



MAYOR JEAN QUAN
CITY OF OAKLAND

TO: Council President Reid and Members of the City Council
FROM: Mayor Jean Quan and City Administrator P. Lamont Ewell
DATE: March 30, 2011
RE: Receive an Informational Report on the City's Fiscal Condition and
Framework for a Balancing Plan

SUMMARY

While the long-term forecasts for the City are positive, Oakland, like the State of California and many other governments, has reached a critical time in history. As we continue to reel from the effects of the worst financial crisis since the Great Depression, we must take immediate action to balance and address structural deficits in the budget so that Oakland will be well positioned when the economy rebounds. It is imperative that the City immediately reduce current year expenditures and focus its limited resources on a FY 2011/12 budget that reflects its core services most essential to our residents.

Due to the depth of the crisis, the Mayor has asked the City Administrator to take the following immediate actions:

- Immediate reductions in current year spending, where possible;
- Further reductions in travel and vehicle expenses;
- Reduction and elimination of cell phones and consolidation of service plans; and
- Continued hiring freeze and City Administrator approvals on all necessary hiring.

The projected FY 2011/12 general purpose fund (GPF) deficit is \$46 million, despite addressing over \$170 million in shortfalls over the last several years. However, this deficit is likely to be **much larger** due to signs of 1) weakening revenues in the current fiscal year; 2) expected State and Federal budget actions; and 3) mounting health care, pension costs and increases in the cost of doing business. The projected shortfall grows each subsequent year as expenditures rise and revenues recede.

The current budgetary issues are widespread, touching virtually every government service Oakland provides. The policy and management decisions which must be made to stabilize the upcoming budgets will be among the most difficult ever faced by this City. Unlike any other time in our history, this process is going to necessitate nothing short of elected officials, City employees and Oakland's residents working together to make the

required tough choices and critical investments in the coming years. Furthermore the financial challenges are simply too great to be remedied by any one approach in one year and all budget balancing strategies must be on the table. The size of the projected deficit necessitates the following:

- Staff reductions;
- New revenues;
- Restructuring of City departments;
- Prioritization of services and corresponding program eliminations;
- Additional employee concessions; and
- Creative collaboration between local, county, state, federal governments and the private sector.

In preparation for the upcoming tough decisions, City departments were asked in December to develop budget reduction options. The City Administrator in conjunction with the Budget Office and departments has completed an initial review of those options, with many additional items still under review. This memorandum transmits a list of the contemplated budget balancing options being considered. **No final decisions are necessary at this time on any particular reduction or new revenue. This is provided for Council's information in an effort to apprise all Council Members of the magnitude of the problem.** It is intended that the ensuing budget conversations will assist City staff as they continue to prepare the Proposed Budget which will be presented at the end of April.

I am requesting Council Members to submit by April 8, 2011 a list of their individual priorities and additional items or strategies that they would like to see reflected in the upcoming budget. Additionally, given that a key issue to be addressed is the annual PFRS payment of \$46 million, I am also requesting Council Members to include in their priorities their preferred approach to addressing the annual payment commitment.

BUDGET-BALANCING OPTIONS

As the City looks to next fiscal year there are only three ways to balance the budget: cut non-mandated expenses, raise revenues or use some combination of the two. Consequently, every machination of balancing options are on the table for consideration: eliminating entire programs, reorganizing to remove layers of management, limiting operations to a four-day work week, and identifying ways to increase revenues. Depending on State and Federal action, current year revenue performance, and further analysis by City staff, additional, deeper or alternative programmatic reductions may be proposed that could affect service levels in other ways.

The Administration's balanced framework for developing its Proposed Budget is as follows:

\$20-25 million in departmental reductions (Attachment A represent over \$30 million in potential reductions);
\$11-15 million in revenue increases, including approximately \$11 million from an \$80/parcel tax;
\$10-15 million in employee concessions; and
\$10-15 million in various other balancing measures, such as land sales.
Total = \$51 million to \$70 million

Some of the budget reduction options for FY 2011/12 with significant public impacts currently under consideration are listed by department in Attachment A. In addition to the items included in the attachment, City Administration is also considering various reorganizations and consolidations of City services and programs that require additional analysis and costing. These items include, but not limited to the following:

- Centralization of general government functions;
- Consolidation of payment centers;
- Civilianization of Police Internal Affairs and other functions;
- Partnerships with other cities and other agencies;
- Consolidation of inspection services;
- Facilities consolidation (including libraries, recreation centers and senior centers);
- Elimination of all City vehicles other than OPD, OFD and heavy equipment;
- Merging of City departments;
- Increasing certain fees for services;
- Transfer of Animal Shelter services to other outside agency;
- Installation of cameras on street sweeping vehicles;
- Moving City towards a “Cloud Computing” model (which would allow most city documents to be stored securely on the web, instead of desktops); and
- Partnerships with OUSD, County, and other outside agencies for program efficiencies.

Of note, the attached options may not be the ones proposed by the City Administration, and additional options may also be proposed that are not included on the list above or the attached departmental pages. This list is merely provided for Council’s information to make you aware of the magnitude of the problem, and no decisions are necessary at this time on any particular reduction or new revenue.

PROJECTED DEFICIT

FY 10-11: General Purpose Fund

Based on second quarter results, a shortfall of **\$6.50 million** is projected by the current year-end. Year-end revenues are projected to be under collected by at least \$10 million, primarily due to lower parking citation revenue from decreased citation issuance. The

forecast includes adjustments for implementation of mitigation measures proposed by the Parking Division to partially offset the citation revenue shortfall; however, if the offsets from the mitigation measures are not realized, the shortfall in parking citation revenue will likely be much greater. Expenditures are projected to be under budget by current year-end, primarily due to not having to transfer from the General Purpose Fund to the Measure Y Fund because of the passage of local Measure BB.

FY 11-12, FY 12-13: General Purpose Fund

Maintenance of the current level of services in the GPF in the next two fiscal years, given existing revenue estimates, would result in an annual shortfall of at least \$46 million and \$62 million, as reflected in the table below.

		FY 11-12	FY 12-13
Gen Purpose Fund	Expense	436,059,018	455,570,442
	Revenue	390,279,753	393,395,168
Gen Purpose Fund Deficit		(45,779,265)	(62,175,274)

REVENUE OUTLOOK

Overview

Although Oakland has significantly decreased spending, the City's revenues have collapsed. The global financial crisis sparked by the nationwide real estate crash has caused declining housing values, unacceptably high unemployment rates and diminished economic development within Oakland. The San Francisco Federal Reserve Bank reported in January 2011 that 4.5 million homes nationally remain in distress and at risk of foreclosure; of those over 650,000 or 15% are located in California. In Oakland, many neighborhoods have the highest rates of foreclosure or bank owned property in the Bay Area with as much as eight percent of the total loans in distress.¹ Not surprising, within the last year, the property assessment roll for Alameda County had a negative assessed value for the first time in more than 50 years and median home values countywide have plunged 42 percent since July 2007.

Similarly affected, the state's unemployment rate remains only slightly below the record-high rate reached in spring 2010. The Governor's most recent economic forecast reflects the general consensus among economists that recovery from the Great Recession will be long and slow. Relatively weak national economic growth means that the job market – nationally, in California, and Oakland – will rebound very gradually. The Governor's forecast projects the unemployment rate to drop by just 0.3 percentage points from an estimated 12.4 percent in 2010 to 12.1 percent in 2011, and then remain high – at 11.3 percent – in 2012. The Governor's forecast anticipates that it will take until the third quarter of 2016 for California to regain all of the nonfarm jobs it lost during the

¹ http://www.frbsf.org/community/issues/assets/preservation/resources/foreclosure/ca_northern_0111.cfm

recession.² Locally, the employment outlook is even bleaker with the most recent data revealing an astoundingly sustained high unemployment rate of 16.5% for the City of Oakland.³ Not only do persistent levels of high unemployment affect state and local revenues, it also increases residential need for social supports and places added demands on vital public services.

The lack of economic growth has also curtailed economic development in Oakland, as it has elsewhere in the country. Tightened capital markets, diminished consumer spending and surpluses both in commercial and residential real estate have halted local projects. Impeded and/or abandoned development efforts have affected revenue, as business, sales and residential growth has stagnated and/or declined. The shrinkage in resources is particularly troubling because as Oakland's revenue base is losing ground, the City's operating costs and local demand for services continues to rise.

Local Impact of the Economic Downturn

In Oakland over the past six years, general fund revenues have plummeted from an actual high of \$511 million in FY 2005/2006 to a budgeted amount of \$390 million for FY 2011-2012, representing a \$121 million or 24% drop. The General Fund represents 42 percent of the City's total \$1 billion budget for FY 2011/12. The General Fund pays for basic programs and services such as police and fire protection, libraries, senior centers and recreation programs, as well as elected offices and municipal business functions. The remaining 58 percent of the City's funds are restricted for specific purposes such as streets, housing development, sewer maintenance, economic and redevelopment and bond-funded programs.

Declines in property, sales and real estate transfer taxes due to the housing market meltdown were responsible for the greatest portion of the drop in the general fund. In FY 2005/06, the real estate transfer tax generated almost \$80 million in revenue. In FY 2011/12, it is projected at \$28 million, a 65 percent drop. For FY 2011/12, the City is projecting a continued decline in its property tax of approximately 1.5%, or almost \$2 million. In addition to housing related revenues, the City is projecting flat or slight decreases in revenues in all other categories, such as business tax, sales tax, and transient occupancy tax (hotel tax). A summary of historical and projected revenue is provided in the table below:

² California Budget Project

³ <http://www.labormarketinfo.edd.ca.gov/?pageid=1006>

**FY 2005-06 Through FY 2011-13
GENERAL PURPOSE FUND REVENUES**

REVENUES	Actual					FY 10/11 Budget		Projected as of Q2 FY 10/11 FY 10/11	Estimated Revenues FY 11-13	
	FY 05-06	FY 06-07	FY 07-08	FY 08-09	FY 09-10	Adopted/ Amended FY 10-11	Adjusted FY 10-11		Baseline FY 11-12	Baseline FY 12-13
Property Tax	105.35	116.47	131.74	134.47	131.78	125.15	125.15	125.15	123.27	123.27
Sales Tax	44.87	46.69	53.09	46.12	35.88	36.14	36.14	36.14	36.50	37.23
Vehicle License Fee	2.98	2.27	1.81	1.28	1.25	1.11	1.11	1.11	1.11	1.11
Business Tax	43.79	50.33	52.54	54.29	54.14	50.81	50.81	50.81	50.81	51.32
Utility Consumption Tax	48.77	51.43	52.52	52.70	51.11	50.80	50.80	50.80	51.21	51.62
Real Estate Transfer Tax	79.48	61.50	36.21	34.27	36.97	33.49	33.49	28.63	28.49	29.63
Transient Occupancy Tax	11.26	11.82	12.20	10.46	8.47	8.64	8.64	8.64	8.73	8.90
Parking Tax	8.47	8.89	8.52	7.66	7.52	7.52	7.52	7.52	7.67	7.82
Licenses & Permits	18.97	1.06	1.61	1.28	0.72	0.69	0.69	0.69	0.64	0.64
Fines & Penalties	24.74	25.96	21.94	25.57	27.35	31.96	31.96	25.11	32.03	32.03
Interest Income	3.13	3.20	4.47	1.71	1.10	1.64	1.64	0.80	0.80	0.80
Service Charges	61.05	45.35	44.06	43.85	45.03	47.98	47.98	47.04	46.57	46.57
Grants & Subsidies	1.68	5.42	4.65	4.31	1.95	0.15	0.15	0.15		
Miscellaneous	2.87	12.28	4.07	11.48	8.05	8.96	9.31	7.67	1.02	1.02
Fund Transfers	53.83	28.62	25.70	38.69	21.86	12.61	12.66	17.38	1.44	1.44
TOTAL	\$511.26	\$471.28	\$455.13	\$468.13	\$433.18	\$417.65	\$418.05	\$407.66	\$390.28	\$393.40

EXPENDITURE OUTLOOK

Over the past several years as Oakland has grappled with declining revenues, leadership has responded with over \$170 million in cuts. As the City looks to FY 2011/12 and 2012/13 the GPF baseline expenditures are projected to be \$436 million and \$456 million respectively. These figures represent increases of \$17 million (4%), and \$36 million (9%), compared to the FY 2010-11 Mid-cycle Budget. The largest increases are associated with three categories: salaries, pension costs, and Internal Service Funds.

Salaries

Salaries increase by \$8.2 million from the current fiscal year to FY 2011/12, despite the fact that no cost of living increases were assumed. The increase was primarily due to excluding business shutdown savings. In FY 2009-11, employees conceded closing city offices twelve days each year, representing nearly a 5% salary reduction for non-sworn employees. The resulting savings to the City's General Fund was estimated at \$3.5 million. However, business shutdown savings have not been assumed to carry forward into FY 2011-13, since an agreement has not yet been reached regarding labor contracts that expire at the end of FY 2010/11.

In addition, MOU-driven step and merit increases were included in FY 2011/12. Previously, departments were instructed to absorb these costs in their operating budgets, which resulted in budget overages. Given the City's low vacancy rates following several years of staff reductions, the continuing absorption of the step and merit increases is

unrealistic and they have therefore been incorporated into the FY 2011-13 baseline budget.

Pension Costs

FY 2011-12 pension rates--set by CALPERS actuaries for the City's major bargaining units--increased between two to four percentage points over FY 2010/11. The increases resulted from 1) losses in the CALPERS investment portfolio and 2) updated projections of actuarial factors such as the ratio of workers to retirees. The hike in rates created \$5.9 million in growth in General Fund retirement costs.

Internal Service Fund (Police Vehicle Costs)

Police vehicles were under-budgeted in Fiscal Years 2009-11 and as a result, Police overspent their vehicle budget by approximately \$2.1 million per year. The correct FY 2011-13 appropriations have been incorporated into the baseline budget to better align appropriations with expected expenditures. Doing so allows for a clearer understanding of the City's cost structures and a more informed approach to cost reduction.

FY 2011-12 General Purpose Fund Baseline Expenditures: FY 2010-11 Midcycle to FY 2011-12 Baseline (\$Millions)				
Category	FY 2010-11 Midcycle	FY 2011-12 Baseline	Increase	Comment
Salaries	\$174.1	\$182.2	\$8.2	Removal of business shutdown days; addition of step/merit increases
Retirement	\$48.6	\$54.5	\$5.9	CALPERS rate increases
Internal Service Funds	\$26.0	\$28.2	\$2.1	Police vehicles budgeted at correct level
All Other	\$170.4	\$171.1	\$0.7	Includes netting together of Operations & Maintenance, Overtime, Debt, Fund Transfers, and other miscellaneous line items
Total Change			\$16.9	

POTENTIAL FEDERAL AND STATE BUDGET IMPACT

In addition to the drops in revenue and increased costs and demands for services, the City is also facing severe program cuts and revenue losses due to federal and state budget proposals. This is happening just as the City is in its greatest need of providing job creation and services for our residents. Keep in mind, *prior* to the recession half of our residents – 200,000 people out of the approximately 425,000 – were low and moderate income, according to the 2000 Census. It is highly likely that the economic concerns of a vast number of Oakland residents have not been alleviated in the course of the past

decade and many more have witnessed the worsening of their financial standing. Therefore the sweeping proposals which affect program areas as diverse as education, job training, housing and economic development is even more concerning. The elimination of Head Start or Oakland's Redevelopment Agency is a plausible outcome given the Federal and State proposals. Moreover, the magnitude of what is being discussed and the unknown likelihood of what will be adopted has added immeasurably to the complexity of the planning and budgeting process for FY 2011-2013.

The following is a summary of the latest information regarding both the Federal and State budgeting discussions:

Federal Budget Impact

Workforce Investment Act Programs (WIA)

Congressional Republicans are proposing to eliminate all funding--over \$3.6 billion--for the Workforce Investment Act. This would zero out all new funding for state and federal programs under WIA. Oakland's WIA programs provide workforce training to 467 youth to stay in school and graduate and assist 200 adults find jobs and become more self-sufficient. Locally the proposed cuts will eliminate the training programs, close four job training centers which serve about 10,000 to 15,000 people a month, and eliminate the Mayor's Summer Jobs Program.

Head Start and Early Head Start Programs

Cuts of up to 20 percent are being proposed to both Head Start and Early Head Start programs. If funding is reduced or eliminated it would affect close to 2,000 families currently receiving critical child development services. The reduced access to affordable quality child care may adversely affect employment outcomes, as parents may be forced to provide direct child care for their children or find other less reliable and/or developmental alternatives. The reductions would also have a profound impact on early childhood jobs, as 300 positions would be eliminated.

Homeless and Hunger Programs

Oakland stands to lose almost all of its funding for homeless and hunger services, at a time when more people are finding themselves less food secure and homeless or on the verge of homelessness due to the recession. Although the President's budget proposal seeks a 23 percent increase in targeted homeless assistance funding, the House is proposing severe cuts to these funds. The City of Oakland has recently adopted long-term target strategies to identify permanent housing for homeless individuals and families. These cuts would devastate any local programmatic improvements the City and our partner community providers have achieved.

In addition, FEMA is facing a 50 percent budget reduction, which would equate to a loss of \$263,000 in Oakland. This would directly affect more than 20 community-based service providers, reducing the funds available to sustain services to those most in need of food and shelter. Cuts would also have a multiplier effect, impeding the non-profit providers' ability to leverage Oakland's FEMA allocation for additional funds.

Adult Programs

The White House budget proposes a 45% cut to Senior Community Service Employment Program funding. Oakland's ASSETS is an employment and training program for adults 55 and older with limited incomes. It prepares participants to enter or re-enter the competitive job market by offering vocational classroom training. If the federal cuts pass the program stands to lose an annual allocation of \$177,000 in WIA funds. This will have a multiplier effect placing \$1.3 million in Senior Community Service Employment (SCSE) funding in jeopardy as the WIA dollars are used to access these funds. The SCSE program offers additional work based training for low-income elders who are unemployed and have poor employment prospects.

Furthermore, the budget proposal under consideration by the House of Representatives would eliminate the Senior Companion Program and Foster Grandparent program in Oakland. This innovative program matches seniors with youth in the foster care system. The match affords kids and families in the child welfare system additional supports, while providing seniors an additional avenue for continued community involvement. The proposed reductions would eliminate 80,000 hours of much-needed volunteer staffing assistance to local, community-based public and private programs and would end services to more than 1,000 clients, both seniors and at-risk youth in our community.

Community Services Block Grants

The City of Oakland stands to lose an allocation of \$718,000 which is used to leverage more than \$3.5 million in additional funding with our partners. The proposal would eliminate funding to support first-time homeownership, post-secondary education or small business start-up. It would also result in the loss of funding to support the City's Earned Income Tax Credit Campaign that has helped more than 7,500 low-income workers prepare their taxes for free and capture more than \$9 million in tax refunds that directly affect our economy.

Community Development Block Grants

Oakland's FY 2010/2011 program provides \$10.9 million in services allocated among 59 projects; \$4 million is dedicated to housing and \$2 million is designated to District Programs based on recommendations from the City's seven Community Development District Councils. The Federal government is proposing cutting CDBG funding by 50% in FY 2011/12, which means Oakland will have to reduce over \$2 million worth of services we are currently providing to \$750,000.

State Budget Impact

Compounding the pain of the revenue decreases and expenditure increases, the State of California has attempted to balance its staggering budget deficit by grabbing municipal revenues. Last year, the State raided \$2 billion in local redevelopment funds, costing Oakland \$41 million and instead of funding local job creation, economic growth and urban revitalization projects, this money was siphoned off to help pay the State's obligations.

For FY 2011/12 the State is currently facing a \$26 billion projected shortfall and is proposing to eliminate both the Redevelopment Agency and the Enterprise Zone program in order to close this gap. The City of Oakland funds approximately \$24.9 million in staff out of the redevelopment funds, with approximately \$12.7 million for planners, project managers in the Community and Economic Development Agency (CEDA) and \$12.2 million for other City staff who work in Redevelopment areas, including police officers, elected officials, attorneys. In addition, approximately \$2.5 million in central service overhead for administrative services such as the City Attorney, Finance and Clerk is paid for by redevelopment funds. The following chart details the estimated costs for FY 2011/12:

FY 2011-12 OAKLAND REDEVELOPMENT FUNDING: BY DEPARTMENT		
Department	FY 11-12	FY 11-12
Mayor	511,200	
Personnel \$/FTE	412,316	2.00
Overhead	98,884	
City Council	1,204,208	
Personnel \$/FTE	906,856	7.76
Overhead	297,352	
City Administrator	1,712,867	
Personnel \$/FTE	1,712,867	12.59
Overhead		
City Attorney	3,002,643	
Personnel \$/FTE	3,002,643	14.35
Overhead		
City Clerk	306,300	
Personnel \$/FTE	306,300	2.31
Overhead		
Finance	795,652	
Personnel \$/FTE	795,652	5.30
Overhead		
Police Services Agency	3,384,169	
Personnel \$/FTE	3,127,034	17.18
Overhead	257,135	
Department of Human Services	535,585	
Personnel \$/FTE	535,585	4.12
Overhead		
Public Works Agency	734,614	
Personnel \$/FTE	639,588	7.00
Overhead	95,026	
Community and Economic Development Agency	12,666,553	
Personnel \$/FTE	10,955,578	83.90
Overhead	1,710,975	
Grand Total	24,853,791	156.51

OTHER FINANCIAL ISSUES

In addition to the GPF projected deficit for FY 2011-13 and the potential State and Federal reductions, the City is facing additional large financial challenges including pension and medical benefits, other negative funds (including Measure Y), unfunded capital improvement projects, and critical equipment needs. Each of these items creates added pressures on the City's operating budget and place further demands on limited resources. As the City conducts planning for the immediate fiscal years and beyond, the

following issues must be part of a comprehensive financial strategy to ensure a balanced sustainable approach.

Pension and Medical Benefits

Like many other states and municipalities, Oakland is grappling with the growing cost of retiree pensions and medical plans. In the coming years, Oakland will need to address the rising liabilities of pension and medical costs. The City maintains three pension systems, of which two are closed systems and one is its medical fund. The Oakland Municipal Employees Retirement System (OMERS) has a modest unfunded liability of \$743,000. The California Public Employees Retirement System (PERS) for both Public Safety and civilian employees is approximately 77% funded with an unfunded liability of \$677 million. For Other Post-Employment Benefits (OPEB), the retiree healthcare benefit plan, the City has opted to employ a pay-as-you go strategy. As of the July 1, 2008 actuarial study, the accrued liability is over \$591 million.

The Police and Fire Retirement System ("PFRS") provides pension, disability and beneficiary payments to retired Police and Fire sworn members who were hired prior to 1976 (since that time all retired sworn staff has been covered under the PERS retirement system). Under Article XXVI of the City's Charter, the City is obligated to fund these retirement benefits until 2026. PFRS is currently funded at only 37.6% (actuarial value of assets/actuarial liabilities) or unfunded by \$494 million. Given the low funding level, a one-time or ongoing investment into the system has become a matter of fiscal urgency. Moreover, a payment holiday that the City negotiated with PFRS will expire in July 2011. The City will be required to deposit to PFRS beginning FY 2011/12 an annual contribution of approximately \$45.6 million. Resuming annual contributions of this magnitude to PFRS would place extreme pressure on the City's General Fund and staff has been actively exploring options to meet the City's obligations. These options will be discussed during the FY 2011/12 budget process this spring.

Negative Funds

Many non-GPF City funds have serious financial issues. Some result from historical overspending and/or under-recovery. Others stem from more recent operational shortfalls. At the close of FY 2009/10, over \$138 million remained in negative fund balances, with approximately \$49 million of that caused by Internal Service Funds (ISF). The FY 2009-11 Budget included a repayment plan for the City to repay itself for the use of pooled cash for both program and ISFs. The plan has been monitored closely by staff and to date over \$7 million in payments towards reducing the negative balances and mitigating the accumulation of negative interest has been made. Continued commitment to repayment, especially while interest rates are low, is needed to ensure the necessary financial progress.

Measure Y

By the close of FY 2010/11, Measure Y will realize a negative operating balance. Current year revenue is anticipated to be roughly \$15 million and mandated expenditures for Fire, Police Officers and violence prevention services are projected to be \$18 million. Remaining fund balance will be used to reduce the shortfall to \$1.8 million and at the close of this fiscal year general fund revenue will be used to cover the remainder.

Looking ahead, for each year until Measure Y sunsets in 2015, collected revenues simply will not cover the mandated expenditures. The FY 2011/12 Proposed Policy Budget will include a GPF subsidy to cover the estimated shortfall. As these numbers are still being refined, the GPF subsidy has not yet been added to the \$46 million projected deficit.

Capital Improvement Projects

The estimated total capital improvement need for Oakland is over \$1.6 billion. Only \$53 million of that has funding identified and is expected to be included in the FY 2011-13 Budget. Of the \$53 million, \$30 million is for sanitary sewers and the remaining \$23 million is for all other infrastructure needs. The resources required to improve, repair and maintain the City's streets, facilities, storm drains, sidewalks and parks far exceeds available funds. It is estimated that the City needs \$550 million to repair and build facilities, \$23 million to maintain current street conditions, \$20 million to bring all access entries into ADA compliance, \$30 million to repair or replace high priority storm drains and \$37 million to develop or renovate priority park projects. Given the budget constraints, there are tradeoffs to be considered between capital projects and operational demands. Nevertheless, strategic investment and financial planning for capital improvements is fundamental to the well-being of the City. Residents, businesses and employees rely on access to safe, usable infrastructure. Continued deferred maintenance and investment ratchets up costs and increases the City's exposure to financial and accidental risk. Staff is preparing a separate and more comprehensive report on capital needs city-wide, with potential projects prioritized based on current adopted criteria and financing options to be considered that begin to address the backlog in these various asset classes.

Equipment

The City requires an estimated \$8.4 million in equipment replacement for FY 2011/12. This includes 2 ladder trucks, 2 fire pumper trucks, 2 fire support vehicles, 5 heavy duty equipment, 58 marked patrol cars, 5 unmarked police cars, 2 motorcycles, 20 staff pooled vehicles, and 15 light-to-medium duty trucks. On average, city vehicles, including those used by police, fire and public works, are approximately 10 years old, much older than industry standards. Most cars and trucks are no longer covered under the manufacturer's warranty and major repairs are costly. Additionally, because of the age of the fleet, replacement parts are difficult to find or are no longer available. The delays associated with locating parts cause inefficiencies such as extended times out of service, thereby affecting service delivery across all agencies.

FIVE-YEAR FORECAST

As part of ongoing financial planning, a five-year forecast is being developed to place current budget decision making in the context of a longer time horizon. Since June of 2010, when the most recent five year forecast was released, assumptions for the General Purpose Fund have been reviewed and updated with current data and economic trends. It is anticipated that further updates to expenditures and revenues will be completed following the FY 2010/11 Third Quarter Revenue and Expenditure report and after more information is available based on decisions by the State and Federal governments.

Currently, expenditure data are projected at maintenance of effort levels. The two largest causes of future expenditure increases in the General Purpose Fund are retirement and medical benefits, which grow annually at approximately 7.5% and 8.5% respectively. Revenue is not projected to grow in the initial years, and faces substantial risk of declining further. A slight rebound in revenues is projected to occur by FY 2014/15.

Should no action be taken to address the structural shortfalls, the City's deficit swells to roughly \$87 million in FY 2013/14 and balloons to \$104 million in FY 2015/16. This analysis, though preliminary, reinforces the urgency and the necessity for comprehensive and strategic budget reform that is addressed through a variety of strategies including revenue increases, budget reductions, and changes in service delivery to achieve efficiencies.

	FY 2011-12	FY 2012-13	FY 2013-14	FY 2014-15	FY 2015-16
Expenditures	\$436.06	\$455.57	\$470.33	\$483.68	\$498.07
Revenues	<u>\$390.14</u>	<u>\$393.25</u>	<u>\$382.90</u>	<u>\$387.77</u>	<u>\$394.05</u>
Deficit	(\$45.92)	(\$62.32)	(\$87.43)	(\$95.91)	(\$104.02)

WHAT HAS THE CITY ALREADY DONE?

As revenue has dwindled, the City has done what any householder would do: we cut our expenses. Since July 2008, the City has closed over \$170 million in GPF shortfalls. In fact, the current two-year budget has been re-balanced eight times in the past few years. The City has slashed programs, abolished maintenance crews and reorganized departments to enhance efficiency. Across all funds, the City has eliminated 528 jobs citywide, laid off 269 workers, and 106 employees have taken early retirement or sought other employment. Additionally, the City implemented 12 furlough days a year in 2009/10 and 2010/11, including a week-long closure in December. This action, coupled with increased retirement contributions, has resulted in a 10% pay reduction for most City employees.

In November, because the City could no longer afford to pay 739 Police Officers out of the General Fund, Measure BB which contained technical changes to Measure Y, was placed on the ballot. Approved by voters, this permitted the City to continue to receive approximately \$20 million in revenue. The resources enabled the City to rehire 63 Police Officers, fund the required minimum staffing for the Fire Department and administer violence prevention programs. However, it was not a new funding stream and receipt of the funds was predicated on the continued delivery of public safety services. Given the funding restrictions, the resources did not address the City's structural budget deficit and other ballot measures which would have provided additional resources did not receive voter approval.

In addition, the City has cut over \$2.9 million in subsidies to over eleven local service providers. These subsidies help to support the delivery of vital public services and

essential programming for a healthy, vibrant Oakland. The following provides a quick summary of prior reductions. A more detailed summary by department is included in Attachment B.

Prior General Fund Spending Reductions at a Glance

Examples of belt-tightening measures to address over \$170 million in cumulative shortfalls since July 2008:

- Closed City offices through furloughs
- Eliminated 329.7 GPF jobs (528 across all funds), including police officers
- Closed branch libraries one day per week
- Eliminated more than 100 cars in the City fleet
- Implemented travel restrictions
- Initiated a hiring freeze
- Reduced staff in human resources, administration and elected offices
- Achieved 10 percent concessions from employee unions
- Reduced grants and subsidies to community organizations

LIMITED NON-MANDATED FUNDING

Balancing the projected shortfall in the GPF is complicated by the small discretionary portion of the expenditures outside of public safety and mandated services. Of the \$436 million in estimated GPF costs, only \$72 million (17 percent) is remaining.

Unlike the federal government, which can print money to address financial shortfalls and the State, which can pilfer funds from local government, by law the City of Oakland must balance its budget each year.

The available revenue-raising options to bridge the ever-widening budget gap are painfully few. Typical revenue fixes, such as raising fees or using one-time funds, have already been exhausted, as have reserves used to mitigate the drastic loss in revenue. Complicating matters, many state voter-imposed restrictions exist on local revenue increases such as Proposition 26, Proposition 13 and Proposition 218.

If the City were to fund current operations using only currently available revenues, drastic reductions would be required. Of the currently available revenues, 10% must be used to service the city's debt and another 12% must be used to cover ballot measures, state mandated programs and other locally-mandated spending. Additionally, 71% of revenues are required to maintain public safety at current levels, leaving only \$26 million to cover \$72 million in remaining programs (\$46 million gap). These programs include senior centers, head start, tree services, equal opportunity programs and recreation centers.

BUDGETING FOR THE FUTURE

As the City moves through the budgeting process for FY 2011-13, the following three strategies should be adopted for the current and future budgeting processes:

- 1) City Council adoption of guiding budget balancing principles;
- 2) Ongoing development and extension of multi-year forecasting of expenditures and revenues; and,
- 3) Implementation of a performance management process that provides service outcome data to inform program development and budget decision making.

✓ Budget Balancing Principles

The City's current financial problems were not created overnight, nor can they be solved in one budget cycle. However, if the City adheres to a strict set of balancing principles throughout this process, the guidelines will help frame the upcoming conversations to be more strategic and focused on developing long-term plans for fixing the City's financial condition.

To this end, a set of principles should be adopted that outline guidelines for budgetary decision making and set standards for sound budgetary practices and fiscal performance. If consistently followed, the principles will assist the City in achieving its current and future goals in a fiscally responsible and sustainable manner. They will also serve to guide the creation of the City's budget and outline standards for revenue generation and the execution of operating and capital budget expenditures. If adopted they will go a long way in helping the City develop an agreed upon policy foundation for which the prudent establishment, execution, and monitoring of annual budgets can occur.

Throughout the upcoming process, the following principles and policies are recommended:

- Achieve a long-term structurally balanced budget through efficiencies, permanent reductions to the expenditure base, and/or revenue enhancements. A structurally balanced budget is defined as a budget that does not rely on reserves or the use of one-time revenues for ongoing expenditures.
- Give highest priority to protecting the most essential City services;
- Minimize the negative impact on Oakland residents, businesses and employees;
- Help strengthen the City's position in the financial and capital markets;
- Develop a long-term plan to address negative fund balances;
- Maintain an open and transparent process for City employees and the public. Public involvement shall be encouraged in the budget decision-making process through public hearings, public outreach, and information. Public participation efforts will allow the City to achieve the following objectives: improve performance by identifying public needs and service delivery expectations and

understand the public's priorities in budgeting. Increased public involvement will allow the City to be more responsive to community needs, thereby increasing the value that the public receives from City government.

- General Fund revenues shall not be earmarked for any particular purpose, unless required by law or generally accepted accounting principles (GAAP).
- All of the City's Enterprise Funds shall be fully self-supporting from revenues generated by rates, fees, and charges.

✓ **Multi-Year Forecasting**

Though some budget impacts are unforeseeable, especially during economic downturns, proper financial forecasting, planning and strategic decision making can help mitigate shortfalls and reduce budgetary volatility. Consistent with prior budget cycles, City Administration is completing a five year forecast in parallel with developing the FY 2011-13 Proposed Policy Budget. This document will be shared later this year and will include citywide areas of focus, as well as selected departmental plans. The goal is to use the five-year financial plan as a vehicle to discuss longer-term financial and operational issues facing the City.

It is essential that Oakland not only continue with this analytic work, but that it also looks to enhance the current process and extend the forecasts from five to ten years in the coming months. Doing so will allow City leadership and policy staff to assess increases in costs, investments in capital purchases and evaluate revenue expectations and expenditure demands through the lens of economic forecasting.

✓ **Performance Management**

The City should look to adopt a performance management process which allows the Mayor, Council, Staff and the public to assess the effectiveness of the work completed and the services delivered. Measuring program effectiveness can lead to additional oversight which can, when implemented properly, result in more strategic investments for communities. Execution is not easy and budgetary savings is not guaranteed. Implementation is time and resource consuming; it also requires broad buy-in among policymakers with regard to process and program priorities. Periods of budget cuts and declining revenue present added challenges due to ever constricting funding and federal and state mandates often require continued investment despite uninspiring program performance.

Regardless, there are significant benefits to shifting towards a more data and outcomes driven budgeting process and therefore make such a process worthy of consideration. When combined with adopted budgeting principles and a more robust financial forecasting method performance management will greatly enhance Oakland's ability to assess the adequacy of initial investments in programs and the appropriateness of ongoing spending levels of coveted resources. Further still, the identification of priority programs and the subsequent creation and refinement of existing outcomes and measurements for each will allow for additional structure and more incisive analysis to inform budget decisions. If a performance management process is thoughtfully developed, the added data will enlighten the difficult financial conversations the City of Oakland will

inevitably face in the coming months and years. The limits to our resources demand now more than ever thoughtful assessment of expenditures and service outcomes. Put simply: need far outstrips the availability of funds and every decision is a trade off. Given this immense responsibility the City must continue to evaluate the effectiveness of goods purchased with the resources available.

Attachment A: Possible Budget Options

Attachment B: Service Impacts of Past Reductions