TRANSMITTAL OF THE FISCAL YEAR 2019-20 RECOMMENDED BUDGET

June 10, 2019

Honorable Mayor Bain and City Council Members:

In accordance with the City Charter, I am submitting the Fiscal Year (FY) 2019-20 City of Redwood City Recommended Budget for your consideration on June 10, 2019, and adoption on June 24, 2019. The Recommended Budget addresses the City Council’s strategic priorities and policy direction on fiscal sustainability by relying on ongoing revenue to fund ongoing expenses, using one-time revenues for one-time expenses, maintaining adequate reserves, and addressing long-term liabilities.

The consideration and adoption of the City budget is one of the most important actions that the City Council takes. The budget determines the services the City provides to the community, the staffing of the organization, and sets the amount of funds spent in any given fiscal year.

The City Council has a history of taking intentional, proactive, and strategic steps to ensure the long-term fiscal sustainability of the City, including adopting a structurally balanced annual budget, funding long-term needs, and maintaining a 15 percent General Fund reserve level.

In addition, the City has taken many steps towards strengthening the City’s financial position and increasing transparency and operating efficiencies citywide. Those steps include:

• Approved local pension reform two years ahead of Statewide changes
• Updated development fees to ensure full cost recovery for staff services
• Recommended a half-cent sales tax increase which was approved by 68 percent of voters in November 2018, generating an estimated $8.7 million of additional revenue annually
• Paid down pension liabilities by making additional direct payments to the California Public Employees Retirement System (CalPERS) beyond the annual mandated amount owed
• Opened a Section 115 Pension Trust account to pre-fund the City’s pension obligations over time
• Partnered with outside agencies to provide important community services in the most cost efficient way possible
• Increased transparency regarding the City’s financial health through an expanded annual budget document and increased public communications
• Developed a Five-Year Capital Improvement Program

With the intention of building on these strengths, staff have taken a number of recent steps to improve the City’s budgeting and financial management process. Most notably, staff used the following strategies in developing the FY 2019-20 Recommended Budget:

• Developed a Ten-Year General Fund Forecast for the first time to provide a long-term roadmap to financial sustainability
• Analyzed and recommended an accelerated payoff timeframe for the City’s pension obligations
• Continued to focus on cost containment citywide by identifying numerous efficiencies, innovations, and partnerships
• Streamlined the development of the Capital Improvement Program to provide a more realistic and financially viable projection of the City’s capital needs and revenue sources
In addition, the City Council’s Finance/Audit Subcommittee has taken an active role in providing guidance and recommendations to staff and the City Council on strategic financial initiatives. This included helping staff develop a community Budget Workshop held in April 2019 to engage community members on the City’s budget. The interactive workshop gave residents the opportunity to learn about City finances and suggest potential operational innovations and efficiencies, cost reductions, and new revenue sources. Detailed information regarding the Budget Workshop is provided further in the Budget Message. The Subcommittee also assessed opportunities to shorten the timeframe for paying off pension liabilities and recommends that staff study an 18-year payoff period to reduce total interest payments. This is described further in Section 7 of the Budget Message. Over the course of FY 2019-20, the Subcommittee will assess and recommend potential revenue opportunities that the City may consider in balancing the budget long-term, and will review policies related to purchasing, surplus property, and the budget process.

Moreover, as part of the continuous improvement efforts related to financial management, disclosure, and increasing transparency of the City’s operations, the City Council has approved implementation of the OpenGov online platform in FY 2019-20. The OpenGov software will enhance the City’s budget development process and public reporting, as well as provide resident engagement and web-based interactive performance trends for the community to review. Additionally, staff will seek guidance from professional financial organizations, including engaging the Government Finance Officers Association (GFOA) to perform an onsite best practices review of the City’s financial processes and procedures prior to the upcoming implementation of the City’s new financial and human capital management system. Finance staff will be using the League of California Cities Municipal Health Diagnostic Tool to analyze the City’s financial operations long-term.

The City continues to provide innovative programs and high quality service to the community while maintaining the long-term fiscal health of the City, and advancing the City Council’s major priorities and strategic initiatives. The City Council’s top three priority areas for FY 2019-20 are housing, transportation, and children and youth; these priorities represent a significant component of the City’s discretionary budgetary and policy focus in FY 2019-20. Section 1 of the Budget Message outlines recommended initiatives for FY 2019-20 to advance these priority areas.

This Budget Message includes the following sections in order:

1. City Council Priorities
2. Recommended Use of FY 2018-19 Projected Year End Operating Balance
3. Economic Overview
4. FY 2019-20 Recommended Budget at a Glance
5. Ten-Year General Fund Forecast – Net Budget Position
6. General Fund Revenues
7. General Fund Expenditures
8. Capital Improvement Program (CIP)
9. Enterprise Funds
10. Debt Service
11. Appropriations Limit
12. Acknowledgements
1. City Council Priorities

To address the most pressing community and regional challenges, in February 2019 the City Council selected three priority focus areas for the coming fiscal year: housing, transportation, and children and youth (in priority order). The City Council also decided to update the City’s Strategic Plan, and an Ad Hoc Committee has begun work. As that work is still in process, the Recommended Budget reflects the current seven strategic initiatives: community building and communication, community for all ages, economic development, government operations, housing, public safety, and transportation.

Attachment 1 provides detailed information on all the projects and initiatives included in the FY 2019-20 Recommended Budget related to the City Council’s top three priorities. An overview of work in each area is provided below.

Housing

The City Council’s top priority is housing. In addressing housing stability for all in the community, the City is pursuing short-term, mid-term, and long-term approaches to housing. New initiatives are arising based on City Council input and community feedback shared during last year’s Home For All community conversations.

Over the course of FY 2019-20, staff will continue to implement and evaluate the effectiveness of the recently approved new protections for community members who rent, including minimum rental lease terms and requiring relocation assistance under certain situations. Building on prior housing policy initiatives and ongoing programs, staff recommends a comprehensive approach to increasing housing stability for Redwood City residents.

The complete list of activities is provided in Attachment 1; the following activities are a subset of housing-related activities included as part of the FY 2019-20 Recommended Budget:

- Apply for the County’s Home for All grant by July 2019 to help streamline the City’s process for installing Accessory Dwelling Units (ADU) and make it easier for residents to build ADUs
- Amend the City’s Mixed Use Live/Work Zoning Code to allow more flexibility for residential housing developments by July 2019
- Consider zoning code amendments by summer 2019 that would make it easier to build ADUs that fit well into neighborhoods
- Host a joint study session meeting in summer 2019 between the Planning Commission and the Housing and Human Concerns Committee to discuss missing middle housing (duplexes, triplexes, and fourplexes)
- Work with the Housing Endowment and Regional Trust (HEART) of San Mateo County by September 2019 on their Green and Livable Accessory Dwelling Unit Resource Program that will provide free final designs and construction drawings for residents to build ADUs
• Report to the City Council by October 2019 on community input and ideas to preserve naturally affordable housing suggested at the June 2019 Rental Property Owner Engagement event

• Commence construction of 20 for-purchase Habitat for Humanity affordable housing units at 612 Jefferson by fall 2019

• Commence construction of a 100 percent affordable housing apartment development at 353 Main (125 affordable housing units) by fall 2019

• Launch two pilot Housing and Homelessness Innovation Team initiatives by January 2020: a Downtown Streets Team, which will hire homeless residents to help clean and beautify the City with the goal of helping people develop job skills and landing a full-time job; and the Housing Locater Assister, which will assist homeless or at-risk households find affordable housing

• Collaborate with the City’s school districts to explore work force housing opportunities for school district and City employees by February 2020

• Develop a plan by June 2020 to increase the City’s overall effectiveness at serving homeless residents and helping them get housing

• Convene an annual meeting with affordable housing development organizations/developers to provide updates on City affordable housing policies/programs and Opportunity Zone benefits by June 2020

In recognition of the critical importance of meeting residents’ needs for housing, the Recommended Budget also includes two important organizational changes. I recommend moving the Housing Division from the Community Development and Transportation Department to the City Manager’s Office, and upgrading the current CDBG/HOME Administrator classification to the position of Housing Leadership Manager to provide leadership for housing initiatives. Additionally, I have asked Human Services Manager Teri Chin to serve as a Homeless Services Manager, coordinating efforts across departments to meet the needs of homeless residents and leading two new initiatives related to homeless individuals: the Downtown Streets program, and the Housing Assistance Locator program. To allow the Human Services Manager to take on this role without affecting other important work, the Recommended Budget includes a three-year contract Human Services Coordinator position. Together, I believe these changes will increase our organizational capacity for advancing the City Council’s goals related to providing housing stability for Redwood City residents.

Transportation

The topic of transportation is a close second to the need for housing within the community. To ease congestion and increase safety, the Recommended Budget continues momentum on both regional and local projects to make it easier to get around within Redwood City and beyond and support efficient and safe travel in the community. Much of this work requires close coordination with regional transportation partners and advocacy for Redwood City’s needs. As with the housing focus, building on prior transportation initiatives, staff recommends a comprehensive approach to addressing transportation challenges in the coming year.
The complete list of activities is provided in Attachment 1; the following activities are a subset of transportation-related activities included as part of the FY 2019-20 Recommended Budget:

- Address challenges community members are experiencing due to the Redwood City School District’s consolidation of elementary school sites. Goals include contract with a Safe Routes to School consultant to update walking and biking maps and to support creation of biking school buses; implement additional traffic enforcement for four weeks at the start of the 2019-20 school year; and, increase citywide communications to help residents across the City prepare for new transportation patterns around schools in August 2019

- Complete Marshall Street Pedestrian Enhancement Project by October 2019

- Kick off the Roosevelt Traffic Calming project and present design options for community input by October 2019, and preferred design alternatives in early 2020

- Increasing parking enforcement staffing by two positions (for a total of 4 positions) by fall 2019 to address additional neighborhood parking and Downtown parking needs

- Reclassify two existing parking enforcement officer positions to expand their duties related to abandoned vehicle abatement and traffic safety duties in support of the Traffic Unit by fall 2019

- Complete construction of the US Highway 101 Pedestrian Undercrossing between Bair Island Road and Main Street providing an important pedestrian and bicycle connection from the neighborhoods east of Highway 101 to the downtown area by December 2019

- Complete traffic improvements at Jefferson and Middlefield by early 2020

- Advance design of the Whipple Grade Separation project and develop conceptual grade separation alternatives by early 2020

- Make significant pedestrian and bicycle improvements Downtown, including the permanent closure of Theatre Way to automobile traffic, by spring of 2020

- Complete design of US Highway 101/84 Interchange Project by summer 2020

- Coordinate with regional partners throughout the year to further key transportation projects including the Redwood City Ferry Terminal Project, the Dumbarton Transportation Project, and the Caltrain Electrification and Modernization Project

Children and Youth

The City Council’s third priority area is children and youth. Multiple City departments plan programs annually to support children and youth, and a comprehensive list is provided in Attachment 1.

The Recommended Budget proposes several one-time efforts to support safe travel to schools and afterschool programming in light of challenges that community members are experiencing due to the Redwood City School District’s recent decision to consolidate elementary school sites. These efforts are
being carefully coordinated with Redwood City School District staff. The City Council-appointed Transportation Committee will also assist in implementing student transportation safety efforts. Additionally, the City will continue to collaborate with all of the school districts serving Redwood City by focusing on after school care, student enrollment, and school safety. The following activities are included as part of the FY 2019-20 Recommended Budget:

- Safe Routes to School consultant to update walking and biking maps and support creation of biking school buses
- Additional traffic enforcement for four weeks at the start of the 2019-20 school year
- Increased City afterschool programming
- Scholarships for afterschool care for families who previously received reduced-cost afterschool care at Hawes School
- Citywide communications to help residents across the City prepare for new transportation patterns around schools beginning in August 2019

Other efforts to support children and youth included in the Recommended Budget include:

- Invest in parks and library infrastructure to expand Redwood City’s spaces for children including Hoover Park Turf Project by August 2019, Magical Bridge Playground by December 2019, and temporary pop-up activities like Putt’n Around Mini-golf throughout the year
- Support low income residents and vulnerable communities by completing an equity audit of Library policies and procedures by December 2019
- Launch new library programs and activities for seniors, veterans, LGBTQ+ residents, people of color, people with disabilities, and opportunity youth (those aged 16-24 who are not currently in school or employed), and work directly with these populations in the development of new programs and library collections that meet their needs by December 2019
- Install the Pirate Ship Imaginative Art Area for children and families at the Redwood Shores Branch Library by the end of 2019
- Advocate throughout 2019 for AB452, in collaboration with State leaders, which would create a “Child Care Facilities Grant Fund”
- Create a new makerspace/technology lab for people of all ages at the Downtown Library by April 2020
- Explore a temporary pop-up teen center in the Downtown by spring of 2020
- Conduct a Teen Citizen Police Academy by June 2020
• Increase by 20 percent the Library’s program offering wireless hot spots and mobile devices for home use by circulating 1200 devices by June 2020

• Conduct a Junior Fire Academy to support teen exposure to the fire service by June 2020

• Advance the conceptual plan for updating Roselli Garden as part of the Downtown Parks initiative by summer 2020

2. RECOMMENDED USE OF FY 2018-19 ESTIMATED YEAR-END OPERATING BALANCE

At this time, staff anticipates a FY 2018-19 year-end operating balance of approximately $5.6 million. This is due both to underspending in operating departments, largely attributable to staff vacancies, and to stronger-than-projected property tax and transient occupancy tax (hotel tax) growth.

On February 25, 2019, during the mid-year budget study session, the City Council approved a strategy to utilize approximately 80 percent of the City’s estimated operating balance, or $4.2 million, towards paying down the City’s pension liabilities (discussed further in the Budget Message, currently at $242 million), including the transfer of funds to the City’s Section 115 pension and retiree health trust accounts, and to use approximately 20 percent of the operating balance, or $1.4 million, as one-time funding towards the City Council’s priorities in the areas of housing, transportation, children and youth.

Staff recommends allocating these funds as follows. The final amounts will be determined after the fiscal year-end close is completed in the fall. If the final amount exceeds the current estimate, staff recommends that an additional operating balance be used to fund pension liabilities. If the final amount is less than the current estimate, staff will provide a recommendation with the updated provided to the City Council in the fall.

Pay Down Long-Term Liabilities - $4.2 million

- $3.0 million payment to the pension trust
- $600,000 payment directly to CalPERS
- $600,000 payment towards the retiree health (OPEB) trust

Support Council Priorities - $1.4 million

Housing

- $390,000 for three year contract Human Services Coordinator position to allow Human Services Manager to serve as citywide Homeless Services Manager ($130,000 for FY 2019-20)
- $150,000 to upgrade existing positions in the Housing Division, including establishment of a Housing Leadership Manager position to lead housing-related policy initiatives
- $130,000 for two years of housing-related planning consulting services ($65,000 for FY 2019-20)
- $50,000 for two years of below market rate housing administration services to allow staff to focus on high-value activities rather than routine administrative duties ($25,000 for FY 2019-20)
- $50,000 in matching funds for Second Unit “One Stop Shop” pilot program with Home for All
Transportation

- $200,000 for a transportation demand management reporting tool to aid efforts to reduce employment-related traffic congestion and Safe Routes to School consultant to update walking and biking maps and support creation of biking school buses
- $30,000 for an electronic message board for announcements of transportation-related construction and meetings
- $20,000 for assistance with transportation-related study sessions and communications
- $20,000 for traffic enforcement for four weeks at the start of the 2019-20 school year

Children and Youth

- $240,000 to replace lost grant funds and increase City afterschool programming
- $20,000 to subsidize afterschool care for former families of Hawes School
- $10,000 for special projects

Other Council Priorities

- $200,000 for emerging City Council initiatives over the course of the fiscal year
- $60,000 for two years of policy development consulting services to support the City Council Governance Subcommittee ($30,000 for FY 2019-20)
- $60,000 for a portable barricade system to be used during various events in the Downtown Courthouse Square area
- $60,000 for legislative consulting services
- $50,000 for land use consulting services
- $15,000 for the Civic Cultural Commission Grant program in order to support transition to the new special events fee structure without adversely impacting non-profit event providers
- $15,000 for membership in National League of Cities for two years to enhance awareness of federal legislation and grant opportunities affecting Redwood City ($7,500 for FY 2019-20)

3. Economic Overview

The economic conditions discussed below help inform the development of the FY 2019-20 Recommended Budget and the Ten-Year General Fund Forecast. Of note is the near-certainty of a recession during the Forecast period. It is unknown when this may occur, but many economists suggest it will occur at some point during FY 2020-21. In addition to the City’s internal research and forecast development, staff has received information from a variety of sources, including the California Legislative Analyst’s Office, and consultants working for Avenu Insights & Analytics, the National Economic Education Delegation, and the UCLA Economic Forecast.

Federal

By June 2019, the economy will have been in an upward, or expansion, phase of the business cycle for ten years, which is the nation’s longest ever expansion cycle, based on figures that go back to the 1850’s. Notably, since 1945, the average economic expansion has lasted about 5 years. The consensus among economists is that a recession is in the near future; however, most economists agree that there is no immediate (within the next 6 months) recession. Many experts are suggesting the recession will begin in late 2020 or early 2021. It is unknown which event will be the tipping point, but economists are watching several factors.
The federal economy (real gross domestic product) grew at a pace of 3.2 percent (year over year basis) in the first quarter of 2019. Professional forecasters see economic growth easing to 2.4 percent later in 2019. The economy is operating at nearly full employment, with a national unemployment rate of 3.8 percent. Economists forecast that the unemployment rate will increase slightly to 4 percent over the next several quarters, and remain around 4 percent during 2020.

Economists are cautiously optimistic that trade disputes with China are easing. China and the United States are continuing talks of a trade deal; these talks have stalled recently. If a deal is reached and China can stabilize their economy, it will have a positive effect on fears of a global economic slowdown. If a deal is not reached, and tariffs are raised on Chinese goods, there is potential for an economic downturn.

The federal funds interest rate also continues to hold steady for the time being. In March 2019, federal officials reiterated that they did not expect to raise rates again in 2019. Current conditions, tame inflation rates and growth slowdown, have encouraged the Feds to remain “patient” before raising interest rates.

Personal Consumption Expenditures (PCE) are also on the rise. During March 2019, PCE rose by an unexpected 0.9 percent, which is the largest monthly increase since August of 2009. With the Gross Domestic Product (GDP) at 3.2 percent, and unemployment at 3.8 percent, consumer sentiment surveys indicate that a majority of consumers have a positive outlook for their personal finances. The national economy currently appears to have weathered the prolonged government shutdown and stock market volatility that caused a slump in the economy during the first part of 2019.

In March 2019, the yield on the 3-month Treasury bill was higher than the yield on the 10-year Treasury note for the first time in more than 10 years, indicating that the cost of borrowing money in the short-term is more expensive than borrowing in the long-term. When the yield curve becomes inverted in this manner, it can have a direct effect on business investment, and possibly lead to a contraction in the economy due to a slowing in production and rising unemployment. Based on the current yield curve, many economists agree that a recession is likely to occur sometime within the next two years.

Cautious optimism seems to be the mood currently. Investors and economists continue to try to predict not only the timing of the next recession, but the factors that will signal the coming of the recession. Ultimately, a recession would affect consumer behavior and the performance of some of the key revenue sources for local government agencies, including in Redwood City.

**State**

The State’s economic conditions remain positive, primarily due to the constitutional reserve projected at $14.5 billion at the end of FY 2019-20. The Legislative Analyst’s Office (LAO) projected that the California Legislature would have an additional $14.8 billion in resources available to allocate in the budget process. These monies could be committed to additional reserves or to new one-time and/or ongoing programs. If the latter is the case, local agencies could benefit from these decisions.

Another positive projection for the California budget is the possibility of $1.0 billion or more in one-time tax revenue collected in the near future, due to several initial public offerings (IPOs) this year. Uber had an IPO in May 2019, and Airbnb and four other California-based companies will have IPOs later this year, which are collectively projected to generate up to $1.0 billion in tax revenue for the State.
Wage and salary growth will remain steady, in large part, to the low state unemployment rate of 4.3 percent as of March 2019. The pace of job growth will continue to slowly decline, again, due in large part to low numbers of Californians looking for jobs. The state’s revenue from personal income tax, sales tax, and corporation tax, (the three largest taxes), is expected to increase by 5.5 percent, while expenditures are projected to grow at an overall rate of 1.5 percent.

The LAO has created a State Fiscal Health Index (Index) to track the strength of the economic conditions relevant to the State’s fiscal health. As of December 2018, the Index remained near historic highs; however, it has slightly declined as of March 2018. This is the first month-over-month decline in the Index in two years, and is a continuation of a trend of slowing growth that started in June 2018. While it is too soon to draw any firm conclusions about the decline, the likelihood of continued revenue growth over the next year appears to be diminishing.

Local

The City of Redwood City has a population of approximately 85,300 that is evenly split between men and women. The population has grown by more than 12 percent since 2010. This is significantly higher than the increase of California (7.4 percent) and San Mateo County (7.2 percent) during the same period. The median age of all residents is 37 years.

The regional economy (San Francisco Bay Area) is very robust. According to the Bureau of Labor Statistics, as of February 2019, the unemployment rate in this area was 2.8 percent, while the unemployment rate in Redwood City was 2.3 percent. Bay Area home prices were up 0.5 percent over the past two months, and up 3.5 percent from a year ago. Year over year job growth rose to 2.4 percent, far outpacing the 1.7 percent growth for the nation and 1.4 percent state job growth. The Bay Area economy is ranked 19th in the world with a GDP of $748 billion as of July 2018.

According to Zillow.com, the median home value in Redwood City is currently $1.6 million. Although Bay Area home prices are up 3.5 percent from a year ago, home values in the City have decreased by 2.1 percent over the past year, indicating a slight softening in the local housing market. The median home rental rate in the City is $4,200 per month, compared to the San Francisco metro area of $4,500 per month. The downside of high home values and rental rates is that Redwood City is one of the most expensive places to live in the Bay Area.

According to the 2019 Silicon Valley Index, published by Joint Venture Silicon Valley, in the Silicon Valley region, the median household income was $118,357 in 2017 (latest available numbers.) California overall had a median income of $71,805, while the nationwide median household income was $60,336. The per capita income in Silicon Valley was $102,410, compared to $59,796 for California, and $51,640 nationwide.

Average annual spending on housing (rent and mortgage) in the San Francisco area is over 41 percent. According to the U.S. Census Bureau, as of 2017, the owner-occupied housing rate was 59.7 percent, compared to the national average of 64.4 percent. The Bay Area lost a net of 45,670 people during 2017; people leaving the area were concentrated in lower-paying sectors.

While the San Francisco Bay Area economy remains strong, there is concern that the soaring costs of housing are threatening the area’s economic diversity as more and more people leave the State.
For these reasons, it is important for the City to take a forward-thinking, long-term approach to mitigating the City’s financial liabilities and to proactively prepare for future recessionary impacts that loom on the horizon.

The Ten-Year General Fund Forecast section of the budget document provides detailed analysis and assumptions on the City’s General Fund projected revenues and expenditures.

4. RECOMMENDED BUDGET AT A GLANCE

The FY 2019-20 Recommended Budget for all funds totals $301.6 million in revenues and $290.0 million in expenditures (before transfers in/out). The General Fund revenue portion of the budget is $157.4 million. In prioritizing the long-term fiscal sustainability of the City, the Recommended Budget is structurally balanced, while maintaining a General Fund reserve of 15 percent.

FY 2019-20 Recommended Budget (All Funds)

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*Includes $8,972,411 of Utility Users’ Tax revenue that is transferred to the Capital Projects Fund

NOTE: Revenues and Expenditures are shown before transfers in/out
Total FY 2019-20 Recommended Revenues and Expenditures by Fund

**FY 2019-20 Revenues - All Funds (in millions)**
- **General Fund** $157.4 (52.2%)
- **Enterprise Funds** $92.9 (30.8%)
- **Capital Project Funds** $2.4 (0.8%)
- **Special Revenue Funds** $10.1 (3.3%)
- **Internal Service Funds** $38.8 (12.9%)

**FY 2019-20 Expenditures/Expenses - All Funds (in millions)**
- **General Fund** $136.6 (47.1%)
- **Enterprise Funds** $86.2 (29.7%)
- **Capital Project Funds** $14.7 (5.1%)
- **Special Revenue Funds** $14.1 (4.9%)
- **Internal Service Funds** $38.5 (13.3%)
Efficiencies, Innovations, and New Partnerships

As previously mentioned, City departments have proactively examined ways to innovate and improve existing processes, and seek new partnerships beyond those already established, to contain costs and increase revenue. A few of these resourceful ideas include utilizing new technologies to automate critical and labor intensive work, and finding new ways to meet the community's needs without additional staffing. In order to improve the City's ability to fund services as well as pay down the City’s long-term liabilities, the City will need to continue to contain costs through efficiencies, innovations, and partnerships.

Attachment 2 provides a detailed list by department, describing the many innovations, efficiencies, and new partnerships proposed to occur citywide over the course of FY 2019-20.

Budget Workshop

On April 10, 2019, the City hosted a Community Budget Workshop at the Veterans Memorial Senior Center. Twenty-five attendees participated in sessions that focused on potential new revenue sources, innovations, efficiencies, and cost reductions the City could explore.
Attendees shared their ideas and, at the end of the evening, ranked their top choices among all the collective ideas heard.

The main themes regarding innovations, efficiencies and cost reductions included:
- Exploring other shared services with non-profits and other agencies
- Contracting out for services to save costs, and providing contract services to other agencies to generate more revenue
- Managing the City’s utility costs by shifting to an all-electric vehicle fleet and furthering solar projects

The main themes regarding potential revenue sources included:
- Using City property to generate revenue
- Tapping into the businesses community to increase revenue through potential new taxes (business tax/head tax or vacancy tax) and other community benefits
- Increasing the business occupancy rates

Attachment 3 contains further details on the ideas received and questions from attendees.

**FY 2018-19 Financial Sustainability Plan Update**

The City Council took a forward-thinking and prudent approach to addressing the City’s fiscal challenges through adoption of the Financial Sustainability Plan (FSP) in FY 2017-18, which included reducing operating costs and increasing revenue in order to balance the City’s budget over the next five years. Operating cost reductions of approximately $3.8 million were included in the FY 2018-19 Adopted Budget and additional reductions of $2.2 million were planned for FY 2019-20.

Additionally, as part of the FSP, the City Council placed two revenue measures on the November 2018 ballot: a half-cent general sales tax increase (Measure RR) and a cannabis excise tax (Measure DD). On November 6, Redwood City voters passed both measures, with 68 percent of voters supporting Measure RR, and 79 percent of voters supporting Measure DD.

The increased sales tax is anticipated to produce approximately $8.7 million in FY 2019-20. The successful passage of these measures provides much-needed revenue to offset projected cost increases, including growing pension contributions, and allows for the restoration of some of the budget and service reductions that were included in the FY 2018-19 Adopted Budget.

On December 3, 2018, the City Council approved restoration of budget and service reductions totaling $2.7 million, which include the restoration of Police staffing and Library hours. In addition, the recommended reductions of $2.2 million that were originally set to be implemented in FY 2019-20 have been eliminated and are not included in the FY 2019-20 Recommended Budget.
5. **Ten-Year General Fund Forecast – Net Budget Position**

The Ten-Year General Fund Forecast contemplates an economic downturn occurring within FY 2020-21, and when combined with rising mandated pension contributions, a budget deficit is projected to begin in FY 2021-22 and increase annually over the Forecast timeframe.

As shown in the graph below, without any adjustments to current operating costs or revenue sources, the annual budget deficit is projected to be almost $1.0 million in FY 2021-22, and grow to approximately $18.0 million in FY 2028-29.

Because of the projected deficit, the City will need to continue to explore all the strategies previously identified in the Financial Sustainability Plan adopted in FY 2017-18, including operating cost reductions and revenue enhancements. As previously mentioned, in FY 2019-20, the City Council Finance/Audit Subcommittee will be discussing opportunities for the City to increase revenue, among other financial strategies.

Additionally, the City Council, staff, and community partners will need to continue to work together to align services and resources and address community needs. Maintaining the City’s long-term fiscal stability requires meaningful action and a proactive approach to addressing the City’s projected deficit and long-term liabilities through both revenue increases and expenditure reductions over time.

A comprehensive analysis of the City’s Ten-Year General Fund Forecast is included as a separate section of the budget document, and General Fund revenues and expenditures are explained in further detail below.
6. **GENERAL FUND REVENUES**

General Fund revenues (including transfers in) are expected to increase to $158.8 million in FY 2019-20, which is approximately 10.7 percent above the FY 2018-19 adopted budget of $143.4 million. Most of the City’s General Fund revenues continue to derive from property, sales, utility users’ tax (UUT), and transient occupancy taxes (TOT).

Highlights of the FY 2019-20 General Fund revenues include:

- Property taxes are budgeted at $54.5 million. This is a 4.8 percent increase over the FY 2018-19 adopted budget of $52.0 million. The increase is primarily driven by the completion of new development, and increased assessments of commercial and residential properties.

- Sales tax is budgeted at $32.3 million. This is a 35.1 percent increase over the FY 2018-19 adopted budget of $23.9 million. The significant increase in budgeted sales tax revenue is due to the passage of a one-half cent local sales tax in November 2018 that became effective on April 1, 2019. This new tax is expected to generate approximately $8.7 million additional revenue in FY 2019-20. City sales tax revenues are primarily derived from automobile dealerships and several large retailers. Sales tax revenues continue to be vulnerable to changing consumer preferences.

- UUT is budgeted at $9.0 million, which is a decrease of 7.2 percent over the FY 2018-19 adopted budget of $9.7 million. Pursuant to City Council policy, the entirety of this revenue is transferred to the Capital Projects Fund to be used exclusively for capital projects. This revenue stream is declining as consumers “cut the cord” on their traditional cable providers and switch to other services, such as streaming video or online content.

- TOT is budgeted at $8.6 million, which is a 28.4 percent increase over the FY 2018-19 adopted budget of $6.7 million. The significant increase is due to the recent opening of a new hotel in the City, as well as increased occupancy rates and average room rental rates. New TOT revenue generated by short-term rentals will be set aside for affordable housing and will not be dedicated to the General Fund.

- Educational Revenue Augmentation Fund (ERAF) revenues are reimbursements to the City from the State via the County of San Mateo; the ERAF shifted hundreds of millions of dollars in local property taxes annually to schools from local governments. This revenue source is budgeted at an estimated $4.2 million for FY 2019-20. This is a 5 percent increase over the FY 2018-19 adopted budget of $4.0 million. Projections reflect conservative growth as this revenue stream remains susceptible to legislative changes and complicated school funding formulas.

- Downtown property taxes (Former Redevelopment Agency tax increment) are budgeted at $8.8 million in FY 2019-20, a 22.2 percent increase over the FY 2018-19 adopted budget of $7.2 million. This increase is primarily due to significant development activity in the downtown area.
The chart below details the major revenue sources for the City.

Property tax, including Downtown Property Taxes, will continue to be the most significant revenue stream, representing 40.2 percent of total General Fund revenue, which is down slightly from 41.5 percent in FY 2018-19.

The next largest source of revenue is sales tax at 20.5 percent (up from 16.8 percent in FY 2018-19), followed by Charges for Services (San Carlos Fire Service fees, plan check fees, and garbage collection franchise fees) at 11.0 percent (down from 11.7 percent in FY 2018-19).

Other taxes (TOT, property transfer tax, franchise fees, business license taxes) represents 8.8 percent (up from 8.4 percent in FY 2018-19), and UUT represents 5.7 percent (down from 6.8 percent in FY 2018-19) of total General Fund revenues.

Although the UUT is considered part of the General Fund, by Council policy, this revenue is used exclusively for capital projects rather than ongoing operating expenses.
Property Tax

Property Tax collected downtown and from throughout the City is the largest contributor to the City’s revenue stream, representing 40.2 percent of all revenues. This includes all property taxes, including the downtown area. The chart below illustrates the proportion the City receives of property taxes paid. On average, the City receives 18 percent of the property tax paid in the City, with the remainder of property tax revenue going to school districts, the County, and special districts.

Where Do Property Taxes Go?
Homeowners in the City have seen a slight decrease in median home prices in the last year (according to Zillow.com), but it is predicted that home values will rebound modestly with an expected increase of 0.3% percent within the next year. The current median home value in the City is $1.6 million.

**Sales Tax**

As customary for all cities in the State, the City receives an additional 1 percent tax on all sales originating within the City limits. Following approval of Measure RR in November 2018, the Redwood City sales tax rate is now 9.25% and will be 9.75 percent as of July 1, 2019 when it will increase due to a countywide half-cent transportation sales tax increase.

The chart below shows how sales tax is distributed. The City receives 16 percent of the sales tax collected in the City.

As shown below, the dominant source of sales tax generation for the City is the transportation category, which accounted for 28.6 percent of all sales tax revenue from calendar year 2018. This is down from 31.6 percent for calendar year 2017. This category includes new and used automobile sales and gasoline sales. The general retail category, which includes department stores, apparel stores, and miscellaneous retail, accounted for 28.4 percent of sales tax revenue, down from 29.1 percent for 2017. Food products, including restaurants and grocery stores, accounted for 18.0 percent of sales tax revenues, which is up from 16.8 percent in 2017.

Residents are spending more of their disposable income on non-taxable items than before, like housing, medical care, and education. The Consumer Price Index reveals that in the last couple of years, the prices of these items have increased rapidly, while the cost of many taxable items has dropped.
Additionally, burgeoning trends toward online purchasing impact the City’s sales tax revenue, since the method of distributing the tax varies. For purchases made at physical establishments located in Redwood City, sales tax is distributed based on “point of sale.” For online purchases, the tax is treated as a “use” tax. A use tax is charged on goods sold to California customers from out-of-state retailers. Use taxes are allocated to countywide pools where the goods are used. The taxes are distributed proportionately countywide based on the City’s pro rata share of sales tax.

Changing consumer preferences affect City sales tax revenues as well. New automobile leases (rather than purchases) cause the stream of sales tax revenues to be realized over the life of the lease (typically several years) rather than at the time of purchase. Finally, the preferences of younger consumers who are more frequently purchasing “experiences” (generally not taxable), rather than goods, has a negative effect on sales tax revenue.

The FY 2019-20 Recommended Budget reflects a 35.1 percent increase in sales tax revenue over the FY 2018-19 Adopted Budget. This is due primarily to the passage of Measure RR by the Redwood City voters in November 2018. This measure enacted a one-half cent sales tax increase for purchases within Redwood City. In FY 2019-20, the new local sales tax is budgeted to increase total City sales tax revenue by $8.7 million.

A number of other factors can affect sales tax revenues generated in the City. The increasing population and growth in personal disposable income could sustain increasing sales tax revenues. However, sales tax revenues are also very vulnerable to changing demographics of the consumer and their typical purchasing patterns. As online sales increase, this also has the effect of eroding the City’s sales tax revenues, as sales tax on these purchases is recorded in the county pool, rather than allocated directly the City. Currently, the City's sales tax consultant, Avenu Insight & Analytics, is projecting an economic slowdown during FY 2020-21 through FY 2021-22. In the later years, sales tax revenues are estimated to increase by 3.4 percent annually, and then flatten out to approximately 3.0 percent annually.
The U.S. Supreme Court’s ruling in *Wayfair v. South Dakota* allows states more authority to require out-of-state sellers to collect use tax. The California Department of Tax and Fee Administration has announced that it will require out-of-state retailers to collect and remit use tax beginning on April 1, 2019 if a retailer has California sales of more than $100,000, or 200 separate transactions. The effect of the U.S. Supreme Court’s decision on the City’s sales tax revenue is still being determined, but an initial estimate of $524,000 is included in the FY 2019-20 Recommended Budget.

Given the susceptibility of sales tax revenue to changing demographics and lifestyle trends, and the importance of this revenue stream, it is important to support and expand, where possible, the City’s sales tax base in FY 2019-20. Staff will continue to work to support existing businesses, encourage new retail establishments, conduct outreach to top sales tax generators, and develop programs that support small businesses.

During calendar year 2018, the top 25 sales tax generators were (in alphabetical order):

```
AB Sciex
Arco AM/PM Mini Marts
Boardwalk Chrysler Dodge Jeep Ram
Boardwalk Nissan
Carlsen Porsche
Carlsen Subaru
Central Concrete Supply Co.
Chevron Service Stations
Costco Wholesale
Davies Appliance
Eat Club
Enterprise Rent-A-Car
Ferrari Maserati of Silicon Valley
Granite Rock
Hopkins Acura
Land Rover Redwood City
Oracle USA
Putnam Lexus
R & B Company
Safeway Stores
Shutterfly
Target Stores
Towne Ford Sales
Towne Mazda
Toyota
```

During this period, these businesses generated 50.0 percent of the City’s total sales and use tax revenue, which is down from 51.9 percent for calendar year 2017. Sales tax generated by these top 25 businesses decreased by approximately $86,000 or 0.8 percent when compared to calendar year 2017.

### 7. General Fund Expenditures

The recommended FY 2019-20 General Fund expenditure budget is $136.6 million, which is $11.7 million, or 9.4 percent more, than the FY 2018-19 adopted General Fund expenditure budget of $124.9 million. Salaries, wages, and benefits are $95.8 million, or 70.2 percent of the recommended General Fund expenditure budget. This is a decrease from 72.2 percent for FY 2018-19.

Police and Fire Department salaries and benefits, as in most California cities, are a significant portion of the budget, amounting to approximately $63.9 million, or 66.7 percent of all salaries, wages, and benefits in the General Fund.

Rising employee-related costs, due primarily to escalating payments to fully fund benefits for already-retired employees, are the most significant contributor to rising expenditures.
Pension Challenges

The City has two pension plans with the California Public Employees’ Retirement System (CalPERS): one for miscellaneous (non-safety) employees and one for safety employees such as sworn fire and police personnel.

As shown below, pension benefits are funded by a combination of employer contributions, employee contributions, and investment earnings on those contributions.

When there is a gap between the assets available to fund benefits, and the assets needed to fund benefits, the City must make up the difference. Currently, about 16 percent of the City’s General Fund goes towards paying for pension benefits; this amount will grow to almost 24 percent over the next ten years, as required City pension contributions ramp up to fully fund benefits for already-retired, as well as current employees.

The City’s most recent actuarial report from the California Public Employees’ Retirement System indicates that the City has an unfunded pension liability of $242.0 million as of June 30, 2017, up from $238.8 million a year prior, an increase of 1.3 percent, and a retiree health liability of $57.6 million. The City’s total unfunded pension and retiree health liability is $299.6 million.

The City’s overall funded status for its pension plans is 65.1 percent, up from 63.2 percent the prior fiscal year.

### CalPERS Unfunded Actuarial Accrued Liability (millions)

<table>
<thead>
<tr>
<th></th>
<th>Miscellaneous Plan</th>
<th>Safety Plan</th>
</tr>
</thead>
<tbody>
<tr>
<td>Actuarial Accrued Liability</td>
<td>$319.1</td>
<td>$374.9</td>
</tr>
<tr>
<td>Market Value of Assets</td>
<td>$215.2</td>
<td>$236.8</td>
</tr>
<tr>
<td><strong>Unfunded AAL</strong></td>
<td><strong>$103.9</strong></td>
<td><strong>$138.1</strong></td>
</tr>
<tr>
<td><strong>Funded Ratio</strong></td>
<td>67.5%</td>
<td>63.1%</td>
</tr>
</tbody>
</table>
The increase in the City’s unfunded pension liability is due to the lowering of the CalPERS assumed rate of investment return (otherwise known as the discount rate) to 7.0 percent in FY 2018-19. CalPERS is modifying its investment strategy to a more conservative approach to reduce the likelihood of investment volatility. This is needed to ensure there is cash on hand to pay benefits statewide and to reduce the chance the public agencies will have to fill large gaps when investment returns do not meet projections.

The City did not experience an even more significant increase in unfunded liability for two primary reasons: first, actual CalPERS investment returns for the fiscal year ended June 30, 2017 were better than expected at 11.2 percent, which is higher than the assumed rate of 7.0 percent; second, the City made additional annual contributions to CalPERS, beyond the required annual payment, in the amount of $1.5 million in 2017.

The City’s unfunded pension liability is primarily related to retired or inactive (employees not currently employed by or retired from the City) employees: 60% of the unfunded liability for the miscellaneous plan (non-safety employees) is associated with retired or inactive employees, and 73% of the unfunded liability for the safety plan (safety employees) is associated with retired or inactive employees.

The City is not unique in facing these pension challenges, and public agencies across the state, including school districts and state agencies, are facing increasing pension costs. The City began reforming pension benefits in 2011, and statewide pension reform occurred in 2013. Though these efforts provide long-term relief, they are not sufficient to fully fund promised benefits.

Unfortunately, no statewide pension reform measures appear to be imminent. As a result, it is up to local government agencies to absorb steeply increasing contributions and to implement other strategies that will help place their pension plans on sound financial footing.

The City Council has taken a proactive and strategic approach to addressing the City’s pension liabilities. The City implemented a second tier pension formula in 2011 even before the statewide Public Employee Pension Reform Act (PEPRA) was enacted in 2013. As these newer formulas only apply to recent hires, there has been little immediate impact on the City’s total pension costs. However, such changes will reduce future liabilities and costs over the long-term. The City has also negotiated cost-sharing agreements with each bargaining group to ensure current employees pay a greater proportion of pension costs. Employees contribute between 8.0 and 18.0 percent of their salary toward their pension benefits, depending on bargaining unit and pension tier. Although these cost-sharing agreements represent important commitments by City employees to help pay for their pension benefits and assist the City in paying the required annual payments to CalPERS, such arrangements do not provide any additional payment toward the City’s unfunded liabilities.

In September 2017, the City Council approved establishing a Section 115 pension trust account with Public Agency Retirement Services (PARS) to pre-fund the City’s pension obligations over time. An initial trust deposit of $10.5 million was made in January 2018, including $8.8 million from the General Fund and $1.7 million from other City funds, as some employees are budgeted in other funds, primarily the water and wastewater utilities. In March 2019, an additional $550,000 was deposited into the trust. As of the end of April 2019, the investment balance of the trust account was $11.6 million.

The City has provided a great deal of public disclosure about its pension challenges and use of key strategies. The City Council has held numerous public hearings in the last two years related to rising pension costs and the City’s strategies to address them. This topic was addressed at City Council meetings
on May 22, 2017, June 12, 2017, February 26, 2018, June 11, 2018, and February 25, 2019. The City substantial public information regarding pension obligations during the process of placing the sales tax revenue measure on the November 2018 ballot. The City also maintains a “Fiscal Update” webpage, and has posted data and Frequently Asked Questions about the City’s pension challenge for the public to review at this site: www.redwoodcity.org/fiscalupdate.

The Ten-Year General Fund Forecast includes General Fund contributions towards the City’s pension liability beyond the required annual payment, including additional direct annual payments to CalPERS of $500,000, and annual contributions of $1.1 million to the City’s Section 115 pension trust account. Trust proceeds, including investment earnings, will be used in future years to help pay for increased annual pension costs. Increasing the funds invested in the trust, and maintaining those funds over a longer timeframe, will provide greater resources to pay the City’s pension costs in the future.

Benefit costs associated with existing staff, coupled with liabilities associated with retirees, are expected to increase significantly over the next ten fiscal years.

As shown in the chart below, the City’s required annual pension costs are expected to rise significantly to pay off the unfunded liability. In ten years, the City’s annual CalPERS payment is projected to be approximately $45.5 million, which is $17.7 million more than it is estimated to be in FY 2019-20 ($27.8 million), or a 64 percent increase. Notably, these estimates are at a 50 percent confidence level, meaning that there is a 50 percent chance they could be higher or lower.
**Timeframe for Pension Plans to be Fully Funded**

Full funding of future pension obligations is an important goal. The City Council has options in terms of the approach to achieving this goal, and this section reviews three approaches:

1. **Making the Required Annual Contribution (minimum obligation)**
2. **Making the Required Annual Contribution Plus Making Additional Annual Payments (current approach)**
3. **Making Sufficient Contributions to Fully Fund Pension Obligations within 18 Years (aspirational goal)**

Each approach has tradeoffs in terms of the annual funding required (which impacts revenue needs and resources for other services), the interest to be paid associated with the approach, and the total timeframe required to fully fund pension costs. The Finance/Audit Subcommittee will study this further in the coming year for a future City Council discussion of whether or not to set a particular timeframe to fully fund pension obligations.

**Option 1. Making the Required Annual Contribution**

If the City were to fund only required annual pension payments, with no additional payments, the City's unfunded pension liability will be paid off (fully funded) in 19 years, or FY 2037-38, for the Miscellaneous Plan, and 22 years, or FY 2040-41, for the Safety Plan. This approach does not include the extra annual contributions currently included in the Ten-Year Forecast or utilization of the balance in the Section 115 pension trust account; the pension trust account is intended to be used to assist the City in making annual contributions in future years when annual contributions are expected to be their highest.

**Option 2. Making the Required Annual Contribution plus Making Additional Annual Payments**

The City has engaged the actuary firm of Bartel Associates, LLC (Bartel) to assess options to pay off unfunded liabilities over a shorter timeframe.

If the City were able to accelerate payments toward unfunded liabilities, the City would realize interest savings over time, similar to making additional payments on a home mortgage. As previously mentioned, the Ten-Year General Fund Forecast includes a strategy to make $1.6 million in annual additional payments directly to CalPERS or annual contributions to the City’s Section 115 pension trust account, or some combination thereof that equals $1.6 million.

If these payments are made directly to CalPERS, it is expected that this strategy will shorten the number of years required to pay off the total unfunded liability by one year: the unfunded liability for the Miscellaneous Plan would be paid off in 18 years instead of 19 years as projected in Option 1, and the unfunded liability for the Safety Plan would be paid off in 21 years instead of 22 years as projected in Option 1. This is shown in the chart below.

This shorter timeline would save the City $6 million to $27 million in interest payments, depending on when the City utilizes the balance in the Section 115 pension trust account. For example, the City could use the balance in year 1 of the plan (FY 2019-20) or year 10 of the plan (FY 2029-30), or any other year. If the City utilizes the Section 115 pension trust account balance in year 1, the City could save up to $27 million in interest. However, this comes with more risks and less flexibility. The risks include the City
depleting the trust balance early, and not having a balance in future years when annual payments are expected to almost double. If the City waits 10 years to utilize the Section 115 pension trust account, the City’s pension trust account would be earning compounded interest over time, the balance of which could be used to pay directly to CalPERS when payments almost double.

Staff recommends making additional annual payments directly to CalPERS, and making additional annual payments to the pension trust, the balance of which will be used when it is most needed.

**Option 3. Making Sufficient Contributions to Fully Fund Pension Obligations within 18 Years**

The City Council Finance/Audit Subcommittee has begun to discuss a more ambitious funding strategy: making even higher additional annual contributions (beyond the budgeted $1.6 million) directly to CalPERS over the next 18 years to accelerate the payoff period. Doing so would be a challenge, likely requiring significant revenue increases and cost reductions given the projected budget deficits in future years, but may be advantageous.

As shown in the chart below, if the City has a goal to pay all unfunded pension liabilities within 18 years, the additional annual contributions would vary from $268,000 to $13.7 million per year. With this strategy, the City’s pension plans are projected to be fully funded in FY 2036-37. This could save the City approximately $38 million in interest payments over the next 23 years. This is a preliminary estimate only, and the City’s interest savings could vary significantly year to year depending on when and how much of the Section 115 Pension Trust proceeds are used.

In Fiscal Years 2022-23 through 2024-25, the City does not have any estimated additional payments, as certain existing amortization bases will be paid off (amortization bases consist of pension plan components used to project the City’s annual unfunded liability). The City’s additional payments would ramp up again in FY 2025-26 as new bases are created.
The chart below contains annual mandated contribution and additional payment projections at a fixed point in time as of May 2019, and are subject to change annually.

Of note, the City will need to evaluate the annual contribution requirement amounts each year, due to the various factors that can contribute to changes in required contribution amounts. Factors include the City’s actual prior contributions made to CalPERS, the actual rate of return on investments realized by CalPERS, and any assumption changes implemented by CalPERS.

### Pension Plans Fully Funded in 18 Years

<table>
<thead>
<tr>
<th>Year</th>
<th>Estimated Current Contributions</th>
<th>Estimated Accelerated Contributions</th>
<th>Additional Annual Payment</th>
</tr>
</thead>
<tbody>
<tr>
<td>FY 2019-20</td>
<td>$27,737</td>
<td>$30,463</td>
<td>$2,726</td>
</tr>
<tr>
<td>FY 2020-21</td>
<td>$30,207</td>
<td>$31,716</td>
<td>$1,509</td>
</tr>
<tr>
<td>FY 2021-22</td>
<td>$33,220</td>
<td>$33,488</td>
<td>$268</td>
</tr>
<tr>
<td>FY 2022-23</td>
<td>$35,968</td>
<td>$35,968</td>
<td>-</td>
</tr>
<tr>
<td>FY 2023-24</td>
<td>$37,916</td>
<td>$37,916</td>
<td>-</td>
</tr>
<tr>
<td>FY 2024-25</td>
<td>$39,636</td>
<td>$39,636</td>
<td>-</td>
</tr>
<tr>
<td>FY 2025-26</td>
<td>$40,183</td>
<td>$40,511</td>
<td>$328</td>
</tr>
<tr>
<td>FY 2026-27</td>
<td>$40,003</td>
<td>$42,167</td>
<td>$2,164</td>
</tr>
<tr>
<td>FY 2027-28</td>
<td>$41,629</td>
<td>$43,906</td>
<td>$2,277</td>
</tr>
<tr>
<td>FY 2028-29</td>
<td>$43,402</td>
<td>$45,735</td>
<td>$2,333</td>
</tr>
<tr>
<td>FY 2029-30</td>
<td>$45,494</td>
<td>$47,971</td>
<td>$2,477</td>
</tr>
<tr>
<td>FY 2030-31</td>
<td>$47,241</td>
<td>$49,748</td>
<td>$2,507</td>
</tr>
<tr>
<td>FY 2031-32</td>
<td>$46,895</td>
<td>$51,604</td>
<td>$4,709</td>
</tr>
<tr>
<td>FY 2032-33</td>
<td>$47,305</td>
<td>$53,021</td>
<td>$5,716</td>
</tr>
<tr>
<td>FY 2033-34</td>
<td>$46,729</td>
<td>$54,893</td>
<td>$8,164</td>
</tr>
<tr>
<td>FY 2034-35</td>
<td>$46,241</td>
<td>$56,025</td>
<td>$9,784</td>
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<tr>
<td>FY 2035-36</td>
<td>$45,223</td>
<td>$56,761</td>
<td>$11,538</td>
</tr>
<tr>
<td>FY 2036-37</td>
<td>$42,889</td>
<td>$56,630</td>
<td>$13,741</td>
</tr>
<tr>
<td>FY 2037-38</td>
<td>$42,434</td>
<td>$26,169</td>
<td>$(16,265)</td>
</tr>
<tr>
<td>FY 2038-39</td>
<td>$40,683</td>
<td>$24,697</td>
<td>$(15,986)</td>
</tr>
<tr>
<td>FY 2039-40</td>
<td>$39,450</td>
<td>$23,240</td>
<td>$(16,210)</td>
</tr>
<tr>
<td>FY 2040-41</td>
<td>$38,266</td>
<td>$21,492</td>
<td>$(16,774)</td>
</tr>
<tr>
<td>FY 2041-42</td>
<td>$33,511</td>
<td>$19,576</td>
<td>$(13,935)</td>
</tr>
<tr>
<td>FY 2042-43</td>
<td>$32,835</td>
<td>$19,263</td>
<td>$(13,572)</td>
</tr>
<tr>
<td>FY 2043-44</td>
<td>$30,538</td>
<td>$17,969</td>
<td>$(12,569)</td>
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<tr>
<td>FY 2044-45</td>
<td>$20,788</td>
<td>$17,879</td>
<td>$(2,909)</td>
</tr>
<tr>
<td>FY 2045-46</td>
<td>$17,730</td>
<td>$17,676</td>
<td>$(54)</td>
</tr>
</tbody>
</table>

Total $1,034,153 $996,120 $(38,033)

*Negative amount reflects pension plans being fully funded in FY 2036-37
The table below summarizes these three approaches for fully funding pension obligations. Staff will refine projections regarding use of pension trust proceeds and, after seeking input from the Finance/Audit Subcommittee, will present an update to the City Council in FY 2019-20 with the mid-year budget update.

<table>
<thead>
<tr>
<th>APPROACH TO FULLY FUNDING PENSION OBLIGATIONS</th>
<th>PROJECTED INTEREST SAVINGS</th>
<th>PROJECTED TIME TO FULLY FUND PENSIONS</th>
<th>PROJECTED DATE WHEN PENSIONS WOULD BE FULLY FUNDED</th>
</tr>
</thead>
<tbody>
<tr>
<td>Option 1. Making the Required Annual Contribution</td>
<td>None</td>
<td>22 years</td>
<td>FY 2040-41</td>
</tr>
<tr>
<td>Option 2. Making the Required Annual Contribution plus Making Additional Annual Payments</td>
<td>TBD based on when the City uses pension trust proceeds</td>
<td>21 years</td>
<td>FY 2039-40</td>
</tr>
<tr>
<td>Option 3. Making Sufficient Contributions to Fully Fund Pension Obligations within 18 Years</td>
<td>$38 million</td>
<td>18 years</td>
<td>FY 2036-37</td>
</tr>
</tbody>
</table>

Other Post-employment Benefit (OPEB) Liabilities - Retiree Health Benefits

A second category of retirement-related benefits, which affect the City’s finances, is the City’s retiree health program. The City currently provides eligible retirees with reimbursement of their medical insurance premiums, subject to their collective bargaining agreement, which includes a maximum reimbursement amount.

In 2010, the City established a Section 115 OPEB trust account through the California Employer’s Retiree Benefits Trust (CERBT) program to fund retiree health benefits. As of March 31, 2019, there was a balance of $36.7 million in the trust account. As of the most recent actuarial report, June 30, 2017, the City’s unfunded liability for these benefits was $57.6 million. An updated actuarial report is being prepared.

The Ten-Year General Fund Forecast includes anticipated additional General Fund contributions to the CERBT Section 115 OPEB trust account of $300,000 annually in order to build resources towards paying off the unfunded retiree health liability in future years.

Industrial Disability Retirements

Public safety employees who are injured on the job and are thus unable to perform essential job duties may apply for and receive an industrial disability retirement (IDR). The City currently reimburses safety employees who retire on an IDR up to $1,675 per month for health plan premiums, which includes medical coverage for the retiree and their family. Safety employees who retire on a service retirement and qualify for paid medical benefits receive health plan premium reimbursement for the retiree only. The City must pay 22 percent of payroll for sworn Police employees, and 12 percent of payroll for sworn Fire employees, to fund retiree health benefits.
In 2018, the City had an actuarial report prepared that analyzed the 2011 through 2017 retiree health (OPEB) valuation data. During this period, there were 28 IDRs for Police and eight IDRs for Fire. For Police, the ratio of actual to expected IDRs is almost 3:1, or about 200 percent higher than the CalPERS actuarial retiree health projections; for Fire, the ratio is almost 1.5:1, or about 50 percent higher than CalPERS actuarial retiree health projections.

The high IDR rates greatly impact the City’s unfunded retiree health liability by increasing the City’s costs. Over the course of FY 2019-20, City management and affected public safety bargaining units will begin working together on IDR Committees in an effort to develop alternative solutions to reduce the City’s retiree health liability as related to IDRs.

**Docktown Marina**

In December 2016, in response to a lawsuit over residential uses at Docktown Marina, the City Council approved the Docktown Plan, which assists individuals living at Docktown to find new housing. On January 8, 2018, staff provided City Council with an update on the Docktown Plan, estimating the total costs (including provision of relocation benefits, acquisition of property when desired by tenants, capital costs associated with liveaboard uses at the Port’s Municipal Marina, and legal and consultant costs) at $20.8 million, with $13.8 million remaining to be funded. In February 2018, the City Council approved a plan to fund these costs through a combination of FY 2017-18 General Fund operating surplus and short-term loans from the Equipment Replacement Fund ($6.0 million) and the Parking District Fund ($1.7 million) to provide sufficient cash flow to pay relocation costs. At this time, the loans are projected to be repaid by June 2020 and are included in the Ten Year General Fund Forecast. The total cost was estimated at $20.8 million in FY 2018-19. Current expenditures are less than $20.8 million. Staff will assess whether a budget amendment is required during FY 2019-20 to fund any additional costs.

**8. CAPITAL IMPROVEMENT PROGRAM (CIP)**

The CIP is a valuable resource to achieving the City Council’s strategic priorities. Each year, the CIP project recommendations are presented to the City Council in the spring for adoption with the budget in June. Proposed projects include infrastructure and facility upgrades, as well as major capital investments in the community. Based on City Council direction, projects are prioritized and funding is then allocated for the upcoming fiscal year.

A Five-Year CIP is prepared for City Council review annually. The Five-Year CIP provides a longer-term perspective on needed capital investments and is a fiscal and strategic tool to plan, fund, prioritize, and monitor capital investments in the community. The Five-Year CIP includes the proposed capital budget for FY 2019-20, as well as planned project needs for FY 2020-21 through FY 2023-24. The proposed Five-Year CIP includes 102 projects with an estimated cost of $293.7 million.


Major CIP projects are described more fully in the CIP section of the budget document.
Capital Outlay Fund

The Utility Users’ Tax (UUT) is the primary funding source for the Capital Outlay Fund budget. In prior fiscal years, these funds have been used to support and improve existing facilities through ongoing capital projects, and to provide new or completely upgraded facilities.

The proposed projects for FY 2019-20 serve the following functional areas: Administration, Facilities, Parks, Stormwater, Technology, Transportation, and Redwood Shores Levee/Lagoon. The total Capital Outlay Fund budget for FY 2019-20 is $10.9 million, which includes the following: $456,000 for various facilities improvements; $825,000 for park renovations and amenity improvements; $1.2 million for technology projects (including the new Finance and Human Resources software system and other infrastructure and application support); $1.4 million for the Roadway Pavement Management Program; and $2.3 million in other transportation-related projects.

Gas Tax Street Improvement Fund / Transportation Fund / Transportation Grants Fund / Traffic Mitigation Fees Fund

The State of California imposes per-gallon excise taxes on gasoline and diesel fuel, sales taxes on gasoline and diesel fuel, and registration taxes on motor vehicles. These revenues are allocated through the Highway Users Tax Account (HUTA) for research, planning, construction, improvement, maintenance, and operation of public streets and highways. Estimated revenues for FY 2019-20 are $2.3 million.

The Road Repair and Accountability Act of 2017 (Senate Bill 1, or SB1) allows for increases to gasoline excise taxes, vehicle registration fees, diesel excise taxes, diesel sales tax, and a new vehicle registration fee. These revenues will be allocated through the Road Maintenance and Rehabilitation Account for maintenance and rehabilitation of state highways, local streets and roads, and active transportation projects. Estimated SB1 revenues for FY 2019-20 are $1.5 million.

The Transportation Fund includes $1.9 million for various projects in FY 2019-20, including $286,837 for the active transportation corridor program, $1.3 million for the roadway pavement management program, and $100,000 for the Americans with Disabilities Act compliant ramp installation program.

Parks Impacts Fees Fund / Parks In-Lieu Fee Fund

The total FY 2019-20 budget for these two parks-related funds is $700,000. The two parks funds will support two projects in FY 2019-20, including $500,000 for the Red Morton / Armory Play Picnic Area Renovation project, and $200,000 for the Redwood Shores Library playground.

Water Capital Projects Fund

The CIP provides projects throughout the City to raise the whole water system in a balanced manner, rather than focusing solely on one element of the system, or one area of the City. The goal of the program is to assure supply and pressure for adequate fire protection and drinking water, for not only daily use and planned growth, but to protect the City in the event of a major disaster. A total of $6.5 million has been budgeted for Water Capital projects in FY 2019-20, including $5.3 million for the distribution system replacement program, $200,000 for cathodic protection, $617,000 for the new Finance and Human Resources software system, and $150,000 for recycled water distribution pump station quality improvements.
Sewer Capital Projects Fund

Total funding for improvements to the City’s sanitary sewer system is $5.6 million for FY 2019-20. Of the total, $2.5 million is budgeted for the replacement and rehabilitation of existing sanitary sewer pipeline and miscellaneous collection system repair and replacement, $617,000 for the new Finance and Human Resources software system, and $1.0 million is budgeted for the sewer pump station rehabilitation program.

9. ENTERPRISE FUNDS

Water Fund

The City relies on imported water from the San Francisco Public Utilities Commission (SFPUC) for all of the community’s drinking water supply; water supply costs account for 49 percent of the City’s total water utility operating expenses. Regular increases to the cost of wholesale water from SFPUC translates into necessary water rate increases by the City in order to meet the revenue requirements of the Water Enterprise Fund. The City’s program for water rate increases minimizes the spikes that occur with large increases for wholesale water purchases. The City’s multi-year financing plan is built around this goal, and a rate study for the water enterprise is in progress to evaluate future water rates.

FY 2019-20 is anticipated to begin with a fund balance of $20.8 million and end with a fund balance of $26.6 million.

Sewer Fund

As approved by the City Council, the Recommended Budget is based upon a proposed 4.5 percent rate increase for FY 2019-20. As customary, the rate increases are tied directly to capital improvement projects by and through Silicon Valley Clean Water (SVCW) (formerly called South Bayside System Authority). SVCW is in the middle of an $850 million capital improvement program, and as the largest member of the Joint Powers Authority, Redwood City is responsible for financing approximately 48.6 percent of the total project costs. Annual debt service payments are projected to increase substantially in future fiscal years. In February 2018, SVCW issued bonds with a par value of $141 million. Redwood City is responsible for debt service payments totaling $82 million through FY 2048-49.

In FY 2019-20, the annual debt service amount to be paid by the City will be $10.7 million. SVCW is currently in the process of issuing additional debt in the amount of $252 million to provide funds for capital projects, specifically the Regional Environmental Sewer Conveyance Upgrade Project. The City’s portion of this debt issue will be approximately $122.4 million.

The City’s program for sewer rate increases minimizes the spikes that occur with large capital projects, such as those envisioned by SVCW. Consequently, the City’s multi-year financing plan is built around this goal, with proposed rate increases of 4.5 percent each year from FY 2019-20 to FY 2021-22.

FY 2019-20 is anticipated to begin with a fund balance of $64.6 million and end with a fund balance of $65.8 million.
10. DEBT SERVICE

The City maintains strong financial policies to assure the financial health of the City, both in the short- and long-term. The City issues debt primarily to finance large capital investments, such as construction of public infrastructure, and to refinance existing debt to achieve savings. The City would not issue debt to finance current operations or normal maintenance. Reflecting the City’s policies and past history of strong financial management, in 2018, Moody’s upgraded the City’s general credit worthiness to “Aa1.”

The most financially conservative means of financing projects is the pay-as-you-go method, when current revenues are used to pay for capital projects to avoid interest payments. This method is not always possible when the City does not have sufficient cash on hand to pay for a large-scale capital project with significant funding needs. Currently, the City’s primary source of revenue for capital projects is the Utility Users’ Tax revenue.

The prudent use of debt financing, rather than using pay-as-you-go funding, allows capital costs to be distributed over a project’s useful life, facilitates better allocation of resources, and increases financial flexibility. Debt can also be used in conjunction with pay-as-you-go financing to pay only a portion of the project using debt if insufficient funds are available from non-debt sources.

The City does not currently have any outstanding debt issues related to governmental activities (non-enterprise), as all prior debt is paid in full. However, there are currently two outstanding debt issues totaling $12.8 million (2012 and 2015 Revenue Bonds) in the Port Fund, and three outstanding issues totaling $48.0 million (2013, 2015, and 2017 Revenue Bonds) in the Water Fund. The City, as a member of Silicon Valley Clean Water Authority (SVCW), is also responsible for a portion of debt issued by SVCW. Currently, there are four outstanding debt issues, with the City’s direct obligation to SVCW totaling approximately $145 million (2009, 2014, 2015, and 2018 Revenue Bonds).

SVCW is a joint powers authority that owns and operates the wastewater treatment plant in Redwood City and is responsible for transmission, treatment, and disposal of wastewater from its member agencies (City of Belmont, City of Redwood City, City of San Carlos, and West Bay Sanitary District). As mentioned, SVCW is currently in the process of issuing additional debt in the amount of $252 million to provide funds for capital projects, specifically the Regional Environmental Sewer Conveyance Upgrade Project. The City’s portion of this debt issue will be approximately $122.4 million. In order to complete all of the 217 capital projects in the SVCW Capital Improvement Plan, SVCW is anticipating the issuance of additional debt in the amount of $227.5 million over the next five years.

The City is also a member of South Bayside Waste Management Authority (SBWMA), also known as “Rethink Waste.” SBWMA owns and manages the Shoreway Environmental Center, which receives all of the recyclables, organics, and garbage collected in its service area. SBWMA issued $53.5 million in revenue bonds in 2009 to pay for the construction and renovation of a solid waste materials recovery facility and transfer station and related equipment. The current amount of debt outstanding is approximately $44.7 million. SBWMA is currently in the process of issuing $64 million in new debt to refund the 2009 debt issue and to provide approximately $20 million in cash to be used to upgrade equipment at the Materials Recovery Facility and to fund the Organics-to-Energy project. Unlike SVCW, the City is not responsible for any portion of the debt issued by SBWMA.
The City is currently in the design development phase of the Veterans Memorial Building/Senior Center-YMCA Project. The Phase 1 project cost is estimated to be $59.4 million. It is anticipated that the City will require debt financing of approximately $48.6 million for this project. Staff anticipates issuing lease revenue bonds to cover the required financing. The issuance of this debt will be classified as governmental activity debt, which will be the first governmental debt issued since 2013. As noted above, the City currently has no governmental debt issues outstanding.

11. Appropriations Limit

Article XIIIIB of the California Constitution defines and establishes the City’s appropriations limit. No city in California may spend from its “proceeds of taxes” more than the amount of its “appropriations limit”. The appropriations limit is determined by a formula contained within Article XIIIIB of the State Constitution. The City’s appropriations limit for FY 2019-20 is estimated to be $741.8 million. The FY 2019-20 appropriations subject to limitations are $110.9 million. The City is well within the legal limit.

12. Acknowledgments

I would like to take this opportunity to thank the City Council for their guidance throughout the budget process. I am particularly grateful to Assistant City Manager of Administrative Services Kimbra McCarthy and Financial Services Manager Derek Rampone, the Executive Team, the Finance team, and City Manager staff for their tremendous support in developing this year’s proposed budget: Sylvia Bravo Peters, Principal Analyst; Jennifer Chang and Carolyn Kerans, Senior Accountants; Jun Nguyen, Revenue Services Manager; Alex Khojikian, Deputy City Manager; Deanna La Croix, Management Analyst; Meghan Horrigan, Public Communication Manager; Tony Gelphman, Information Technology Manager; and Debbie Matsuura, Senior Information Technology Analyst.

Respectfully Submitted,

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City Manager

Attachment 1:  City Council Budget Priorities – Summary of Recent Accomplishments, Goals, and Ongoing Services Related to Housing, Transportation, and Children and Youth
Attachment 2:  Department Efficiencies, Innovations, and New Partnerships
Attachment 3:  Community Budget Workshop Summary