



June 25, 2019

Honorable Mayor and City Council
City of Union City

PROPOSED OPERATING BUDGET FOR
FISCAL YEARS 2019-20 AND 2020-21
AND FIVE YEAR CAPITAL IMPROVEMENT PLAN (CIP)
FOR FISCAL YEARS 2019-20 THROUGH 2024-25

Transmitted herewith is the biennial Proposed Operating Budget for Fiscal Years (FY) 2019-20 and 2020-21, and the Five Year Capital Improvement Plan (CIP) for FY 2019-20 through FY 2024-25 for the City of Union City (City). Both budget documents are balanced (resources equal to or greater than uses and both reflect the values and priorities of the City.

BACKGROUND

Financial Reserves - The City Council of the City of Union City (City) has wisely adopted budget policies that mandate maintaining adequate financial reserves (a 20% minimum General Fund [GF] unassigned reserve level) and assigning operating budget surpluses and financial windfalls (one-time monies) to trust funds (PARS) established to pay down the City's significant unfunded pension (PERS) and retiree medical (OPEB) obligations. While these policies have resulted in historically high unassigned General Fund (GF) reserves and OPEB set-asides, more work must be done in the future to maintain adequate GF reserve levels and allocate more money to the PARS trusts so that a minimum of 80% coverage (preferably 100%) is achieved for the City's unfunded liabilities.

The primary purpose of the GF reserve is to serve as the City's "savings account" for unexpected emergencies, natural disasters, and unbudgeted essential expenses. A secondary purpose for the GF reserve, albeit not a "best practice", is to provide short-term stability to the GF budget in times of deficit. It is this latter purpose that is reflected in the Proposed GF Operating Budget attached to this transmittal letter. This approach is not without risks and must be understood as a short-term "solution" to a long-term fiscal challenge (i.e., a structural budget deficit).

Structural Deficits – the two most feared words in budgeting are the combination of "structural" and "deficits", because they are often defined as deficits resulting not from adverse events or forecasting errors, but rather, from a basic imbalance of revenues and expenditures that if not corrected, can drive a city into insolvency. There is a strong and often political debate over the cause of structural deficits: to many, they arise from a "[too much] spending problem", while to others, they reflect a "[not enough] revenue problem". And many believe that balancing both considerations (i.e., reducing spending and growing revenues) is the preferred approach to eliminating structural budget deficits. The proposed GF

Operating Budget takes this third approach, in combination with use of reserves to serve as a “bridge” to a future, structurally balanced budget.

The primary expenditure factors driving Union City’s structural deficit are pension (PERS) costs and Contract Services costs whose rate of growth exceed the City’s projected rate of revenue growth. This imbalance is projected to continue for the foreseeable future, which makes it the most challenging budget deficit the City has ever faced in its 60+ year history.

The City’s “PERS problem” is shared with almost every public agency that contracts with PERS for employee retirement benefits: a combination of unprecedented, generous (and unfunded) pension enhancements dating back 10-20 years, unrealistic PERS actuarial planning (especially earnings assumptions), and poor investment performance. The result, now that the actuarial deficiencies within the PERS financial model have largely been corrected, are projected rate increases that extend for the next 15-20 years. This long-term upward pressure on PERS rates charged to cities is unprecedented and widely considered to be unsustainable for the majority of California cities (and the State of California, as well).

The City’s “contract services budget problem” is largely due to its contract for fire services with the Alameda County Fire Department (ACFD). The ACFD contract dates back to July 2010, and has resulted in a marked improvement in the quality and range of fire services to the City, its businesses and residents. The contract also reflects the structure of the ACFD as a specialized County department that is under the sole purview and control of the County Board of Supervisors. ACFD contracting cities (San Leandro, Dublin, Newark, Emeryville and Union City) have no control over the ACFD budget, and also have no role in labor contract negotiations which are the primary driver of ACFD budget cost increases. Contract cities also face vigorous pressure from the County to assume perpetual proportional financial responsibility for ACFD’s very large (\$125 million) unfunded OPEB liability.

The City’s “revenue problem” is based on several factors, but primarily arises from its dependence on ballot measures (i.e., taxes) to provide additional City revenues, and a proportionally small tax base as compared to almost every other city in Alameda County.

Voters in Union City have generally been very supportive of ballot measures that provide funding to maintain and even expand City services. A Public Safety Parcel Tax has been approved (2004), expanded (2008) and extended (2016); this parcel tax directly supports Police, Fire, and Youth Violence Prevention programs and services in Union City. A ½ cent local Sales Tax has been approved (2010) and extended (2014) to provide general funding for City services (the majority of which are police and fire services). And, a cannabis tax was approved just last year (2018), which would support the GF and all City services. Unfortunately, a Charter City/Real property Transfer Tax (Measure EE) was not approved by Union City voters in 2018; the measure was projected to provide between \$4-7 million annually, and its passage would have resolved the City’s structural deficit for an estimated 2-5 years (and lowered the deficit for many years after that). The 2018 experience illustrates both the opportunities and risks associated with reliance on ballot measure revenues.

The latter (small tax base) is reflected by the City’s low per capita tax revenues and influenced by the City’s relatively small amount of developable land (e.g., more than 50% of Union City’s land area lies east of Mission Blvd. and is protected from development by voter approved legislation). The great majority of developable land within Union City has already been developed as, or is being planned for, residential development. The sole major exception to this is the City’s Station District, which has been planned and partially executed as a true “mixed-use” transit-oriented development that takes advantage of the Union City BART station.

“A budget is telling your money where to go instead of wondering where it went.”

Dave Ramsey (multi-media financial advisor personality)

BUDGET OVERVIEW

Municipal budgets are essentially financial plans that must balance revenues and expenditures, and they rely heavily on accurate projections of both revenues and expenditures over the upcoming two-year period. We, like most cities in the Bay Area, are fortunate to be in the midst of the longest sustained period of economic growth on record; this economic growth contributes to the Proposed General Fund Budget featuring revenue increases of \$2.8 million (4.7%) and a projected total FY 2019/20 General Fund total revenue projection of \$58,824,154. Expenditures are projected to be \$60,725,135 for FY 2019/20 (an increase of \$3.1 million or 5.4%), resulting in a projected GF budget deficit of \$2,900,981. This projected deficit includes expenditure reductions approved by the City Council and requires a transfer of reserves in the amount of \$2,900,981 in order to be balanced as required by State law.

For FY 2020/21, revenues are projected to grow by \$1.8 (3%) to a projected total of \$60,697,648. Expenditures are projected to increase by \$2.3 (3.6%) to \$63,012,558, resulting in a projected deficit of \$3,314,910. This projected deficit is also net of expenditure reductions approved by the City Council and will require an additional \$3,314,910 transfer of GF reserves to be balanced.

The cumulative drawdown on GF reserves is projected to be \$6,215,891, and will be specifically drawn from the GF undesignated reserve (\$4,215,891), the City's General Liability (designated) reserve (\$1,000,000) and the Workers Compensation Liability (designated) reserve (\$1,000,000). In the case of the GF undesignated reserve, the remaining reserve balance after both transfers is estimated at \$11,056,499 (18%). In the cases of the two liability reserves, both reserves will remain “super-funded”, thanks to a combination of 90% “confidence interval” (CI) funding and extra reserves on top of the 90% CI.

“Honest talk about the deficit is risky. Voters are more enthusiastic about the abstract notion of deficit reduction than about the painful details of accomplishing it”.

Christina Romer (Chair, Council of Economic Advisors – Obama Administration)

IMPORTANT ISSUES POTENTIALLY IMPACTING THE PROPOSED BUDGET

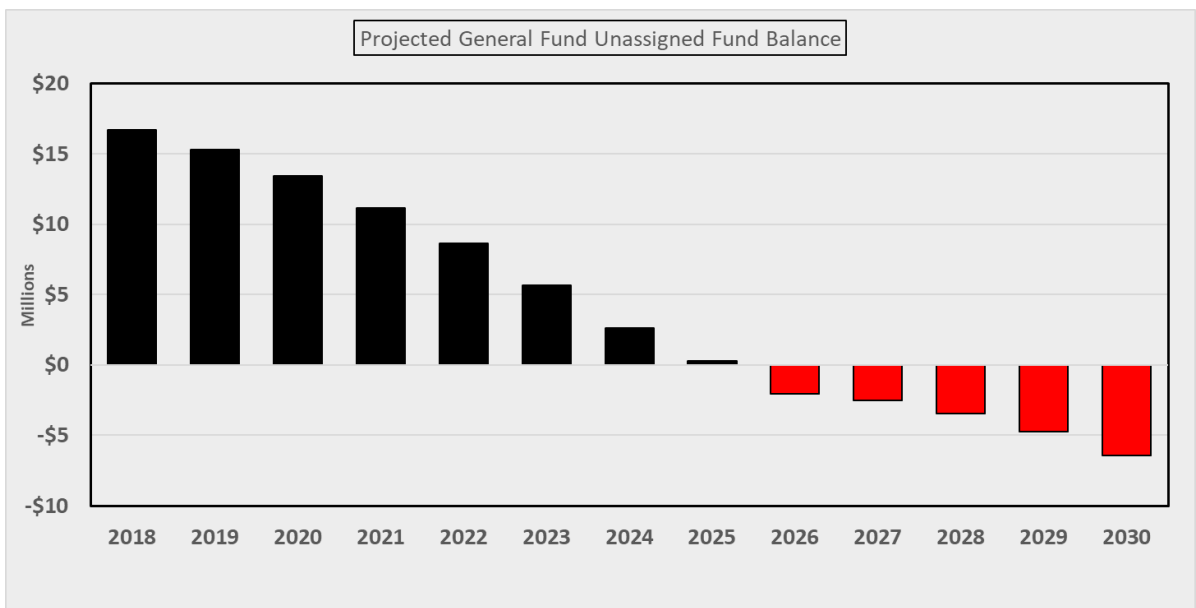
All budgets are basically projections of revenues and expenses into the future. As such, budgets are subject to change from the moment they are adopted, and must be continuously monitored by staff so that trends, both positive and negative, can be identified and dealt with. This is why the City Council has mandated quarterly budget status reports from staff, and why staff will also report new developments as they occur to the City Council and public.

As this budget transmittal letter is written in late June 2019, several trends and issues stand out as likely to be significant forces affecting the Proposed Budget and by extension, Union City's future:

- **PERS Investment Earnings** – PERS rate stability relies heavily on its investment portfolio, which is subject to stock market fluctuations. While the major stock markets have generally risen over the past two years, they have been increasingly volatile. This fact, combined with PERS assumed rate of return of 7% (generally considered too high by most market analysts) makes PERS's ability to meet its investment targets problematic. In addition the PERS Board has chosen to limit PERS investment options to achieve social and environmental policy objectives, a move that most analysts believe limits the “earnings upside/profit potential” of the PERS market portfolios. Every

PERS earnings outcome that fails to meet the 7% target in investment returns will result in larger rate increases, this increasing City pension expenses and its structural deficit.

- **Economic Recession?** – almost every economist believes the current economic expansion (aka bull market) must eventually end, and most think this will result in a recession of some sort in late 2020. How severe and how widespread this recession might be is a matter of conjecture at this point, but we can take some solace in the recent East Bay Economic Outlook prepared by the East Bay Economic Development Alliance (East Bay EDA) which makes a convincing case for the strength of the East Bay's (defined as Alameda and Contra Costa Counties) "fundamentals". These fundamentals include high employment/low unemployment, strong taxable sales growth, strong real property assessment (i.e., value) growth, and an expanding economy in multiple sectors (housing, commercial, industrial, and especially, technology), while Union City is experiencing all of these benefits (as well as the downsides of extremely heavy traffic, extremely high home prices and rents, extremely high construction costs, and increasing displacement/homelessness), our level of benefit and growth lags behind most East Bay cities. With this in mind, we must remain conservative and mindful of our spending, and tenacious in our work to grow the City's revenue base.
- **'Real' Budget Balancing** – as previously noted, using reserves to balance budgets with structural deficits is simply unsustainable. To see this in visual form the graph below has been provided to show the impact of the Proposed Operating Budget on GF unassigned fund balance (i.e., the GF undesignated reserve).



- The City Council will have opportunities to consider and approve (or not approve) spending reductions and revenue enhancements that can truly balance the City budget and reduce future deficits. The two most important options for the City Council to consider are:

Closure of Fire Station 30 – a special City Council Meeting has been scheduled for July 16, 2019 as a study session of the staff proposal to save an estimated \$3.2 million annually by closing Fire station #30. This meeting will feature in-depth discussion of the pending Fire Services Study prepared for the City by CPSM, as well as the recent Standards of Cover Report commissioned by ACFD on behalf of Union City and performed by CITYGATE ASSOCIATES LLC. Without a major spending reduction such as this, the City runs a very real risk of having to make even more drastic spending reductions in the not-too-distant future.

Cannabis Business Program (CBP) Policy Adjustments – as widely reported, California’s implementation of state-wide legalization of cannabis resulting from the passage of Proposition 64 in 2016 has been ineffective as compared to other states with legalized cannabis. A combination of high State (and in some cases, local) taxes, combined with highly complicated regulations and an evolving cannabis marketplace has resulted in partial implementation of the decentralized cannabis industry envisioned by the backers of Prop 64, and a “black market” that appears to be as strong and problematic as ever. In Union City’s case, despite the issuance and/or approval of 12 cannabis permits over the past year and a half, not a single cannabis business has opened its doors, yet. The City Council would be well-advised to consider increasing the flexibility of its cannabis permit regulations, and give serious consideration to providing an Adult-Use permit option, after conducting public study sessions on the pros and cons of such policy shifts. As noted in the Proposed Operating Budget document, the CBP is estimated to generate up to \$1.4 million annually to the City once all permits have been activated; allowing greater flexibility via an Adult-Use option can be expected to increase these estimates, but must be accompanied by appropriate security safeguards and illegal cannabis enforcement.

- **Labor Agreements** – Representing roughly 56% of the Proposed Budget in terms of expenditures (excluding ACFD staff costs), the City’s employees are the primary “delivery system” for the services that Union City provides on a “24/7/365” basis to its residents, businesses, and visitors. And like its budget, a lot can be deduced about the value an organization’s places on its employees by the way it compensates, communicates with, and involves the people who do the work, including those who supervise, plan and manage the work and the workers. With all labor agreements either open or opening soon, the City Council will have an opportunity to evaluate options for providing affordable compensation adjustments; doing so will assist with employee recruitment and especially, with employee retention. Retaining and recognizing the compassionate, productive and dedicated women and men who comprise the Union City family is perhaps the most important task before us.

CONCLUSION

The Proposed Operating Budget and Capital Investment Plan (CIP) reflect the hard work of every City Department and their respective budget teams, and these budget teams are deserving of recognition and thanks for their efforts. As my retirement from public service is imminent, I am passing the proverbial baton to our new City Manager, and long-time Union City employee, Joan Malloy, to manage and implement the Proposed Operating Budget and 5-Year CIP. I am positive that Joan will thrive as our new City Manager, and my sincere hope is that she will be a better City Manager than her predecessor.

It has truly been an honor and a privilege to serve you, our staff family, and the citizens, businesses and visitors here in the wonderful place called Union City. No matter where Helen and I end up, we will always remain connected to and care about this special place and the special people we've met and worked with these many years.

A handwritten signature in black ink, appearing to read 'Tony Acosta', written over a horizontal line.

Antonio E. "Tony" Acosta
City Manager and
Executive Director of the Union City Successor Agency