coming year. One of the Town's core strategies is financial stability. As staff prepares the budget each year, it is with a focus on creating a balanced budget that meets the Council's Goals and Objectives while maintaining long-term financial stability.

The General Fund is the primary operating fund of the Town and most of the revenue to the fund comes from Property Taxes. It is important to note the General Fund is also the single largest contributor to the Town's Capital Improvement Fund for capital projects.

This staff report provides, in brief:

- An overview of the FY 2022/23 Year-End Projected Fiscal Condition (end of year projection)
- An overview of the Town's Major Revenue Sources and 5-Year Forecasts
- An overview of the Town's Major Expenditure Categories and 5-Year Forecasts
- An overview of the Budget Process and Policy Discussions

Forecasted revenues and expenditures **do not represent actual budget expectations** year over year. Forecasts serve only to evaluate budget assumptions. Below is the FY 2023/24 Budget Review Calendar for the coming months.

FY 2023/24 Budget Calendar
City Council Meeting March 1, 2023 – Meeting #1
An overview of the FY 2022/23 Year-End Projected Fiscal Condition An overview of the Town’s Major Revenue Sources and 5-Year Forecasts An overview of the Town’s Major Expenditure Categories and 5-Year Forecasts An overview of the Budget Process and Policy Discussions
City Council Study Session Meeting April 5, 2023 – Meeting #2
Review and Discussion of the Operations Budget
City Council Study Session Meeting May 3, 2023 – Meeting #3
Review and Discussion of the Special Funds & Capital Projects Budget
City Council Study Session Meeting June 7, 2023 – Meeting #4
Review and Discussion of the Final Draft Budget & Special Revenues/Other Funds
City Council Regular Meeting June 21, 2023 – Meeting #5
Adoption of the Final FY 2023/24 Budget

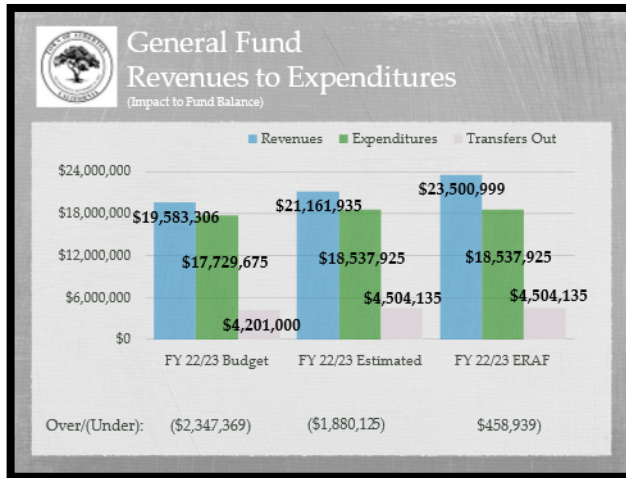
ANALYSIS

FY 2022/23 Year-End Projected Fiscal Condition

As noted during last month’s Mid-Year Budget Report, Property Tax revenue for the year *increased by 4.45%* over the adopted budget. Most of the increase was due to Secured Property Tax revenue and Property Tax in Lieu of Vehicle License Fee (VLF). The Property Tax in Lieu of VLF will reflect an increase of \$284,329. There is still a shortfall of \$198,958. It was estimated that the FY 2021/22 shortfall would be appropriated in the State’s 2023/24 budget; however, that did not occur. The FY 2022/23 VLF amount is \$1,527,046 and the funds available from the State are \$1,455,466. This reflects another shortfall of \$71,580. The total VLF shortfall to the Town is \$270,538. The County and local agencies, including the Town, have sent correspondence to the State urging the State legislature to include these shortfalls in the FY 2023/24 State Budget.

Mid-Year Budget adjustments were made in the amount of \$808,250. Of that amount, \$650,000 were identified as one-time expenditures related to specific staffing, one-time operational and facility maintenance expenditures, planning contract services and related expenditures for the Housing Element Update.

The Educational Revenue Augmentation Fund (ERAF) is a vital source of funding that helps the Town reduce long-term liabilities and fund one-time capital project needs. The State, as part of its annual budget, continuously targets ERAF and attempts to conscript it for their own budget needs. As a result, the Town treats ERAF as “one time” revenue for specific projects or priorities. The Town does not include ERAF as a revenue source for ongoing operational expenditures. ERAF has been used for the Town Center Project, debt service and the reduction of other long-term pension obligations. The use of ERAF is a year-to-year decision by the City Council as part of the budget process.



FY 2022/23 General Fund revenues are projected at \$23.5m (inclusive of ERAF \$2.33m).

FY 2022/23 General Fund expenditures are projected at \$18.53m.

Net mid-year adjustments included \$808,250.

In addition, there was a transfer out of \$4.504m, largely for capital projects and finalizing of Town Center project.

The projected year-end fund balance for FY 2022/23 is \$14,044,272, well above the Town’s reserve requirements for FY 2022/23. Removing reserves and the America Rescue Plan funds of \$1.7m, there is an Unallocated General Fund Balance of \$6,775,895 or 37% of adjusted expenditures.

Projected FY 2022/23 Ending Fund Balance		\$14,044,272
Required 15% Emergency Reserve		(\$2,780,689)
Required 20% Contingency Reserve		(\$2,780,689)
TOTAL RESERVE REQUIREMENT		(\$5,561,378)
<i>American Rescue Plan Reserve</i>		<i>(\$1,707,000)</i>
General Fund Unallocated Balance		\$6,775,894

User Fee Study

In FY 2022/23, the Town will complete a comprehensive fee study which will include revisions to cost allocation plans and calculation of a fully burdened staff rate. This study will inform an update to the Town’s Master Fee Schedule. With the completion of the Town Center and some “time in facility” staff is accumulating sufficient experience data that will assist in defining appropriate overhead. Most fees are set at full cost recovery; however, some fees, such as those for planning applications, are intentionally set below full cost recovery to encourage compliance and to account for customer service hours provided to applicants as part of the process. Valuation-driven fees, such as Building Permit fees and Plan Check fees, have remained consistent with the market since 2013. These fees were *not adjusted* by the labor component increases. These fees will

be reviewed during this phase of the comprehensive Master Fee Study. The FY 2023/24 Budget will include revenue projects based on the proposed Master Fee Schedule updates.

Major Revenue Sources and 5-Year Forecasts

The Town's major revenue sources are Property Tax, Building Fees, and ERAF.

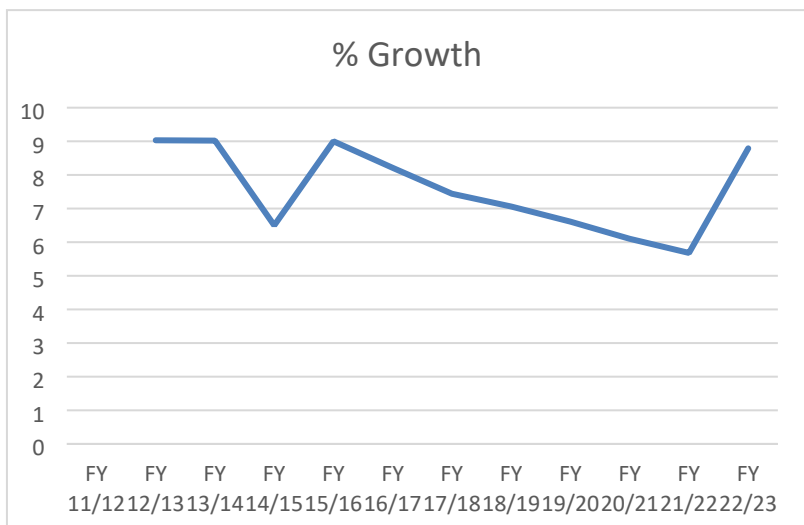
Property Tax Revenue

Property Taxes comprise about 70% of the total General Fund Revenues. Since FY 2011/12, the Town has seen an Assessed Property Value growth of about 223% - roughly 7.5% per year. However, while some years are higher and some years are lower, the overall trend is a decrease in growth.

Tax Year	Assessed Property Value	Growth Year over Year
2011/12	\$6,373,832,577	
2012/13	\$6,949,217,818	9.03%
2013/14	\$7,575,935,532	9.02%
2014/15	\$8,068,565,397	6.50%
2015/16	\$8,791,201,962	9.00%
2016/17	\$9,512,555,665	8.21%
2017/18	\$10,220,091,841	7.44%
2018/19	\$10,941,160,453	7.06%
2019/20	\$11,664,530,505	6.61%
2020/21	\$12,376,059,220	6.10%
2021/22	\$13,078,821,692	5.68%
2022/23	\$14,227,857,062	8.79%

Atherton's changes in property values are based mainly on CPI growth, residential remodels, and new construction on razed properties. The Town's Property Tax Consultant HdL Companies suggests that the Town use a projected increase of 4.5 to 5.5 percent in Property Tax revenues.

This is a combination of the projected CPI growth plus a review of construction activity that will come online in the next assessment period. For the 5-year forecast, staff projected a 5.5% increase in year one, and a 4.5% increase in years two and 4% increase in years three through five. For the purposes of budgeting in each successive current fiscal year, these are conservative projections that can be adjusted year over year.



Building Permit Revenues

Building permit revenue is another major revenue source for the Town. Total revenue includes the basic building permit fee (calculated based a valuation per square foot); various flat fees for plumbing, mechanical and electrical permits; grading and drainage permits; and plan check fees. Building Permit and Plan Check Fees are valuation-driven fees. These fees will be reviewed during the phase of the comprehensive Master Fee Study.

During Mid-Year, building permit revenue increased beyond initial projections. The increase was due to increased building activity in Town during FY 2022/23. Staff typically projects building fee revenue increases conservatively at 2% per year. With the increase in building activities the forecast is set at 3% over the next three years and 2% in the fourth and fifth year.

ERAF

From FYs 2013/14 to FY 2015/16, the Town allocated \$3,211,958 of ERAF funds toward Council priorities related to retiree healthcare and pension liabilities. ERAF revenues received from FYs 2016/17 to FY 2021/22 were directed to the Town Center Project – a total of \$10,002,346.

Fiscal Year	Budget Amount	Actual Amount	Use of Funds
FY 2013/14	\$700,000	\$1,020,000	OPEB Liabilities
FY 2014/15	\$700,000	\$1,125,000	\$680,684 – OPEB Liabilities \$444,316 – Workers’ Comp
FY 2015/16	\$1,200,000	\$1,066,958	\$112,998- WC Equity \$548,950- CalPERS UAL \$405,010- Additional CIP
FY 2016/17	\$1,033,000	\$1,103,185	Town Center
FY 2017/18	\$1,066,958	\$1,280,172	Town Center
FY 2018/19	\$1,025,000	\$1,691,772	Town Center
FY 2019/20	\$1,300,000	\$1,784,091	Town Center
FY 2020/21	\$1,312,500	\$1,863,658	Town Center
FY 2021/22	\$1,100,000	\$2,279,468	Town Center

For FY 2022/23, projection for ERAF was near the FY 21/22 revenue amount received of \$2.27 million. Actual revenue for FY 2022/23 was \$2,339,064. This is an increase of \$23,064 over budget of \$2,316,000 and is the highest ERAF that the Town has *ever* received. This is due to several factors, including but not limited to, catch-up provisions, property values, and school revenues. Even though the Town has seen increases in ERAF recently, staff still believes that down the line the State could make additional changes to the calculation to reduce the excess ERAF. This has become more evident in recent legislation being introduced that requires jurisdictions backfill the State’s VLF obligations using Excess ERAF monies that local taxing agencies are entitled to receive. The proposed language does not make counties and cities whole for the State’s VLF obligations. The protection of ERAF revenue is an annual event.

Staff recommends that for projection purposes, FY 2023/24 ERAF revenue be estimated at \$2.3m. *The Council will review and direct ERAF during the annual budget process.*

These three major revenues represent the primary revenues to the Town. Below is a table that reflects 5-year projections for these three revenue sources.

Major Revenues					
	FY 2023/24	FY 2024/25	FY 2025/26	FY 2026/27	FY 2027/28
Property Taxes	\$15,734,995	\$16,443,070	\$17,100,792	\$17,784,824	\$18,496,217
Building Fees	\$1,988,570	\$2,047,867	\$2,106,943	\$2,148,882	\$2,191,660
Excess ERAF	\$2,300,000	\$2,300,000	\$2,300,000	\$2,300,000	\$2,300,000
Total Revenues	\$20,023,565	\$20,790,937	\$21,507,735	\$22,233,706	\$22,987,877

As part of the budget process staff reviews and projects other significant revenues to ensure there is adequate funding to meet operational service levels. Except for Planning Revenue (3%), these revenues are projected at 1% to 2% and/or based on historical amounts received in the 5-year forecast. Park Program Revenue is projected based on current program revenue as we continue to monitor use post-pandemic. The following table reflects the projections of other significant revenue sources.

Other Significant Revenues					
	FY 2023/24	FY 2024/25	FY 2025/26	FY 2026/27	FY 2027/28
Sales & Use Tax	\$321,300	\$327,726	\$334,281	\$340,966	\$347,785
Franchise Fees	\$1,031,220	\$1,046,688	\$1,057,155	\$1,067,727	\$1,078,404
Business License	\$283,560	\$287,813	\$290,692	\$293,598	\$296,534
Planning Revenue	\$299,009	\$307,661	\$317,219	\$323,563	\$330,034
DPW Revenue	\$702,990	\$722,859	\$743,323	\$757,376	\$771,709
Park					
Program Revenue	\$237,456	\$241,018	\$243,428	\$245,862	\$248,321
Other Revenue	\$1,093,169	\$1,114,506	\$1,135,846	\$1,166,916	\$1,189,411
Total Revenues	\$3,968,704	\$4,048,271	\$4,121,944	\$4,196,088	\$4,262,198

Major Expenditure Categories and 5-Year Forecasts

The 5-Year Projections for Salaries and Benefits are shown below. These amounts do not represent any contractual labor adjustments (i.e. CPI or negotiated benefit increases). Should salaries and benefits be adjusted through labor negotiations, the amounts may change.

Salaries & Benefits					
	FY 2023/24	FY 2024/25	FY 2025/26	FY 2026/27	FY 2027/28
Administration	\$728,304	\$757,436	\$787,733	\$811,365	\$835,7061
Finance	\$628,758	\$653,908	\$680,065	\$700,467	\$721,481
Building	\$274,628	\$285,613	\$297,037	\$305,948	\$315,127
Police	\$7,350,795	\$7,644,827	\$7,950,620	\$8,189,138	\$8,434,812
DPW	\$523,117	\$544,042	\$565,803	\$582,777	\$600,261
Total	\$9,505,602	\$9,885,826	\$10,281,258	\$10,589,695	\$10,907,387

Major operational expenditure categories within the department budgets are *Professional Services* and *Other Technical Services*. These expenditure categories represent a variety of contract services, software licensing, and basic operational costs. These are built into the projection table below and represent services such as building and safety services, maintenance services, park event services, tree maintenance, legal services, planning services, IT services, and animal control services. Services provided under contract are not Town staff. There may be some operational cost adjustments with the Town Center related to maintenance of equipment and required services. Basic budget assumptions for the General Operations expenditure budgets are 3.0% to 4.5% year to year in the forecast. The first two years of the forecast project 4.5% increases, followed by 3.5% and then 3% in the last two years. *Actual budget requirements may be slightly different as we move through the budget process* – for example, as part of the budget process, the Council may allocate specific funds toward expanding community events, the Historic Train Station, or the 100-Year Celebration.

Operational Expenditures					
	FY 2023/24	FY 2024/25	FY 2025/26	FY 2026/27	FY 2027/28
Council	64,281	67,174	69,525	71,611	73,759
Administration	263,844	275,717	285,367	293,928	302,746
Attorney	323,950	338,528	350,376	360,888	371,714
Finance	256,402	268,212	277,166	285,481	294,045
Planning	408,554	424,896	441,892	459,568	477,950
Building	1,130,174	1,181,032	1,222,368	1,259,039	1,296,810
Inter-department	1,025,679	1,071,835	1,109,349	1,138,723	1,166,253
Police	1,382,493	1,444,705	1,495,270	1,540,128	1,586,332
DPW	2,518,855	2,632,204	2,724,331	2,806,061	2,883,611
Total Amount	\$7,374,232	\$7,704,303	\$7,975,644	\$8,215,427	\$8,453,220

Pension Liabilities

Over the years the CalPERS pension discount rate reduced from 7.5% to 7.0%. In 2021, CalPERS reduced the discount rate again as the FY 2020/21 investment return of the pension fund was 21.3%. This triggered CalPERS Funding Risk Mitigation Policy (FRMP) which sets thresholds to be used when investment returns outperform the discount rate. This was the first time this triggered the Policy which requires that the discount rate be lowered in years that investment returns meet a specific threshold. Since the investment return was +13 percentage points higher than the discount rate of 7%, it resulted in the discount rate being lowered by .20%. As a result, the discount rate was reduced to 6.8%. In November 2021 the CalPERS board adopted a new investment return assumption of 6.8% It was during this time the CalPERS Board selected a portfolio that would provide a projected rate of return of 6.8% while balancing risk and reward on investments. The new discount rate for the next several years is set at 6.8%, and the implemented changes took effect July 2022. *It was communicated that the new discount rate of 6.8% would affect public agency employers in FY 2023/24. The effect of these changes is a gradual increase in the required contributions for UAL and Normal Cost increases.*

The contribution rate set by CalPERS for Miscellaneous Employees (non-sworn) is 11.06% in FY 2022/23 and in FY 2023/24 the rate is changed to 12.63% and represents 1.57% change in the rate.

The contribution rate set by CalPERS for Public Safety Employees (sworn) is 25.64% in FY 2022/23. It will have a 3.45% increase to 29.09% in FY 2023/24. The Town's CalPERS actuary advised that due to the reduction in the discount rate, pension costs will increase in the next several years; but there will also be a reduction in the UAL that will reflect the recent 21.3% investment return in FY 2020/21.

The Town Audit & Finance Committee reviews the annual CalPERS actuary reports to assist the Town in identifying strategies for reducing the Town's long-term liabilities. Strategies include efforts to reduce future pension payments by paying down unfunded liabilities and managing future increases by creating reserves. In April 2022, the City Council directed staff to allocate \$5 million toward the Town's Unfunded Accrued Liability (UAL) for the Public Safety Classic Plan. CalPERS allows employers to make Additional Discretionary Payments (ADP's) at any time and any amount. Optional ADP payments serve to reduce the Town's UAL and future required contributions. This can result in significant long-term savings. Prior to the ADP of \$5 million, the FY 2022/23 current minimum required employer contribution towards the UAL for this plan was \$1,172,082. The estimated UAL was as follows:

CalPERS UAL Contribution	UAL FY 2022/23	UAL FY 2023/24	UAL FY 2024/25	UAL FY 2025/26	UAL FY 2026/27
Public Safety UAL	\$1,172,082	\$1,235,697	\$1,323,634	\$1,380,442	\$1,434,332
Public Safety UAL w/\$5m ADP	\$815,591	\$817,530	\$797,300	\$748,300	\$696,300
Difference – Savings	\$356,491	\$418,167	\$526,334	\$632,142	\$738,032

Making the \$5 million contribution reduced the Public Safety UAL for FY 2022/23 to \$815,591 and a net savings of \$356,491. It was first projected that making the ADP payment would produce a net savings of \$1.75 million in Public Safety UAL over the next five (5) years. The recent CalPERS Actuary report as of June 30, 2021 reveals updated UAL payments showing that the savings is now estimated at \$2.67 million. The additional savings is indicative of the ADP contribution and the investment return of 21.3% in FY 2020/21.

The Town's estimated Unfunded Actuarial Liability (UAL) payments (minimum annual payments to CalPERS) look as follows:

Unfunded Accrued Liability Payments					
Plans	FY 2023/24	FY 2024/25	FY 2025/26	FY 2026/27	FY 2027/28
Miscellaneous	\$446,369	\$443,000	\$426,000	\$408,000	\$381,000
Public Safety	\$817,530	\$797,300	\$748,300	\$696,300	\$625,300
Total	\$1,263,899	\$1,240,300	\$1,174,300	\$1,104,300	\$1,006,300

The above UAL's are invoiced to the Town at the beginning of each fiscal year. Paying at the beginning of the year as a lump sum versus monthly results in a savings to the Town. These projections reflect the new 6.8% discount rate that the CalPERS board adopted in November 2021.

Staff monitors the discount rate and effects of CalPERS changes over the years. With CalPERS' discount rate of 6.8% and this year's preliminary return of -6.1%, the estimated overall funded status CalPERS Pension stands at 72%. The Town FY 2021/22 Financial Reports recorded a net pension liability of \$12.2m (local miscellaneous and public safety). This is a decrease of \$7.02m

from the previous year. Staff will continue to present the CalPERS Actuarial Reports to the Finance Committee and work with CalPERS actuary to continue to review and discuss pension liabilities as we discuss opportunities to further pay down unfunded pension liabilities.

Debt Service Lease Payments

The Town issued COP Lease Financing of \$7.68m for cash flow purposes for the Town Center Project. The COP is a ten (10) year financing tool with a five (5) year call option and average annual debt service of approximately \$861,000. The first semi-annual payment began December 2020. We have made \$2.13m in payments on the COP Lease. The Town can exercise the call option in June 2025 and pay off the COP. The call option estimated payment amount is \$4.7m. Through term, the total lease financing payments is \$8.6m of which includes interest of \$915k.

Capital Projects

Capital Projects will be addressed in detail at Meeting #3 – May 3. Capital projects focus on streets & transportation, drainage, and Town Buildings & Park Facilities. Staff is still reviewing priority projects from the various Master plans for Council review and discussion.

Funding sources for capital projects are the following:

General Fund	Library Funds
Capital Improvement Fund	Channel Funds
Measure A, Measure W, & Measure M	Surface Transportation Funds
Gas Tax	Donations (Town Center)
MTC transportation Funds	Remaining Parcel Tax

Fund and Reserve Balances

The General Fund is the Town’s primary operating fund and also maintains reserve balances for emergencies, operating reserves, capital reserves and unallocated reserves. A portion of the Town’s General is set aside as committed to *Emergency Reserves*. Emergency Reserves represent 15% of the **actual** annual General Fund operating expenditures each year.

The Town also has an *Operating Reserve* set aside at 15% of the **actual** annual General Fund operating expenditures each year. Prior years the Operating Reserve set aside was at 20% of actual General Fund Expenditures. During the FY 2023/24 Budget discussions, the Council approved reducing this reserve to 15%. There is no defined use for the Operating Reserve other than set aside funding. These Reserves provided financial assurance to the Town’s lender for the COP. The City Manager does not have discretion to utilize the Emergency Reserve or the Operational Reserve without specific City Council direction. Any remaining fund balance not reserved or committed is designated as *Unallocated Fund Balance*. This Unallocated Fund Balance represents funds that have not yet been assigned. The reduction of the Operating Reserve to 15% freed up approximately \$926K to be distributed to the Unallocated Fund Balance.

Budget Process and Policy Discussions

The budget process is done in stages to allow the City Council and public time to review the General Fund Operations Budget, the Capital Improvement Budget, Special Revenues, and Internal Service Funds. The budget process provides staff the opportunity to examine programs, propose changes in current services, outline operational needs and recommend capital outlay items to the City Council.

Budget Goals

As staff prepares the budget, staff will set goals for each department that continue to maintain or enhance the level of service throughout the community, while ensuring that the Town maintains its core strategy of fiscal stability. These goals are based on the overall Council Policy Goals.

POLICY FOCUS

The policy focus for this item is discussion and overview of the budget process, philosophy, and assumptions. There are policy areas for Council discussion and direction. Discussion includes budget revenue and expenditure assumptions, the use of excess ERAF, use of OPEB retiree health expense reduction, reserve policies, and a policy focus on the reduction of long-term liabilities.

GOAL ALIGNMENT

This report and its contents are in alignment with the following Council Policy Goals:

- Goal A – Maintain Fiscal Transparency
- Goal F – Be Forward-Thinking, Well-Managed, and Well-Planned

FISCAL IMPACT

None.

PUBLIC NOTICE

Public notification was achieved by posting the agenda, with this agenda item being listed, at least 72 hours prior to the meeting in print and electronically. Information about the project is also disseminated via the Town's electronic News Flash and Atherton Online. There are approximately 1,200 subscribers to the Town's electronic News Flash publications. Subscribers include residents as well as stakeholders – to include, but be not limited to, media outlets, school districts, Menlo Park Fire District, service providers (water, power, and sewer), and regional elected officials.

The Town maintains a Fiscal Transparency web portal and includes all budget information on its website. Links to these various areas are below:

Fiscal Transparency Web Page: <http://www.ci.atherton.ca.us/index.aspx?NID=269>

Archive of Town Budgets: <http://www.ci.atherton.ca.us/index.aspx?nid=273>

Financial Data Portal (OpenGov): <http://www.ci.atherton.ca.us/index.aspx?nid=361>

Financial Audit Archive: <http://www.ci.atherton.ca.us/Archive.aspx?AMID=39&Type=&ADID=>

Actuarial Valuations Archive:

<http://www.ci.atherton.ca.us/Archive.aspx?AMID=61&Type=&ADID=>

Labor Contracts, Agreements, and Salary/Benefit Information:

<http://www.ci.atherton.ca.us/index.aspx?nid=192>

ATTACHMENTS

FY 2023/24 General Fund Five Year Forecast