

April 20, 2020

To the Honorable Mayor and City Council
2021 Fiscal Year Operating & Capital Budget Transmittal

Dear Mayor and Council Members:

In accordance with the City Charter, I am presenting the City of Palo Alto's Fiscal Year 2021 Proposed Operating Budget and Fiscal Year 2021 Proposed Capital Budget along with the Fiscal Year 2021-2025 Capital Improvement Program (CIP) Plan. The operating budget totals \$818.9 million and the capital budget totals \$288.7 million in FY 2021 and \$793.4 million over the five-year CIP. As required by the City Municipal Code, the Planning and Transportation Commission (PTC) will review the 2020-2024 CIP in May 2020 to evaluate the program's compliance with the Updated Comprehensive Plan which was adopted by City Council in November 2017. As discussed previously with the City Council, this a baseline for us to continue conversations to ensure alignment of revenue and expenses and long-term fiscal sustainability in light of the global health crisis.

At the time of the development of the FY 2021 budget, the world is grappling with the novel coronavirus (COVID-19), a global pandemic. Society through both government and industry are responding in order to slow the spread and contain the virus in order to safeguard as many lives as possible. The financial implications of this public health emergency are significant, with regional, national and global impacts on economies in response to shelter in place orders required by the State of California and the County of Santa Clara and related social distancing restrictions. Since the Santa Clara County Ordered a Shelter in Place on March 16, 2020, Palo Alto has seen retail stores, many hotels, and restaurants close their doors completely as the community struggles to adapt to this extraordinary challenge. We have also seen our daytime population drop as workers and visitors shelter in place, telework, and limit their movements to slow the spread of the virus. The impacts have been stark and immediate.

On March 12, 2020 the City Manager, acting as the Director of Emergency Services, issued a Proclamation of Local Emergency regarding the presence and community spread of COVID-19 in Santa Clara County and our region. The Proclamation allows the City to exercise extraordinary police powers, should these be needed; provides immunity for emergency actions; authorizes issuance of certain necessary orders and regulations; activates pre-established emergency processes; and is a prerequisite for requesting state or federal assistance related to the emergency, should such assistance become available. On Sunday, March 15, 2020, the City Manager activated the Emergency Operations Center and since that time, the City has managed the EOC virtually through a cross-functional multi-departmental team.

On March 16, 2020, the City Council ratified the Proclamation of Local Emergency. In the weeks since COVID-19 was detected and found to be transmitting via community spread, City staff have taken numerous actions to promote community safety and address existing and potential impacts on City services and operations. The City has transitioned a majority of its workforce to

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remote (telework) status, while maintaining essential services such as fire, police, public works, and utilities.

Due to the immediate constraints on social activities, severe impacts to transient occupancy taxes, sales tax, documentary transfer tax, and revenue from licenses, permits, and charges for services are ongoing. Although anecdotal, staff expects hotel occupancy levels to be below 10 percent and restaurants and retail establishments to remain primarily closed while the current Shelter-in-Place Order and social distancing practices are in effect. The financial outlook beyond the current environment are also unknown as unemployment claims have reached unprecedented levels and the financial markets are volatile. Further, while the current County of Santa Clara Public Health Order runs to May 3, there are indications at both the local and State levels that the public health emergency will extend for months to come.

While mindful of the unprecedented circumstances at hand, this Budget Message includes the following sections to outline the City's resource allocations for the year ahead and beyond:

1. City Council Priorities
2. Council Adopted Budget Principles
3. Continuing Fiscal Sustainability Actions Previously Adopted
4. Fiscal Reality and Budget Priorities
5. Summary of Other Funds (including the FY 2021-2025 Capital Improvement Plan)
6. Budget Timeline
7. Acknowledgments

City Council Priorities

In February of this year, which may seem like a lifetime ago, the City Council held a retreat and selected three priorities to focus on in 2020. The priorities include:

- Housing with an emphasis on affordable housing
- Sustainability, in the context of the changing climate
- Improving mobility for all

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"Housing with an emphasis on affordable housing

"Sustainability, in the context of the changing climate

"Improving mobility for all

Two of these priorities, mobility, and sustainability, relate to City Council priorities from 2019. For the City Council Retreat staff report highlighting past Council priorities and community input gained to help inform this discussion, go here:

<https://www.cityofpaloalto.org/civicax/filebank/blobdload.aspx?t=62811.92&BlobID=75033>

Since February, the City Council has adopted housing and sustainability workplans, guiding staff work associated with these priorities, and a revision to the existing transportation workplan was planned by June 2020. While progress is being made on all priorities, the realignment needed to reflect current circumstances will severely impact our ability to continue this work.

The budget direction below considers suspending much of the work on all three priorities, in order to focus on legally mandated activities and redeploying staff to focus on recovery efforts.

Council Adopted Budget Principles

As part of the FY 2021 - FY 2030 Long Range Financial Forecast, the City Council approved budget guidelines that have driven development of the FY 2021 Proposed operating and capital budgets. The budget principles include:

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 its 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 including planning for recession needs.
3. Ensure appropriate resource allocation for City Council's existing priorities.
4. Focus on business process redesign to enhance quality, flexibility, and cost effectiveness of service delivery (include examining opportunities to streamline, simplify, reorganize, and reallocate resources to avoid duplication of effort).
5. Explore alternative service delivery models (such as partnerships with non-profits or other public/private sector groups) to minimize overlap, maximize cost share, and effectively use resources.
6. Continue to thoroughly analyze non-personnel/equipment/other costs, such as contract services, for cost savings opportunities.
7. Explore the expansion of existing revenue sources or the addition of new revenue sources, including the alignment of existing charges for services and the opportunity to establish new fees, when appropriate.
8. Continue to analyze and prioritize resource augmentations, seeking to offset augmentations with reductions elsewhere for net-zero impacts to the budget whenever possible.

The FY 2021 - FY 2030 Long Range Financial Forecast can be found here:

<http://cityofpaloalto.org/civicax/filebank/documents/74907>

Continuing Fiscal Sustainability Actions Previously Adopted

The FY 2021 baseline budget reflects the current service levels approved by the City Council with revenue projections prior to the COVID-19 emergency. As a balanced budget, the assumptions contained therein continue to follow conservative proactive fiscal management across all funds and includes a \$2.7 million contribution to the Budget Stabilization Reserve in the General Fund. This reflects the significant progress the City has made towards ongoing cost containment over the past several years and the reductions that have been made across the organization. It shows the continued push to proactively fund pensions with continuing the City Council approved additional annual payments to the City's irrevocable IRS Section 115 Pension Trust

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Fund ("Pension Trust Fund") (\$3.4 million General Fund, \$5.5 million all funds), additional payments to the City's OPEB Trust (approximately \$3.0 million annually all funds).

Investment in capital infrastructure has been a key priority as well and is funded by approval of two (2) Transient Occupancy Tax rate changes as well as a sizeable transfer from the General Fund to the Capital Improvement Fund for the catch-up and keep-up priorities identified by the Infrastructure Blue Ribbon Commission (IBRC). This capital budget continues to prioritize the 2014 Council approved Infrastructure Plan in the General Capital Improvement Fund. In order to accomplish this, some of the larger projects previously planned in the five-year CIP have been pushed out beyond the 2021-2025 timeframe.

The ability to maintain these financial investments in capital and proactive payment of long-term liabilities, while funding Council priorities over the years, has resulted in service and staffing reductions and service delivery changes such as the animal shelter transition to a public/private partnership with Pets in Need. This prioritization of fiscal sustainability did not come without impacts. The FY 2020 Adopted Budget and the FY 2021 Proposed Budget continues reductions in the Fire Department, position eliminations in the Library Department and Public Works, as well as ongoing expense reductions in the Office of the City Clerk, the City Manager's Office, the Office of Emergency Services, and Information Technology.

In addition, efforts to structurally balance the FY 2020 budget, the FY 2020 Adopted Budget included actions that were expected to start in FY 2021, such as the transition of Project Safety Net to a community-funded model with the City as a partner instead of the primary funder, and the realization of approximately \$450,000 in additional savings in the Police Department. This FY 2021 Proposed Budget includes continuation of these efforts.

These actions result in a baseline workforce of 1,034, which decreased by 1 position compared to the FY 2020 Adopted Budget. This is significantly less than the peak level of 1,076 citywide positions in 2009. In the General Fund, positions have decreased 11.9 percent, from 651 to 574, since 2009. Staff released the "City Services Guide" in December 2019 to assist in further conversations about the exceptional services provided by the City and the resources necessary to provide them.

You can find the City Services Guide and the appendix here:

<http://cityofpaloalto.org/civicax/filebank/documents/74888>

<http://cityofpaloalto.org/civicax/filebank/documents/74176>

Fiscal Reality and Revised Budget Approach

This year's proposed budget recognizes the need to set new priorities in light of the significant uncertainty the City faces. Per direction by the City Council on March 23, 2020, these proposed operating and capital budgets include less information and data than normal and are effectively a carryover budget. They reflect the cost of current service levels recalculated to FY 2021 rates and limited adjustments. The capital budget has been updated for the current status and cost estimates of projects based on engineering designs and only adds limited new projects for urgent health and safety needs. These budgets also begin what staff expects to be an ongoing conversation and difficult work ahead to plan for the return or recovery period once the shelter in place order is lifted. It is expected that these deliberations will require resetting expectations and many shared sacrifices moving forward.

Despite reflecting most recent figures, revenue estimates contained in these budgets are nonetheless likely overstated given the current state of the economy. It is expected that once the revenue estimates are revised, significant adjustments will be necessary to ensure a balanced budget in the several funds with economically sensitive revenues. This includes but is not limited to the General Fund, Refuse Fund, Parking Funds, and Enterprise Utility Funds. Staff expects to begin these conversations with the release of these Proposed Budgets and continue through May and June. Ultimately, the City Council must adopt a balanced operating and capital budget by June 30 for the new fiscal year FY 2021 beginning July 1, 2020. Staff will work to achieve this with the City Council.

Depending on the length and depth of this current public health emergency, the severity of the financial ramifications remains unknown. In the General Fund, staff has worked to estimate the impacts on the potential loss in major tax revenues. Based on this, at the time of this transmittal, it is estimated that major General Fund taxes will decline at minimum by \$20.0 million in FY 2021 compared to the estimates carried in this baseline budget. Sales Tax and Transient Occupancy Taxes (TOT) alone make up nearly 30 percent of the General Fund revenues. In addition, preliminary figures from CalPERS reflect that they will not meet their expected investment returns this year. Through March, CalPERS is reporting -4 to -5 percent losses and are currently hovering around -1 percent to 0 percent investment returns. It is expected that these costs will materialize in the City's FY 2022-2023 retirement rates and continue through a 20-year period. As we have all been reading in the current news, it is expected that society will be susceptible to restrictions and a possible resurgence of the infections of COVID-19. As we continue to grapple with these unknown effects, adding to the City Council's adopted Budget Principles highlighted above, I am recommending establishing a set of Budget and Fiscal Recovery Priorities to help guide our work to balance this significant change and continue to evolve through these uncertain times. These include:

- Support economic recovery through changes to our policies and programs
- Focus on resiliency over the long term while making service reductions and changes, ensuring that any services eliminated can be restored in future years
- Seek new ways to conduct our work through efficiencies and a learning environment
- Apply a broad-based approach to reductions, balancing impacts to the community
- Use temporary solutions to bridge extreme revenue losses expected in the short term

Recognizing that some of the necessary measures may not be sustainable in the long term, some deferrals of longstanding priorities will be necessary to respond to the downturn and allow for an economic recovery before resuming. We must assume this may take years, as the actual duration is unknown.

Through these new Budget and Fiscal Recovery Priorities, I've directed our Department Directors to think differently about our budget approach and challenges ahead including the following service changes and themes listed below. This is not a recommended budget approach at this time, nor comprehensive list, however it is intended to demonstrate the magnitude of changes needed to address expected financial constraints. Note that some workforce strategies are subject to bargaining over decisions and/or impacts, in some cases requiring mutual agreement. The City will work with labor to explore savings through these and other strategies.

Citywide Strategies

- Citywide Cost Containment: We will explore additional cost containment through continuing a hiring freeze and freezing all nonessential travel, eliminating current vacancies and reducing future vacancies through attrition, and/or implementing furloughs with corresponding service reductions such as reduced walk-in office hours.
- City General Capital Infrastructure Fund Transfer Suspension: The City's General Fund transfers upwards of \$30 million annually to the General Capital Infrastructure Fund, consisting of a baseline transfer as well as the allocation of TOT receipts as designated by the City Council. This is expected to be significantly impacted by the losses in TOT revenues and reduction in the General Fund transfer would help bridge operating budget impacts. Both will significantly reduce the capacity for capital investments in the near term. We must prioritize investments including the Public Safety Building, 2014 City Council approved Infrastructure Plan, Parks improvements such as Birch Street, the newly acquired property adjacent to Boulware Park, and various transportation projects including but not limited to grade separations.
- Proactive Funding of Long-Term Liabilities: The City Council approved a proactive funding strategy to contribute to the City's Pension Trust Fund assuming a normal cost for contribution with a 6.2 percent discount rate. This resulted in additional annual contribution of \$5.5 million in all funds, \$3.4 million in the General Fund. We will explore pausing this practice to soften the extreme revenue losses in the short-term.
- Support of Economic Recovery through Changes to our Policies and Programs: The City is initiating Business Roundtables and other programs and services to continue supporting the business community. While implementation of outputs from the Business Roundtables may require near-term investments, they will also assist in the long term economic recovery of our community. Initiatives include the implementation of our new online permit system to ensure, even while sheltering in place, review of planning and permitting processes and policy changes to support businesses in the City.

Department Specific Strategies

- Public Safety: We will explore the suspension or elimination of specialized police units such as the traffic enforcement unit and investigation unit to maintain minimal police patrol services and shift the priority of police services to focus on urgent calls and reduce the level of service and ability to respond to non-urgent calls for services. Reduce officer training, promotional testing, uniform purchases and eliminate or change to full cost recovery for non-essential programming such as the Parent Project community education program, crossing guards, Stanford Athletics, and school resource officers. Explore the reduced availability of at least one of five fire stations and eliminate or freeze a staff vacancy in the Office of Emergency Services.
- Community & Library Services: We will explore reduced library hours, not opening select library branches, and not re-opening some community services facilities. This includes greater cost recovery through changes in service delivery, charges for services, and/or limiting operating hours, for facilities such as the new Junior Museum and Zoo (JMZ), one community center, the Children's Theatre, or the Art Center. We will also explore reducing the number of days or hours of operation that other Community Services facilities are open such as community centers, museums, theaters or open space preserves. Explore the reduction or elimination of programming such as special events, art exhibits, and teen

programs and re-evaluate the shared services between the City and Palo Alto Unified School District (PAUSD), including suspension of programs unless greater cost recovery can be achieved. Explore termination of the Cubberley lease or resetting to a shared revenue structure.

- **Planning & Infrastructure:** Explore restrictions to use of contract inspectors, elimination of next day inspections and explore scheduled inspections, understanding that this could delay services to our development community. Defer several Council adopted planning efforts such as the housing work plan, all electric commercial buildings initiatives and other work not legally mandated. Restructure work to in-house staff only, explore amendments to the City's municipal code to scale back on application processing requirements associated with wireless communication facilities. Explore other amendments to reduce the number of applications requiring review by the architectural review board and elimination of the individual review program to free up resources that support the Council's long-range planning policy interests.

Explore reducing code enforcement staffing, eliminating the Crosstown and Embarcadero shuttle programs or redesigning the delivery of this service to reduce costs. Evaluate the current parking program including the Residential Preferential Parking (RPP) program to full cost recovery including implementation of license plate recognition for efficiencies in parking enforcement, and implementation of a paid parking program to increase revenues. Explore deferral or reduction in tree trimming, vehicle replacement, suspending rate changes in various utility enterprise funds for the coming year(s) and explore shifting the City's sidewalk replacement and repairs program to cost-sharing or full property owner responsibility.

- **Internal Services & Council Appointed Officers:** Internal Services departments include the Information Technology, Human Resources, and Administrative Services Departments as well as the Council and appointed officers (City Manager, City Attorney, City Auditor and City Clerk). We will explore reductions in these areas in line with the proposed changes in services, aligning timeframes for assistance and review in areas such as recruitments, procurements, and risk management. Technology solutions would be constrained to only essential contracts and systems. The City Council may similarly review its expenses and areas for reduction.

Once again, we must recognize that many of these budget balancing strategies are not sustainable over the long term. However, these or similar solutions are necessary to bridge the gap created by a steep economic downturn, contain costs, and support our economic recovery.

Summary of Other Funds

The City's Enterprise and other funds, including the General Capital Fund, have also been brought forward in these proposed operating and capital budgets as working budgets. They reflect the priorities from the FY 2020 budget development with updates for FY 2021 rates and limited adjustments. The capital budgets have been updated for the current status and cost estimates of projects based on engineering designs and only adds limited new projects for urgent health and safety needs. The City will continue to maintain services and facilities for the community and the region, such as Utilities, Palo Alto Airport, and Wastewater Collection and Treatment plant. Although these budgets in this FY 2021 assume rate increases in various utilities, as noted above, staff is working to explore suspension of rate changes. Minimal changes

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are recommended in the various parking funds, one-time funding approved in FY 2020 are recommended to be continued for an additional year such as funding for the Transportation Management Association (TMA) and a General Fund subsidy in the RPP program. Parking permit prices are also recommended to increase by 2.6 percent, consistent with most other fees, except for resident permits which are recommended to remain at \$50.

In FY 2021, a total of \$96.4 million will be allocated towards the capital program for the Enterprise Funds, with \$390.5 million allocated over the five-year CIP, representing 52.1 percent of CIP expenditures for all funds. Major investments continue in the Wastewater Treatment Plant's capital program, with approximately 64 percent of the expenses reimbursed by five contributing partner agencies outside of the City of Palo Alto, and the general Capital Improvement Fund, which is the second largest section of the 2021-2025 CIP, totals \$335.0 million with 91 projects. It is expected, as noted above, that a prioritization of investments will be necessary with the expected reduction in TOT receipts.

Budget Timeline



Acknowledgements

I would like to thank the City Council for your leadership and our Executive Leadership Team and the entire staff of the City for providing outstanding services to our community. While recognizing the challenges ahead, the Palo Alto community should be proud of your leadership and commitment to service.

A proposed budget takes countless hours of teamwork, collaboration, and patience to produce. I would like to offer special thanks to Kiely Nose, our Chief Financial Officer and the dedicated Office of Management and Budget Team - Christine Paras, Paul Harper, Steve Guagliardo, Jessie Deschamps, Alexandra Harris, Jamie Perez, Kayla Shapiro, and Chaitali Paliwal. Completing this budget could not have been accomplished without the skill, dedication, and professionalism of

this team. Their willingness to work through these unique circumstances and sacrifice countless hours are a testament to their commitment to this organization and to the community. Thanks are also due to David Ramberg, Assistant Director, Administrative Services Department, and Tarun Narayan, Treasury Manager. I am also grateful to the Department Directors of our Executive Leadership Team and the department personnel who worked on the material. There are too many to list here by name, but the budget could not have been produced without the senior/management analysts, division managers, administrative assistants, and others throughout the organization who helped produce this budget.

Respectfully Submitted,

Ed Shikada



City Manager