



## CITY COUNCIL STAFF REPORT

**From: City Manager**

**Report Type: Action**

**Lead Department: Administrative Services**

**Meeting Date: February 13, 2023**

### **TITLE**

Discuss the FY 2023 Mid-Year Budget Review and Approve 1) FY 2023 Budget Amendments in Various Funds, and 2) Amendments to the FY 2023 Table of Organization to add 5.25 full-time and 2.43 part-time Full Time Equivalent (FTE) Positions

### **RECOMMENDATION**

Staff recommends that the City Council review, discuss, and approve:

- 1) Amendments to the Fiscal Year 2023 Budget Appropriation for various funds and various capital projects, as identified in Attachment A and Attachment A, Exhibit 1 and 2 (requires a supermajority, 2/3 approval); and
- 2) Amend the FY 2023 Table of Organization in Attachment B consistent with the budget amendments in Attachment A, adding 5.25 full time and 2.43 part time FTE positions.

### **EXECUTIVE SUMMARY**

This report provides and extensive update on the City's financial status as of December 31, 2022, halfway (6 months) through the current fiscal year. Included in this report are (1) recommended budget adjustments to FY 2023 that reflect urgent / high priority fiscal needs or technical adjustments, (2) recommended changes in staffing levels in FY 2023 adding 5.25 positions and 2.43 part-time FTE, (3) updated information on the City's financial position in and outlook in FY 2023 including positioning for the upcoming FY 2024 budget process, and (4) FY 2023 2<sup>nd</sup> quarter financial status updates (Attachment C). The next significant financial planning and budget discussions will be the review of the FY 2024 proposed operating and capital budgets and municipal fee schedule (May 2023 – June 2023) and recommended utility rates (March 2023 – June 2023).

Each year staff bring forward recommendations to adjust the budget as part of the Mid-Year Budget review. The City continues to reinvest in the most immediate needs of the City in order to maintain high quality services for residents and position the City to proactively position itself

financially in alignment with the 2024-2033 Long Range Financial Forecast<sup>1</sup>. Recommended adjustments address measured investments for immediate needs to be addressed in FY 2023, rather than waiting for the FY 2024 budget process. Revenue adjustments align the FY 2023 budget for major tax revenue sources with current projections and proactively fund reserves to sustain the City through the next forecasted 2 years of projected deficits.

The City Council may amend the annual budget through appropriate motion; Attachment A and B, if approved as recommended, provide the necessary transactional information for official amendment of the annual budget. The budget appropriation actions require a supermajority approval by the City Council (PAMC 2.28.080(c)(1)), or five (5) votes. The staff report provides discussion of the balancing strategy as well as key highlights from the detailed adjustments. This report is organized as follows:

- 1) FY 2023 Mid-Year Budget Adjustments
  - a) General Fund
    - i) Mid-Year Budget Review Balancing Strategy Summary
    - ii) Reinvestment Actions, Recommended Adjustments to the Budget
    - iii) Position/Table of Organization Changes Summary
    - iv) Technical Adjustments and Previous Council Direction
    - v) Budget Balancing Actions and City's Financial Position in FY 2023 and FY 2024
  - b) Other Funds
  - c) Enterprise Funds
  - d) Capital Funds
- 2) Preliminary Q2 Financial Status & public safety overtime (Attachment C & D)
- 3) Timeline and Next Steps

Staff continues to manage resource availability and demands for extreme flexibility and nimbleness in an environment that requires increased resources to deliver the same quality of service. Passage of Measure L (Utility Transfer) and Measure K (Business Tax) by voters on the November ballot will help to bolster revenues to pay for the increased cost of the services but are not enough to cover the projected gap between revenues and expenses for the next several years.

The balancing strategy works to continue the practice of funding ongoing activities with ongoing revenue sources to proactively establish an uncertainty reserve at a level to offset projected deficits for the next several years. Staff will continue to monitor these estimates and may bring forward a year-end budget adjustment report in June with any additional refinements to budgeted levels based on the most current information available.

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<sup>1</sup>2024-2033 Long Range Financial Forecast  
<https://cityofpaloalto.primegov.com/Public/CompiledDocument?meetingTemplateId=1069&compileOutputType=1>

The economic outlook remains uncertain with national, state, regional, and local economic indicators in transition. The economy exited 2021 in overdrive, but that growth combined with global supply chain constraints pushed inflation higher than expected. The federal reserve began raising the fed funds interest rate in March 2022 and is expected to continue in 2023, though at a slower pace, which is intended to tame inflation. It remains unknown if the federal reserve will achieve a “soft landing” where a slowdown in economic growth stems the rate of high inflation but avoids a recession. The UCLA Anderson Forecast for California paints a generally positive picture for the state as compared to national economic concerns. The local economy continued to show strong performance in the latter half of the calendar year 2022, but “headwinds” will likely slow the pace of economic growth. Finally, there are several issues across the City continuing to impact the ability to transition beyond impacts of the pandemic including staff turnover, recruitment and retention, and supply chain issues and inflation that continue to increase costs across all aspects of the City.

## **BACKGROUND**

Annually, staff brings forward the Mid-Year Budget Review to report the financial status of major funds and the Capital Improvement Program as of the second quarter (Q2) of the current fiscal year and recommends adjustments to the Adopted Budget. Adjustments to the City’s budget may become necessary as revenues and expenditures vary from the original budget plan and are typically ministerial. Staff has modified this Mid-year Budget Review to be more robust and include adjustments that proactively reinvest in City services and priority initiatives in advance of the FY 2024 budget process in alignment with expressed priorities by the City Council. Additionally, this report aligns estimates for significant changes that have occurred in FY 2023, including projections for major tax revenues and the status of new labor agreements.

Where possible, budget change recommendations are brought forward for City Council consideration as part of the approval of the Mid-Year Budget Report to consolidate requests and streamline changes to budget appropriations. These adjustments are necessary as revenues and expenditures vary from the original budget plan for many reasons, including, but not limited to, changes in economic factors, project estimates and scope, and City Council policy and direction. The Mid-Year Budget Report reflects adjustments to align with prior City Council approved direction, clean-up actions based on FY 2022 actual experience or current FY 2023 actual activities.

As discussed in the FY 2024-2033 Long Range Financial Forecast (LRFF)<sup>2</sup>, the City made significant service reductions in FY 2021 and FY 2022 Adopted Budgets to align expenses with losses of nearly \$40 million in General Fund tax revenues due to economic impacts resulting from the COVID-19 pandemic. During this time, many services were reduced or eliminated across the

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<sup>2</sup> 2024-2033 Long Range Financial Forecast

<https://cityofpaloalto.primegov.com/Public/CompiledDocument?meetingTemplateId=1069&compileOutputType=1>

organization and essential services were prioritized. In FY 2022, the City began to see gradual signs of improvement and a positive economic outlook that supported initial reinvestments. Further reinvestments were made in the FY 2023 Adopted Budget to restore services that were previously reduced and provide resources to support priority initiatives. Additionally, the budget continued proactive funding of long-term retiree benefits and initiated a three-year plan to recover capital infrastructure investments to pre-pandemic levels.

In the first half of FY 2023, staff brought forward the FY 2022 Annual Comprehensive Financial Report (ACFR) (Staff Report 2301-0715)<sup>3</sup> for Council approval and the First Quarter (Q1) FY 2023 Financial Report (Staff Report 14630)<sup>4</sup> for Finance Committee review. Staff reported higher annual earnings for general fund revenues in FY 2022 as compared to the budget primarily due to a faster recovery of major tax revenues in the last two quarters of the fiscal year. This recovery trend continued in the first and second quarter of FY 2023, with several major tax revenue categories tracking to exceed budgeted levels; actual year end results may vary due to continued economic uncertainty. Staff anticipates using this additional one-time funding and reserves to support near-term reinvestments and bridge projected shortfalls in the LRFF. Ongoing, staff expects that continued economic recovery and a more diverse revenue base will help to stabilize the fiscal outlook.

A list of prior staff reports providing various fiscal updates for Council deliberations can be found in Attachment E for ease of reference.

## **ANALYSIS**

This item serves as a continuation of the many touch points as the City balances responding to emergent priorities with following through on established commitments. This report highlights several areas of staff work ahead and outlines next steps and timing for a series of City Council conversations planned to focus on fiscal monitoring, community and economic recovery, and more. Further strategic work continues aside from the financial reporting discussed above, focused on a Community and Economic Recovery Strategy. Findings and recommended adjustments in this report are based on the data available at the time of reporting and reflect preliminary 2<sup>nd</sup> Quarter financial activity in FY 2023 (Attachment C). Final Q2 data is typically available at the end of March 2023, though material differences are not expected.

The following is an overview of the status for the General Fund, Enterprise Funds, and other funds including recommended budget adjustments as they pertain to the City's FY 2023 Operating and Capital Budgets.

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<sup>3</sup> City Council Staff Report 2301-0715 January 23, 2022

<https://cityofpaloalto.primegov.com/Portal/Meeting?meetingTemplateId=1061>

<sup>4</sup>City Council Staff Report 14630 December 6, 2022 <https://www.cityofpaloalto.org/files/assets/public/agendas-minutes-reports/agendas-minutes/finance-committee/2022/20221206/20221206pfscsm-late-packet.pdf>

## General Fund

### Mid-Year Budget Review Balancing Strategy Summary

The General Fund ended FY 2022 with funding more than the 18.5% target level for the Budget Stabilization Reserve (BSR) in FY 2023. The BSR is currently at \$59.8 million or \$14.2 million above the 18.5% Council target level. Use of this excess BSR funding is recommended to fund actions in this memorandum as discussed in the 2024-2033 LRFF report<sup>5</sup>. Use of several other reserves is also recommended to fund actions in this report and consolidate reserve funding into one Budget Uncertainty Reserve to proactively address the estimated deficits over the next several years. In addition to this funding, a few of the major tax revenue categories are tracking at or above the FY 2023 budget, most significantly Property Tax, Sales Tax, and Transient Occupancy Tax. Adjustments to these Major Tax revenues are recommended to align the budget with current projections for these categories, and staff will continue to monitor other more volatile revenue sources. Finally, there are also potential risks and benefits associated with this balancing strategy that should be considered when looking beyond FY 2023. The risks would further reduce the City's ability to fund the current level of services over the next several years, while the benefits could offset costs for a longer period or even increase available funding sources. These are discussed further in the Proposed Balancing Solutions section of this report.

The following table outlines the major drivers of the General Fund mid-year recommended balancing strategy to offset the collective impact of these activities:

**Table 1: General Fund Mid-Year Adjustments and Balancing Solutions**

Summary of General Fund Adjustments		Net \$ Impact (Cost)/Benefit
<b>Reinvestment Actions:</b>		
	Neighborhood, Community and Library Services	\$(0.4) M
	Public Safety	\$(0.4) M
	Planning and Transportation Services	\$(0.2) M
	Internal Services/Strategic Support	\$(0.1) M
	<i>Subtotal Reinvestment Actions:</i>	<i>\$(1.1) M</i>
<b>Technical Adjustments:</b>		
	Major Tax Revenues (Property Tax, Sales Tax, Transient Occupancy Tax)	\$6.0 M
	General Fund Reserves (2023 Service Reinvestments, Utility Transfer Litigation, Transition Costs, Administrative Support, COVID-19)	\$7.8 M

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<sup>5</sup>2024-2033 LRFF report

<https://cityofpaloalto.primegov.com/Public/CompiledDocument?meetingTemplateId=1069&compileOutputType=1>

Program Funding <i>(Race and Equity, Rent Forgiveness)</i>	\$0.8 M
Labor Negotiation Alignment (Net-Neutral Action) <i>(\$2.6M for new labor agreements, offset by \$0.9M Labor and Inflation Reserve and \$1.7M Vacancy Savings)</i>	\$0.0 M
Establish a Budget Uncertainty Reserve <i>(\$5.0M of the excess FY22 Budget Stabilization Reserve)</i>	\$(14.0) M
Supplemental Pension 115 Trust Contribution <i>(\$5.0M of the excess FY22 Budget Stabilization Reserve)</i>	\$(5.0) M
Capital Improvement Funding <i>(\$4.0M of the excess FY22 Budget Stabilization Reserve)</i>	\$(4.0) M
Electricity and Gas Commodity Purchases/Utility Allocated Charges	\$(0.6) M
Utility Equity Transfer	\$(0.6) M
Legal Services <i>(Utility Equity Transfer Case, Personnel Investigations, Wireless Ordinance Update)</i>	\$(0.4) M
Public Safety Revenue <i>(FireMed Program, First Responder Fee, Stanford Fire Services)</i>	\$(0.3) M
Golf Course Revenue Alignment	\$(0.2) M
Flood Response	\$(0.1) M
<i>Subtotal Technical Adjustments</i>	<i>\$(10.6) M</i>
Use of Budget Stabilization Reserve (BSR) <i>(BSR remains at 19.4% and \$2.5 M above the 18.5% target level)</i>	\$11.7 M
<b>Total Net Impact General Fund Mid-Year Adjustments</b>	<b>\$0.0 M</b>

## Reinvestment Actions

This report includes budget adjustments, grouped by service area, to continue to realign resources with the priorities identified by the City Council. Major changes are recommended as directed by the City Council and/or recommended by staff are below, and all transactions can be found in greater detail in Attachment A. It should be noted that recommended budget adjustments have been prorated for the remainder of the fiscal year, or approximately five (5) months.

### Neighborhood, Community and Library Services:

*\$17,000 revenue, \$388,000 expense; 1.25 full-time, 2.43 part-time staffing*

The Community Services Department's recommendations reflect strategic investments in its operations and represent current community needs. The restoration of 1.00 FTE Division Manager of Park Open Space & Golf is due to the need for additional administrative support for the department from the growing list of capital projects where extensive project monitoring and specialized expertise are required. Additional trash pickup at parks is reflective of community

feedback for increased service levels and the current popularity of the City's open spaces. The reopening Junior Museum & Zoo (JMZ) has been successful; however, challenges exist regarding a myriad of issues including staffing, ticket and membership pricing, and utilization of technology to improve operations. The organization study requested by the department represents the City's commitment to operating efficient high-quality youth facilities and services for the community. Other recommendations include providing financial aid to Team Sheep (the City's contractors providing community swim classes) while the Rinconada Pool resurfacing project (Building System Improvements PF-01003) is being completed, funding for an overnight warming shelter, and small community grants to teachers.

The Library Department has completed its organizational assessment and staffing analysis approved in the FY 2023 Adopted Budget and actions to restructure operations in two divisions: Community Engagement & Support Services and Branch Management & Operations are recommended in this report. The reorganization will allow the department to provide more administrative support and leadership for staff. The new service model also prioritizes efficiency by hiring/reclassifying staff that enables the library to cross-train and lead initiatives that improve community wellbeing. The new model also will strengthen and broaden community partnerships. Larger and more strategic programming initiatives aligned with City and community priorities and needs like sustainability, climate action, DEI (Diversity, Equity and Inclusion) and technology will be supported. In addition, the library will also have resources to support services to underserved communities. In addition, the department is recommending increasing expenditures by \$30,000 to increase its current collection of materials related to DEI, along with materials in foreign languages common in the community and expand its web-based collections.

*Public Safety Services:*

*\$0 revenue, \$374,000 expense; 1.00 full-time, 0.00 part-time staffing*

The Police Department recommendation includes the addition of 1.00 FTE Court Liaison Officer to support criminal justice reforms, changes in reporting standards, and staff attrition causing significantly higher staff time needed to process arrests and pursue successful prosecutions in coordination the District Attorney's Office.

Additionally, this report includes recommendations funding in the Fire Department for new fire fighter hiring costs such as uniforms, personal protective equipment (PPE), academy fees, and background checks as 16 entry-level fire fighters have been hired in FY 2023. The Department is also shifting \$1.5M in salary and benefits savings to offset overtime costs associated with the academy. For more information, see the technical adjustments section below. Recruitment and retention remain the top priorities in the immediate term for the Fire Department. These investments are focused on ensuring the Department can continue to provide suppression and rescue services for the City while meeting necessary staffing levels and training requirements.

Planning and Transportation Services:

*\$34,000 revenue, \$173,000 expense; 2.00 full-time, 0.00 part-time staffing*

This report includes recommendations to recognize the impacts of expanding the Building Inspection and Plan Review staffing classifications to include a senior level. These new classifications will be brought forward to be legitimized in the FY 2024 budget cycle. It also includes recommendations to reclassify administrative staff in accordance with a recent classification study and recommendations to increase Long Range Planning capacity to continue to support work on Council priorities including housing and coordinated area plans.

For the Office of Transportation, this report recommends the reclassification of a 1.00 FTE Management Analyst to a Senior Management Analyst, consistent with the classification study's finding that the duties of the position are better aligned with the senior-level position. The Senior Management Analyst will be responsible for higher level oversight of the department budget and contracts for projects and programs including Rail Grade Separation, Safe Routes to School, Parking, Traffic Operations and Safety, and the Bike and Pedestrian Plan. This position will also provide administrative support for staffing needs, prepare staff reports, and act as a liaison for cross-departmental assignments. The cost of the reclassification will be absorbed by vacancy savings from the current budget and will therefore have no budgetary impact in FY 2023.

Internal Services/Strategic Support:

*\$0 revenue, \$125,000 expense; 0.00 full-time, 0.00 part-time staffing*

Included in this report are recommendations to add one-time funding for two outside counsel agreements in the amount of \$125,000 for legal work associated with the Roth Building Rehabilitation.

**Position/Table of Organization Changes Summary**

Critical staffing challenges remain citywide. This report includes recommendations to add 5.25 full-time and 2.43 part-time positions. The recommendations in this report increase full-time staffing levels in the General Fund Table of Organization from the FY 2023 adopted level of 552.81 FTE to 557.06 FTE (1,017.85 FTE to 1,023.10 FTE Citywide). See Attachment B, an amended Table of Organization, for additional detail regarding the full-time position changes.

**Technical Adjustments and Previous Council Direction**

This report includes actions that are technical in nature and are needed to align budget with current trends, and previous direction approved by the Council. Major changes are recommended as directed by the City Council and/or recommended by staff are below, and all transactions can be found in greater detail in Attachment A.

Major Tax Revenue: \$6,000,000 additional revenue

Staff evaluated departmental and major tax revenue through Q2 and recommends actions that result in a net \$6.0 million increase. As noted in the Q1 Financial Report, major tax revenue categories are trending higher than budgeted in FY 2023, and a \$6.0 million increase is



recommended to increase Transient Occupancy Tax (\$4.0 million), Sales Tax (\$1.5 million), and Property Tax (\$0.5 million).

*General Fund Reserves: \$8,700,000 expense savings*

A number of reserves in the General Fund are being reduced in order to fund actions recommended in this report and consolidate reserve funding to ease administration and clarity.

- The 2023 Service Reinvestments Reserve (\$3.8 million) is being eliminated in order to consolidate the funding into the Budget Uncertainty Reserve as discussed below.
- The Utility Transfer Litigation (Equity Transfer) Reserve is being reduced by \$3.5 million due to the passage of Measure L on the November 2022 ballot. This funding was set aside for potential future costs related to the Green v. City of Palo Alto (Santa Clara Superior Court, Case No. 1-16-CV-300760) if Measure L did not pass. The reserve will still have \$17.5 million to fund the estimated settlement of the case.
- The Transition Costs (\$0.2 million) and Administrative Support (\$0.2 million) Reserves are being eliminated in order to fund various actions in this report as well as consolidate reserve funding within the General Fund.
- The COVID-19 Reserve is being reduced by \$0.1 million to fund flood response needs around the City. This reserve will still have approximately \$0.4 million to fund any remaining COVID-19 related costs such as technology equipment for hybrid operations. Any remaining funding in this reserve is anticipated to be liquidated at the end of FY 2023.

*Program Funding (reconciliation): \$800,000 expense savings*

These technical corrections reduce funding for programs that have already spent funding or have been completed and the funding is no longer needed. As part of the FY 2022 Reappropriations to FY 2023 (Staff Report 14728)<sup>6</sup>, unspent funding was moved from FY 2022 to FY 2023 for the Advancing Racial Equity program (\$0.5 million) and the Rent Forgiveness program (\$0.7 million). After further analysis, it was determined that \$0.1 million had been spent on contracts related to Advancing Racial Equity work, and the Rent Forgiveness program had been completed in FY 2022. As a result, technical corrections are needed in this report to reduce the funding for Advancing Racial Equity work to \$0.4 million and eliminating the \$0.7 million funding for Rent Forgiveness to reconcile budget estimates with program activities.

*Labor Negotiation Alignment: \$2,600,000 expense; \$2,600,000 expense savings*  
*(Net-Neutral Action)*

All labor agreements were scheduled to expire on December 31, 2022, except for the Service Employees International Union Hourly Unit (SEIU-H) agreement, which is extended through June 30, 2023. This net-neutral adjustment increases departmental salary and benefit

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<sup>6</sup>City Council Staff Report 14728 October 24, 2022 <https://www.cityofpaloalto.org/files/assets/public/agendas-minutes-reports/agendas-minutes/city-council-agendas-minutes/2022/20221024/20221024pccsm-amended.pdf>

expenditures to align with the status of City and labor group economic proposals for all contracts, including compensation adjustments and other terms of employment. An additional \$2.6 million in estimated expense increases is expected for new labor terms and is fully offset by the elimination of the Labor and Inflation Reserve (\$900,000) and projected departmental vacancy savings (\$1.7 million) based on current expense tracking.

*Budget Uncertainty Reserve (establish): \$14,000,000 expense*

This adjustment establishes a \$14.0 million Budget Uncertainty Reserve to proactively set aside funding to address estimated deficits over the next two years. This action consolidates the City Council prior actions for a two-year budget strategy adopted in FY 2023 and additional funds approved by the City Council in the FY 2022 Annual Comprehensive Financial Report (ACFR). Excess BSR of \$5.0 million was directed to establish an Economic Uncertainty Reserve. The remaining funding is coming from the liquidation of the 2023 Service Reinvestments Reserve (\$3.8 million) and appropriating a portion of the excess FY 2023 major tax revenue (\$5.2 million) both discussed as part of the City's FY 2024-2033 LRFF.

*Supplemental Pension Trust Contribution: \$5,000,000 expense*

This adjustment adds a \$5.0 million transfer to the General Benefits Fund for an additional contribution to the City's Section 115 Pension Trust, bringing total principal contributions to \$55.0 million (\$36.8 million from the General Fund) since inception in 2017. This action was approved by the City Council in the FY 2022 Annual Comprehensive Financial Report (ACFR) for BSR exceeding target levels of 18.5% and reflects General Fund contributions only and is consistent with the City's Retiree Benefits Funding Policy. Staff will include adjustments for proportional contributions from other (non-General Fund) funds as part of the FY 2023 year-end or FY 2024 proposed process consistent with past practice and policy guidelines.

*Capital Improvement Funding: \$4,000,000 expense*

This adjustment formalizes City Council actions to allocate \$4.0 million resulting from FY 2022 year-end excess BSR, bringing the total base General Fund transfer to the Capital Improvement Fund to \$12.8 million in FY 2023 and is consistent with the Council policy guiding use of surplus funds. This funding will be used to fund projects that are anticipated to exceed their current budget such as the Downtown Automated Parking Guidance Systems project (PL-15002) as well as increasing the fund balance in the Capital Improvement Fund for use in the development of the upcoming 2024-2028 five-year Capital Improvement Plan.

*Utility Equity Transfer: \$583,000 expense*

This action reduces the equity transfer to the General Fund from the Electric (\$101,000) and Gas (\$482,000) Funds in FY 2023 as a result of lower than anticipated fixed assets (depreciation) in FY 2022, and increased commodity and operation and maintenance costs, as well as the passage of

Measure L in November 2022. This action is in alignment with the FY 2022 Annual Comprehensive Financial Report (ACFR) as of June 30, 2022 (CMR 2301-0715)<sup>7</sup>.

*Gas Commodity Purchases/Utility Allocated Charges: \$228,000 expense*

Gas commodity purchases increased in the Gas Fund consistent with the preliminary gas supply forecast, which reflects fluctuating market prices and anticipated demand. This action aligns revenue in the Gas Fund and City gas expenses accordingly.

*Electric Commodity Purchases/Utility Allocated Charges: \$427,000 expense*

Electric commodity purchases increased in the Electric Fund consistent with the preliminary electric supply forecast, which reflects fluctuating market prices and anticipated demand. This action aligns revenue in the Electric Fund and City electric expenses accordingly.

*Legal Services Contractual Support: \$395,000 expense*

Recommendations are included to add ongoing funding of \$250,000 for employee-specific personnel investigations and one-time funding for outside counsel agreements in the amounts of \$120,000 for the Utility Transfer Litigation (Equity Transfer) and \$25,000 for a wireless ordinance update.

*Public Safety Revenue: Stanford Fire Service Agreement and FireMed/First Responder Programs \$140,000 revenue, \$461,000 expense*

This report includes technical actions to realize FY 2022 and FY 2023 Stanford fire and communications services revenue, Fire Station 8 overtime reimbursements from the County, and a realignment of revenue estimates for Fire Department programs.

Per the agreement with Stanford, at the second quarter of each year actual expenditures are calculated and reconciled against budgeted levels for the prior fiscal year, resulting in either an additional payment or a reimbursement. For FY 2022 actuals, an additional payment of \$495,000 has been made by Stanford based on this reconciliation. An adjustment of \$539,000 for FY 2023 Stanford revenue is also included to align the forecasted budget for fire prevention services with the actual amounts being invoiced. Additionally, the City has an agreement in place with Santa Clara County to staff Fire Station 8 on alternate months during high fire season months. As a result, the County has provided a reimbursement of \$177,000 for overtime from staffing the station on behalf of the City of Los Altos Hills. Also included in this report is a reduction of \$1.4 million to Fire Department revenue estimates for the FireMed Program and discontinuation of the First Responder Fee Program. Lastly and net neutral adjustment of revenue and matching expenses is recommended to recognize reimbursement from the State for medical transportation costs through the Ground Emergency Medical Transportation (GEMT) program.

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<sup>7</sup> <https://cityofpaloalto.primegov.com/Portal/Meeting?meetingTemplateId=1061>

*Golf Course Services: \$255,000 expense*

This adjustment increases contract expenditure by \$255,000 for City Golf Course operations owed to the management company, OB Sports. The terms of agreement include a revenue share equivalent to 20% of the calculated FY 2022 difference between Gross Revenue and Target Revenue for that fiscal year.

*Flood Response: \$100,000 expense*

Floods caused by multiple atmospheric rivers in California beginning on December 31, 2022 caused periods of heavy rainfall that resulted in flooding, property damage, loss of power, and evacuations across the state. The City provided regular updates and communication to residents during this time, including opening a Community Resource Center at Rinconada Library to provide a warm and dry location to relocate and gather. This action increases associated expenses for materials and equipment rentals, lodging for displaced residents, and additional staffing to provide consistent coverage.

***Budget Balancing Actions and City's Financial Position in FY 2023 and FY 2024***

With the approval of these amendments the BSR would be reduced by \$11.7 million. The projected ending balance of the General Fund Budget Stabilization Reserve is anticipated to be \$48.1 million, which is above the City Council recommended 18.5 percent level of \$45.6 million by \$2.5 million.

This balancing solution follows the City Council approved budget guiding principles as presented annually with the approval of the City's LRFF and seeks to:

- 1) Develop a structurally balanced budget that brings ongoing revenues and expenses into alignment. Develop a plan for any structural imbalance to ensure that the City maintains fiscal sustainability over the short, medium, and long-term.*
- 2) Allocate one-time resources for one-time needs rather than committing one-time resources to ongoing services. Examine appropriate uses of revenue surpluses that exceed forecasted levels such as planning for recession needs, restoration needs, and strategic investments.*
- 3) Ensure appropriate resource allocation for City Council's existing priorities.*
- 6) Continue to thoroughly analyze non-personnel/equipment/other costs, such as contract services, for cost savings opportunities or realignment with current needs.*
- 9) Continue to prioritize proactively funding long term liabilities including but not limited to debt obligations, pension obligations, and capital infrastructure in accordance with City policies as approved by Council.*

When bringing forward budget actions, staff works to align recommendations with the guiding principles for budget balancing as approved by the Council. The above principles most closely align with this FY 2023 Mid-Year Budget Review. Establishing a \$14 million Budget Uncertainty

Reserve ensures that in the short and medium term, the City has a stable financial plan to address current service levels while investing in core priority service areas. Although it does not fully fund all identified priority projects, it does continue to focus reinvestment in areas that support the Council's priorities. A number of adjustments continue to align revenues and expenses with current tracking including use of vacancy savings for increase labor contract costs and excess revenues for proactive planning for the future. Lastly, the City continues to maintain its policies for use of excess BSR through continued proactive funding of pension liabilities and a transfer to support capital investment. Lastly, the BSR remains above target levels by \$2.5 million allowing for further investment in priority areas as part of the FY 2024 annual budget process or may be used to assist should economic challenges become more apparent due to recessionary trends.

With any forecast and adjustments based on projections, there are inherent risks and benefits. Staff seeks to conservatively position the City in order to provide organizational stability, while acknowledging the service and resource needs, capacity to implement, and project pipeline to continue to reinvest at a pace the organization can support. Potential risks and benefits associated with this balancing solution that should be considered when looking beyond FY 2023. The risks would further reduce the City's ability to fund the current level of services over the next several years, while the benefits could offset costs for a longer period of time or even increase available funding sources.

#### Risks

- *Unresolved Gap beyond FY 2025* – The Uncertainty Reserve recommended in this report will cover estimated deficits in the first two years of the forecast (FY 2024 and FY 2025); however, at this time the estimated deficits in FY 2026 and FY 2027 (approximately \$7 million in total) would still need to be resolved.
- *Labor Out of Contract* – The current labor contracts would also be up for renegotiation around the time of developing the FY 2026 budget, which may further increase the current costs estimated for that year and years beyond.
- *A more severe economic recession* would cause increased deficits over the next several years and likely shorten the period of time the Uncertainty Reserve could be used to maintain services requiring reductions in costs, new revenues, and/or use of additional reserves such as the BSR. The LRFF is currently modeled with limited underlying economic growth but growth as a result of inflation in the near term (based on the most recent economic forecasts for California).

#### Benefits

- Establishing a *Budget Uncertainty Level at \$14 million* reserves enough funding to cover the estimated deficits and maintain services for at least the next two fiscal years. This stability is provided both to the community and the workforce supporting the goal to attract and retain employees who deliver the services.

- *Major Tax revenue estimates are measured*, depending on economic variables, additional revenue above these modified budgeted levels may materialize.
- *Reserve accounts health* - The City's Pension 115 Trust and California Employers' Retiree Benefit Trust (CERBT) accounts have the potential to fund annual pension and retiree healthcare costs to provide short-term relief to City funds in order to maintain funding to pay for services.
- *A more robust economic recovery* and the influx of Measure K (Business Tax) funding would provide additional sources of funding to reduce the current forecasted deficits.

#### General Fund: Budget Stabilization Reserve

The General Fund Budget Stabilization Reserve is anticipated to be \$48.1 million, which is above the City Council recommended 18.5% level of \$45.6 million by \$2.5 million.

Should the Council approve the actions recommended in this report, there will be three (3) reserves that remain in the General Fund; this is a consolidation from the current seven (7):

1. Reserve: Utility Transfer Litigation (Equity Transfer) \$17.5 million, from \$21.0 million
2. Budget Uncertainty Reserve \$14.0 million, from \$0
3. Reserve: COVID-19 \$400,000, from \$500,000
4. Reserve: 2023 Service Reinvestments \$0, from \$3.8 million
5. Reserve: Labor and Inflation \$0, from \$900,000
6. Reserve: Transition Costs \$0, from \$210,000
7. Reserve: Administrative Support \$0, from \$175,000

#### Other Funds – Mid-Year Budget Adjustments

##### Information Technology Fund

The Technology Fund will add 1.00 FTE Senior Technologist to serve as an additional project manager. The City has 34 technology projects in process with 23 future projects in the pipeline. The additional staffing will allow the City to keep up with its increasingly complex and demanding technology initiatives. In addition, adjustments for contracts that were implemented, amended, or omitted during the current fiscal year have also been included as technical adjustments. These costs will be allocated across the City's departments and funds in alignment with the allocation methodology used as part of the FY 2023 Adopted Budget; however, for General Fund related charges, those costs will be absorbed the Technology Reserve in FY 2023.

Investments in cybersecurity initiatives have also been recommended. As security incidents such as phishing, data breaches, and viruses become more prevalent online, the need to further insulate the City from cyber threats is needed and been advised by the Baker Tilly audit assessments. These costs will be absorbed by Technology Fund in FY 2023.

#### Public Art Fund – Code Art

The Public Art Fund to increase expenditures for continued support for Code:ART, a three-evening interactive media art festival produced by the City of Palo Alto Public Art Program, which re-imagines Palo Alto's underutilized plazas, alleys, and public spaces through interactive light, sound, and motion. The festival features a major interactive media artwork anchoring the festival and six Urban Interventions activating downtown storefronts, alleys, parking lots or blank walls in new and inventive ways. The artworks will invite play and participation, engaging area locals in an event that outwardly reflects the creative community and culture that thrives here. The Public Art Commission approved the use of \$60,000 from the Public Art Fund to support Code:ART at the September 15, 2022 meeting.

#### Supplemental Law Enforcement Services Fund – Opioid Grant

The City has received grant funding tied to Opioid Settlements. The Police Department will spearhead new community initiatives for substance abuse treatment. The Department will provide additional details regarding future programming as federal and state regulators provide guidance on restrictive uses of the funding. This report includes a net-neutral adjustment in the Supplemental Law Enforcement Service Fund to recognize the annual funding of \$44,291 and appropriate the corresponding expense.

#### Gas Tax Fund

The City receives revenues from California's Highway Users Tax Account (HUTA) and the Road Maintenance and Rehabilitation Account (RMRA SB1). In January, the Department of Finance's updates for estimated revenues from these accounts indicated that receipts would be lower than what is currently in the City's budget. To align with the new estimates, gas tax revenues will be reduced by \$271,000, and transfers to the Capital Improvement Fund for the Street Maintenance project (PE-86070) will be reduced by \$136,600 with the remaining gap to be funded by the Infrastructure Reserve.

#### Enterprise Funds – Mid-Year Budget Adjustments

Mid-year actions being recommended in these funds are primarily related to the alignment of the Utilities Department budgets with current market conditions for revenues and expenses related to the purchase of commodities and the operation of utilities. The actions recommended for FY 2023 mid-year will align revenues and expenses for the contract for tree and vegetation clearing from the overhead electric distribution system; Electric and Gas Fund revenue projections and commodity costs; interfund transfers for the Gas and Electric Fund Utilities Equity Transfers; a Fiber Fund transfer to the Electric Fund; legal support contract services; and increased membership fees for the Bay Area Water Supply and Conservation Agency (BAWSCA). See Attachment A, Exhibit 1 for further information regarding the recommended changes in the Enterprise Funds.

#### Capital Budget – Mid-Year Budget Adjustments

Several Capital Improvement Program projects require adjustments in FY 2023. For a detailed view of all project adjustments by Fund, see Attachment A, Exhibit 2.

- Funding of \$100,000 will be appropriated in both the Capital Improvement Fund Administration project (AS-10000) and the Plant Repair, Retrofit, and Equipment Replacement project (WQ-19002) in the Wastewater Treatment Fund. This action will fund legal costs associated with capital projects in these funds instead of funding the costs in the Attorney's Office General Fund budget.
- The Benches, Signage, Walkways, Perimeter Landscaping, and Site Amenities project (PG-06003) requests \$35,000 to replace the aging slide and pool covers at the Rinconada Kids Pool. Approving this action at midyear will allow the slide to be replaced before summer.
- The Charleston/Arastradero Corridor project (PE-13011) will appropriate revenues, including \$37,200 of grant funding from the State for rubberized asphalt and \$35,000 of Charleston/Arastradero Development Impact Fees to offset costs for this project.
- The Roth Building Rehabilitation project (PF-23001) also has new revenue: \$353,000 from Santa Clara County, \$50,000 from the Palo Alto Museum, and \$978,825 from a Housing and Urban Development (HUD) grant. The combined \$1,381,825 of additional funds will allow the project to increase appropriation for construction costs by \$848,825 and free up \$533,000 in the Capital Improvement Fund to be used for other capital project needs.
- The Street Maintenance project (PE-86070), on the other hand, will need to decrease revenue and appropriation by \$136,600 due to the reduced gas tax revenue estimates discussed in the Gas Tax Fund section above.
- Two projects require technical adjustments: the Byxbee Park Completion project (PE-18006) needs to correct a -\$1,300,000 revenue reappropriation from FY 2022 to FY 2023 that was entered in error as part of the Reappropriation actions. The Civic Center Fire Life Safety Project (PE-18016) needs a correction to address a \$142,000 year-end encumbrance error that occurred while moving from FY 2022 to FY 2023 in order to appropriately fund the project for the scope of work.
- The budget for the Wastewater Collection System Rehabilitation/Augmentation Project 31 (WC-19001) will be increased in FY 2023 by \$5.7 million in order to expedite the timeline for completion of the project. The overall project will only increase by \$2.1 million, with the other funding coming from savings (\$825,000) in the Sewer/Lateral/Manhole Rehabilitation and Replacement project (WC-99013) and funding programmed for WC-19001 in FY 2024 being moved to FY2023. This will allow the project to be completed earlier and avoid higher costs related to night construction.

## **TIMELINE AND NEXT STEPS**

Staff is actively working on the FY 2024 budget and regular reporting activities over the coming months. Below is a list of expected reports and Council updates planned for the remainder of FY



2023. The Council and Finance Committee will continue to be updated through these planned discussions with adjustments brought forward as necessary. Expected upcoming financial status and budget reporting include:

**March/April 2023:**

- Utility Advisory Commission (UAC) and Finance Committee Meetings – Five Year Utility Financial Plans and FY 2024 Rate Recommendations

**May 2023:**

- Release of the FY 2024 Proposed Operating and Capital Budgets & Municipal Fee Changes
- Public Budget Hearings on the Proposed Budgets with Finance Committee, including Utility Rates, Municipal Fees, and the 5-Year Capital Improvement Plan

**June 2022:**

- FY 2023 Third Quarter (Q3) Fiscal Analysis Report (information)
- FY 2024 Operating and Capital Budget Adoption
- FY 2024 Municipal Fee Adoption
- FY 2024 Utility Rates adoption

In addition, routine information reports including but not limited to utilities risk management, investment reports, contracts and lease reporting will continue.

**FISCAL/RESOURCE IMPACT**

Approval of the attached transactions is required to amend the FY 2023 budget appropriation. With the approval of these amendments, the Budget Stabilization Reserve (BSR) would be reduced by \$11.7 million and the projected ending balance of the General Fund BSR is anticipated to be \$48.1 million, which is within the target range of 15% to 20% of the General Fund Budget expenses and is above the City Council target level of 18.5%, or \$45.6 million, by \$2.5 million. The projected changes to the fund balance for all other funds including Enterprise Funds, Internal Services Funds, Special Revenue Funds, and Capital Funds are outlined in Attachment A and accompanying exhibits and impacts to fund balance summarized as follows:

**Table 6: Resource Impact (Non-General Fund)**

<i>Fund Type</i>	<i>Fund</i>	<i>Amount</i>
<i>Capital</i>	Capital Improvement Fund	\$5.6 M
<i>Enterprise</i>	Airport Fund	\$(23,000)
	Electric Fund	\$8.9 M
	Fiber Optics Fund	\$(0.2 M)
	Gas Fund	\$6.2 M
	Refuse Fund	\$(11,000)

<i>Fund Type</i>	<i>Fund</i>	<i>Amount</i>
	Stormwater Management Fund	\$(17,000)
	Utility Administration Fund	\$(0.1 M)
	Wastewater Collection Fund	\$(4.7 M)
	Wastewater Treatment Fund	\$(0.4 M)
	Water Fund	\$(0.5 M)
<i>Internal Service</i>	Information Technology Fund	\$(0.4 M)
	Print and Mail Services Fund	\$(1,000)
	Vehicle Replacement Fund	\$(0.1 M)
<i>Special Revenue</i>	California Avenue Parking Fund	\$(4,000)
	Charleston/Arastradero Development Impact Fee Fund	\$(35,000)
	Gas Tax Fund	\$(0.1 M)
	Parkland Dedication Fee Fund	\$1.1 M
	Public Art Fund	\$(60,000)
	University Avenue Parking Fund	(\$25,000)

### **STAKEHOLDER ENGAGEMENT**

The Office of Management and Budget has coordinated with all departments city-wide and the City Manager's Office, as appropriate, to bring forward the changes discussed and recommended in this report.

### **ENVIRONMENTAL REVIEW**

Council action on this item is not a project as defined by CEQA because the amendments to the FY 2023 Budget Appropriation and FY 2023 Table of Organization are fiscal activities which do not involve any commitment to any specific project which may result in a potentially significant physical impact on the environment. CEQA Guidelines section 15378(b)(4).

### **ATTACHMENTS**

Attachment A, Exhibit 1: FY 2023 Recommended Operating Budget Adjustments

Attachment A, Exhibit 2: FY 2023 Recommended Capital Budget Adjustments

Attachment B: Amended FY 2023 Table of Organization

Attachment C: Preliminary FY 2023 2nd Quarter Financial Status

Attachment D: Public Safety Overtime Analysis

Attachment E: Summary of Financial Status Reports in FY 2023 [for reference only]

### **APPROVED BY:**

Kiely Nose, Administrative Services Director

Report #: 2212-0515