

Date: January 28, 2026

To: Mayor and City Council 

From: Gerry Beaudin, City Manager
Susan Hsieh, Director of Finance

Subject: Update Regarding the Financial Forecast Peer Review Report

SUMMARY

In early 2025, the City Council received a report from Eide Bailly summarizing the firm's observations regarding the City's financial forecast and related financial management practices. The report (attached for reference) responded to the City's request for a robust, transparent, and comprehensive review and analysis of the City's fiscal issues and included detailed observations, findings, and conclusions. The report generally agreed with City staff's reporting on long-term structural deficits, noting that expenses have and will continue to grow faster than revenues. This memo provides the Council with an update on the status of implementing the recommendations outlined in the report.

The Eide Bailly report is broken into four sections:

1. Observations regarding the forecast
2. Observations regarding related financial management practices
3. Sensitivity analysis of key assumptions in the financial forecast
4. Recommendations for the City's consideration

STATUS OF RECOMMENDATIONS The Eide Bailly report included six recommendations on the City's financial forecast and related financial management practices. Those recommendations, along with the progress staff has made on implementing them are included below.

Recommendation 1 – The City's financial forecast should be updated to reflect, as appropriate, our observations.

Staff Update – Overall, Eide Bailly observed that the City's financial forecast employs an appropriate, standard methodology common among California local governments. The report included 11 Observations about the City's Financial Forecast, the majority of which confirmed the forecast's relevance. Three Observations recommended improvements:

1. The Forecast would benefit from projecting revenues and expenditures that behave uniquely as individual line items in the detailed staff version of the forecast (Observation 8).
2. The City has acknowledged its non-General Fund infrastructure and operations needs and is focused on addressing them (Observation 9).
3. The Financial Forecast does not include illustrative charts and graphs or historical data (Observation 10).

The City continues to address Observation 9 through the recent City Council-approved water rate increase and the ongoing sewer rate study, which is expected to be completed later in 2026. In addition, a Stormwater System Management Plan is currently under development.

The updated financial forecast to be presented to the City Council in February 2026 will reflect the relevant changes identified in Observation 8. More illustrative charts will be included in the updated financial forecast presentation, along with three years of historical data, addressing Observation 10.

Recommendation 2 - The City should revise its approach to presenting complex financial information to employ compelling presentations, succinct staff reports, and appropriate supporting documentation to enhance the understandability and usability of information provided to the City Council and the public.

Staff Update - Staff began implementing this recommendation following Eide Bailly's presentation to the City Council last year. Eide Bailly communicated to staff that the budget information presented to the community is comprehensive and valuable. Some of the more detailed information can be attached to the staff reports rather than included in the body of the report.

Staff have aimed to prepare more concise, high-level staff reports and presentations over the last year and to take steps, such as including detailed information as an attachment to staff reports rather than in the body of the report, to improve readability.

To provide simplified, community-friendly budget information to the public, the City produced a budget-in-brief document for the 2025-27 budget. An online budget book was also developed to provide easy public access. Below are the links to the budget documents. The mid-year budget presentation to the Council in February 2026 will focus on key information/trends, as recommended. See links below:

[Budget-in-Brief
2025/26 and 2026/27 Operating Budget – Online Version](#)

Recommendation 3 – The City should develop a multi-year plan to prioritize and complete the remaining elements of its plan to catalog and eventually address its long-term funding needs.

Staff Update – As part of the 2025-27 budget development, staff advised the City Council that, in addition to conducting water and sewer rate studies to address funding needs for utility programs, a comprehensive long-term Financial Stability Plan will be developed, following key strategies presented below:

- Implement immediate program and expenditure reductions
- Explore new revenue options
- Identify resources and implement an economic development strategy aimed at attracting new businesses
- Conduct municipal service reviews/evaluate service delivery models
- Develop a funding plan for infrastructure upon completion of the Citywide Asset Management Plan
- Re-evaluate and develop a pension funding strategy
- Update the reserve policy
- Update the Financial Sustainability Plan and implement new budget strategies where applicable

As part of the two-year budget adoption, the City Council approved cost reductions to sustain core services and provided additional resources to advance economic development initiatives. At the direction of the City Council, staff is also evaluating a hotel tax (transient occupancy tax or TOT) revenue measure.

Following completion of the organizational assessment and Asset Management Plan, staff will finalize the Financial Stability Plan, including implementation details such as timeline and resources. Regular updates will be provided to the City Council.

The water rate increase has been approved by the City Council, and the sewer rate study is underway. In addition, staff is working on a Stormwater System Management Plan to identify the capital needs and funding options.

Recommendation 4 – The City should develop a plan to draw down its pension and OPEB (Other Post- Employment Benefits) trust funds for pension and OPEB costs, as appropriate, and incorporate those drawdowns into the baseline scenario of the financial forecast.

Staff update – In March 2025, the actuary firm Foster and Foster presented an analysis and their recommendation on the use of Pension and OPEB trust funds. The actuary recommended against using the funds set aside in the Section 115 Pension Trust until the obligation is 100 percent funded and recommended using these funds only if necessary for budgetary considerations.

For the OPEB trust, the actuary recommended that the City continue funding the required contribution until the obligation is 100 percent funded, and that the funds be used only for amounts determined in the actuarial reports.

The City Council approved the use of \$3 million in Pension trust funds and \$2.1 million in OPEB trust funds as part of the 2025-27 budget adoption to help balance the budget.

Since the City Council's direction was to use trust funds only for the current budget cycle, the use of Pension and OPEB trust funds is not built into the years beyond FY 2026/27.

Recommendation 5 – Once the City's infrastructure funding plan, and any other funding plans, are complete, the City should revise its reserve policy to reflect Internal Service Fund reserve minimum balances based on a cash flow analysis of future needs.

Staff update – The reserve policy for Internal Service Funds will be updated once the Asset Management Plan and related funding plan have been finalized. The Asset Management Plan is expected to be completed around April 2026. The funding plan will be developed following the completion of the Asset Management Plan.

Staff will also seek input from the City Council before updating the reserve policy to properly reflect the funding needs for the various asset categories. The policy update is expected to take place in FY 2026/27 and may be included in the 2027-29 budget adoption.

Recommendation 6 – Once the City's infrastructure funding plan, and any other funding plans, are complete, the City should develop a presentation illustrating these needs across infrastructure, facilities, vehicles, and equipment.

Staff update – Upon completion of the Asset Management Plan and funding plan, staff will present an analysis to the City Council and community. There will be regular City Council updates (at least annually) to track project progress and plan changes where necessary. A webpage will be created to provide comprehensive, up-to-date information to the public.

Attachment: Eide Bailly Report



Financial Forecast Peer Review

CITY OF PLEASANTON, CALIFORNIA

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February 4, 2025



CITY OF PLEASANTON, CALIFORNIA

FINANCIAL FORECAST PEER REVIEW

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February 4, 2025

Mr. Gerry Beaudin
City Manager
City of Pleasanton
123 Main Street, PO Box 520
Pleasanton, CA 94566

Dear Mr. Beaudin:

Eide Bailly appreciates the opportunity to provide you with this report summarizing our observations regarding the City of Pleasanton's financial forecast, current financial condition, and related financial management practices. This report is broken into four parts – 1) our observations regarding the City's financial forecast, 2) our observations regarding related financial management practices of the City that were observed during the course of our analysis of the financial forecast, 3) a sensitivity analysis of certain key assumptions contained in the financial forecast, and 4) our recommendations for the City's consideration. These recommendations are based on our team's significant experience leading and consulting for numerous municipal finance departments in California and are grounded in best practices of the Government Finance Officers Association (GFOA) and strong financial management practices that build upon the GFOA's recommendations.

It is apparent that the City has made significant positive changes to its financial management practices over the last several years, including the implementation of the financial forecast, to significantly improve upon historical practices that in our assessment were lacking in a number of areas relative to long-term financial planning. These changes align critical elements of the City's past financial management practices with industry best practices and will help to facilitate the City's long-term financial planning, health, and resiliency. The City staff members with whom we interacted were knowledgeable and transparent in sharing information and their dedication and focus on providing the City Council and community with comprehensive financial information from which to make future budgetary decisions was notable. We appreciate the open and honest discussions with the stakeholders we interviewed and would welcome the opportunity to be of assistance to the City in the future as you work toward addressing the recommendations outlined in this report.

Sincerely,

A handwritten signature in black ink, appearing to read "Bradford Rockabrand".

Dr. Bradford Rockabrand, CPA, CIA, MBA
Partner, Government Advisory Services

A handwritten signature in black ink, appearing to read "Scott Catlett".

Scott Catlett, MPA
Director, Government Advisory Services

EXECUTIVE SUMMARY

This report has been prepared at the request of the City of Pleasanton to provide an independent assessment of the quality and content of the City’s financial forecast and related financial management practices. The work was predicated on the American Institute of Certified Public Accountants’ Statement on Standards for Consulting Services framework and adapted to include the experience and perspectives of the engagement team. That experience includes serving as municipal Finance Directors and Budget Managers for multiple California cities, including in complex, full-service cities, experience as consultants to cities and other local governments in multiple states assessing financial condition and financial management practices, and experience teaching graduate courses and industry trainings in public financial management.

Our assessment of the City’s financial forecast and related financial management practices included categorizing our observations into strengths, weaknesses, opportunities, and threats, commonly referred to as a SWOT analysis, in an effort to highlight the most notable of our observations. These key observations are highlighted in the graphic below and reflect both favorable and unfavorable internal and external influences on the City’s long-term financial planning process. In the course of our assessment, we identified a number of additional observations and recommendations, but those listed here are in our view the most notable. Our full list of observations and recommendations are discussed in the subsequent sections of this report.



¹ The City is actively in the process of assessing facility and equipment replacement costs, interfund subsidies, cost allocations, and other key issues that will further inform the forecast and improve its accuracy.

² Communication of information regarding the financial forecast, the City’s financial condition, and related financial management practices will be key in ensuring success as the City resolves the structural deficit.

In our assessment, the City’s financial challenges are not attributable to any single recent or historical decision. They are the cumulative result of a variety of factors including the City’s revenue mix, sales tax base, collective bargaining pressures for competitive salaries and benefits, long-term pension challenges at CalPERS, and other cost pressures that frequently outpace revenue growth such as utility rates, contractor wages, and materials pricing. These challenges are common to many California cities and similar conversations have been had or are underway in cities throughout the state. What is less common, is agencies taking the time and effort to catalog financial challenges and unfunded needs comprehensively and discussing these issues openly in the context of thoughtful long-term financial planning.

Conclusion. In summary, based on the information examined and our related observations we conclude that the City’s financial forecast employs an appropriate and standard methodology common in California local governments. The first step in forecasting is to develop a forecast model and the City has taken that important

step. The inputs are critical, and the City is to be commended for its recent efforts to refine the inputs to make the forecast more thoughtful, thorough, and accurate. These efforts include:

- Employing industry experts who are relied on by numerous California cities to accurately forecast property tax and sales tax trends in the short-term.
- Updating the City's cost allocation plan to provide data regarding appropriate levels of interfund cost recovery and highlighting existing interfund subsidies.
- Undertaking a comprehensive analysis of the resources that will be required to implement a program of regular infrastructure, facilities, vehicles, and equipment replacement.
- Highlighting deficit funding for the City's insurance reserves, pension trust, and OPEB trust.
- Conducting scenario analyses for the ultimate utilization of the City's pension and OPEB trust funds to present decisionmakers with alternatives.
- Modifying the City's reserve policy to clarify that restricted fund balance in the General Fund should not be included in budgetary reserves available for other purposes, which is consistent with industry best practices.

This information is critical to creating a financial forecast that incorporates all known information regarding revenues and expenditures and then proposes solutions to any identified gaps. Although the City's work is not yet complete to prepare a comprehensive financial forecast, based on the information available, we believe that the additional work to be completed in the near-term will only further illustrate that the City's resources are constrained and that its long-term funding needs are significant.

Our assessment also indicates that adjustments can be made to the forecast to enhance its detail, particularly in the years beyond, for example, when existing consultant revenue forecasts or collective bargaining agreement information is available. This enhanced detail may or may not change the results of the forecast in those outyears, but it will facilitate an additional understanding of how the assumptions in the forecast are determined and why the selected growth assumptions for individual categories of revenues and expenditures are utilized. It should also be noted that the City's existing short-term property tax and sales tax forecasts are prepared by the most widely recognized consultants providing these services in California, and absent any additional information not previously considered by the consultants we have not observed any reason to deviate from their recommendations relative to property tax and sales tax growth rates. At the same time, we also believe that the City can work toward a refined and targeted communication strategy regarding the forecast and related financial management activities that will improve clarity regarding the forecast and related assumptions and reduce confusion regarding its purpose, content, and limitations.

In the near-term, our assessment does not indicate that further adjustments to the forecast are likely to provide new information that would substantively change the course of the City's two-year budget process that is currently underway. However, we do propose that the recommendations contained in this report be considered once the budget is adopted, with the City's Finance Director refining and revising the forecast following the completion of related work such as the infrastructure funding plan. At that time, a refined and revised forecast can be presented to the City Council and the community for further discussion.

METHODOLOGY OVERVIEW AND SCOPE OF SERVICES

Effective financial management is one of the most critically important success factors for local governments. There are a number of components to effective financial management that relate to an agency's budget administration, internal controls, procurement practices, long-term financial planning, debt and investment administration, and other areas. Key among these is long-term financial forecasting, as well as financial planning, to identify solutions to any challenges identified in the forecast. In Eide Bailly's broader financial condition and organizational assessment engagements, we undertake a comprehensive review of financial management practices and employ a framework of document reviews, staff interviews, and analysis of key financial health indicators based on best practices and the latest standards, information, and trends in government financial management. In this case, the City's request for proposals was focused on a limited review of the City's financial forecast and related financial management practices, the completion of which was required within a timeframe of approximately two weeks. To address the scope of services and deliver this report in the time required, we modified our typical process to focus exclusively on the financial forecast and related financial management practices and accelerated the process with additional staff resources to achieve the desired timeline.

 **Scope of Services.** The scope of services outlined in the City's request for proposals was further refined through initial conversations with the City's Finance Director and City Manager to arrive at the following key tasks:

- Examine the revenue and expenditure assumptions employed in the City's financial forecast.
- Assess the adequacy of the financial forecast in terms of complexity, scope, and content.
- Request and read related documents to facilitate an understanding of the context and background for the City's financial forecast (See Appendix A for a list of the requested documents).
- Interview key stakeholders, including the City Manager, Finance Director, and financial consultants previously utilized by the City, to gain an understanding of the history associated with the financial forecast and the City's financial condition.
- Conduct a limited sensitivity analysis to assess key elements of the financial forecast at a high level and provide stakeholders with an understanding of the impact of changes in the forecast's assumptions on projected structural deficits in future years.
- Prepare a written report and presentation summarizing our observations and recommendations.

 **Methodology.** Eide Bailly deployed resources from our Government Advisory Services team with extensive background experience in the financial management of California cities and employed key elements of our organizational assessment process to focus on the City's financial forecast. This facilitated our comprehensive assessment in the limited timeframe. In addition to the requirements of the scope of services outlined above, Eide Bailly also broadened our approach to include watching videos of relevant City Council meetings and reading additional staff reports related to the forecast and financial management that have been provided to the City Council. This was done to gain a better understanding of the concerns expressed by the community and the City Council about the financial forecast and to enhance our understanding of the context for this engagement.

Given the expedited nature of the timeline, our assessment was necessarily broad, yet thorough. We began our engagement with an examination of the Excel financial forecast model and documents provided by the City, as well as additional documents included in our document request. Our analysis of these documents included both qualitative and quantitative components, tailored specifically to effectively work within the limitation of an expedited timeframe. We then engaged with City staff to gather their perspectives and insights and obtained an understanding of the City's historical financial trajectory and practices, as well as recent changes and current

circumstances. Multiple meetings were conducted to discuss observations and refine our understanding. We also spoke with financial consultants utilized by the City to gain their perspectives regarding the City’s financial management practices. Quantitatively, we examined supplemental resources from the City’s revenue consultants, analyzed historical data and financial trends to test the assumptions included in the City’s projections, and conducted a sensitivity analysis of the forecast.



Following the conclusion of our information gathering, the engagement team met internally to discuss our individual observations and gain a concurrence on those preliminary observations that were valid and to agree on those that are most notable. A summary of these observations was then prepared and circulated within the team for further review. The group reconvened to further refine the observations and began to develop the related recommendations contained in this report. Once consensus was reached on the final observations and recommendations, this report was prepared, reviewed by an additional Eide Bailly team member who had not participated in the engagement to date for a cold review to solicit questions and provoke clarifications, and then shared with City staff to address any comments or questions that they may have.

As highlighted above, our services in this engagement consisted of consulting services and do not constitute an audit, examination, review, or compilation of historical financial information conducted in accordance with generally accepted auditing standards or with other standards established by the American Institute of Certified Public Accountants (AICPA). Accordingly, we are unable to express an opinion or any other form of assurance with respect to any historical financial information. Our engagement was not designed and cannot be relied upon to disclose errors, fraud, or illegal acts that may exist. Other matters of possible interest to the City might not be specifically addressed in this report.

ASSESSMENT OF FINANCIAL FORECAST

As discussed in the Executive Summary, the primary element of our scope of services was an analysis of the City’s financial forecast. Based on that analysis, we have provided the following observations highlighting the financial forecast’s strengths and weaknesses as identified during the course of our analysis.

NO.	OBSERVATION	DISCUSSION
1	The City’s short-term projections are based on sound data and assumptions.	Based on our assessment of the City’s revenue consultant’s projections and the information provided by the City’s staff, we believe the first two to three years of the City’s financial forecast to be based on the best information available and City staff’s best professional judgment.
2	The City utilizes expert revenue consultants to forecast its two largest General Fund revenues.	The City has retained the state’s preeminent experts on the unique aspects of California property tax and sales tax to develop a forecast for the City’s use. This is a best practice approach employed by all cities with strong financial management practices in place.
3	Revenue consultants’ forecasts only cover a limited period of time, and revenue growth in the outyears of the City’s forecast may differ from the years covered by their forecast.	The City’s revenue consultants provide a detailed five-year property tax forecast and a detailed two-year sales tax forecast. Beyond these periods, reasonable assumptions must be employed to project future likely growth in these revenues. Staff’s analysis can be informed by conversations with these consultants and trend analysis based on actual historical revenues. Although the short-term forecasts may reflect a softening of revenue growth, that trend may or may not continue in the outyears. More detailed analysis of whether more optimistic growth in the later years of the forecast is warranted may therefore be appropriate.
4	The City is appropriately evaluating its infrastructure, facilities, vehicle, and equipment replacement needs.	As a best practice, long-term funding plans should be developed for the regular maintenance and ultimate replacement of critical infrastructure, facilities, vehicles, and equipment. The City has, or is in the process of obtaining, the information required to put plans in place to fund these needs.
5	The City’s current baseline and recession scenarios in the financial forecast project salary increases and other spending continuing at or above the historical pace.	Gaining control of or reducing expenditures is usually key in any recessionary period, as it is when facing a structural deficit. Modeling scenarios with flat or reduced expenditures may therefore be appropriate to better understand variables that can be controlled or adjusted.
6	The City is appropriately evaluating interfund subsidies and cost allocations.	The City recently obtained a comprehensive cost allocation plan and is in the process of evaluating interfund subsidies from the General Fund to certain other funds. Having an understanding of these issues is a critical component of sound long-term financial planning.

NO.	OBSERVATION	DISCUSSION
7	<p>The City has put in place a framework of regular forecast updates and public reviews of the forecast.</p>	<p>A key element of successful long-term financial planning consistent with best practices is to make regular updates to the financial forecast and to present it on a regular basis to leadership and the governing body. The City has implemented these practices and continues to refine its process and practices relative to the financial forecast to enhance its utility and accuracy.</p>
8	<p>The forecast would benefit from projecting revenues and expenditures that behave uniquely as individual line items in the detailed staff version of the forecast.</p>	<p>As currently constructed, the forecast (in most cases) forecasts groupings of accounts at a higher level such as all salaries or all fees. As a best practice, and as a means of illustrating the thoroughness of the forecasting undertaken to stakeholders, an analysis should be undertaken to identify those revenues and expenditures that could benefit from further detailed projections. For example, salaries can be forecasted by bargaining unit to reflect current labor contracts and fees can be forecasted by category to account for unique growth trends. With this detail in the staff forecast, presentation of the information in its current form, in most settings, would still be appropriate to avoid too much detail.</p>
9	<p>The City has acknowledged its non-General Fund infrastructure and operations needs and is focused on addressing them.</p>	<p>Although the primary focus of this engagement was an assessment of the General Fund financial forecast, we did peripherally look at the City's other funds, in particular its enterprise funds. We noted that recent rate increases have improved the health of the City's water fund but that there are still additional needs in these funds that the City is in the process of cataloging to be discussed and addressed in the future.</p>
10	<p>The financial forecast does not include illustrative charts and graphs or historical data.</p>	<p>Typically, a forecast includes historical data for 2-5 years to illustrate trends and facilitate comparisons with the forecast data. Additionally, graphical depictions of data such as a line graph of historical and projected revenues by category can be useful in presentations and facilitate communication of complex information.</p>
11	<p>The City has proactively set aside funds for Pension and OPEB liabilities in trust funds.</p>	<p>Many California cities have and continue to contribute the minimum amount to CalPERS and are funding their OPEB obligations on a pay-as-you-go basis. The City has proactively set aside funds for these important needs that are earning interest and will decrease long-term costs for the City.</p>

NO.	OBSERVATION	DISCUSSION
12	<p>The City does not include the exact projected growth percentages from its revenue consultants in the forecast and uses linear growth rates for most other line items.</p>	<p>The City’s current forecast utilizes growth rates that generally do not change from year to year and are linear over the entire forecast period. In reality, there are factors that influence these costs on an annual basis. As a best practice, the consultants’ exact growth rates for each year should be utilized to tie back to the source of the assumption. Additionally, where growth rates differ by year in other areas, such as negotiated labor contracts, the exact growth rates should be utilized, again to tie back to the source of the assumption and minimize questions regarding these differences.</p> <p>Note: The variances between the consultants’ revenue growth rates and those utilized in the forecast are relatively minor at this time.</p>

ASSESSMENT OF RELATED FINANCIAL MANAGEMENT PRACTICES

Although the scope of services primarily focused on assessing the City’s existing financial forecast, during the course of our assessment we identified related observations regarding financial management practices that merit mention. These observations are summarized in the table below.

NO.	OBSERVATION	DISCUSSION
1	<p>The level and type of information shared with the City Council and the community is very detailed, which can at times make it difficult to focus on key information.</p>	<p>We observed that the staff reports and presentations provided to the City Council and community related to financial information often contain great detail in some areas and information without sufficient supporting detail in others. In our experience, effectively communicating complex financial information is one of the most difficult tasks for finance officers. To improve clarity, critical information should be distilled into key points and graphics, and more details supporting information should be provided in an appendix or upon request. Learning from the approach of peer jurisdictions and/or employing the assistance of GFOA or consultants to focus on this issue would be of great benefit to the City.</p>
2	<p>The City’s current Internal Service Fund Reserve Policies set reserves as a percentage of expenditures.</p>	<p>The City’s reserve policies for internal service funds for facility and infrastructure replacement are currently set as a percentage of expenditures. It is a best practice to use a cash flow analysis of future expenditures, such as what will be included in the City’s infrastructure replacement plan, to identify the annual funding requirements and arrive at an annual contribution amount that will avoid a negative balance in each fund during the forecast period. The minimum reserve balance is then less important rather than that the analysis be undertaken to ensure that reserves are adequate in each year during the forecast period. This change will also facilitate illustrating why the full amount of funding included in these funds is necessary and not available for other purposes as the cash flow analysis will indicate that the funds are fully programmed in future years.</p>
3	<p>The City is not currently utilizing funds in its Section 115 Trust for UAL-related pension payments.</p>	<p>The City is not currently utilizing funds in the Section 115 Trust to make payments toward its unfunded accrued liability (UAL). Based on the analysis undertaken by the City’s actuary and discussions with the City, we believe it is appropriate to begin drawing down on these funds on a limited basis during the forecast period as part of the baseline forecast rather than as a balancing measure. This is an appropriate use of the funds as the City’s pension plan matures and will serve to reduce the structural deficit while illustrating to the community that these funds are being utilized as intended.</p>

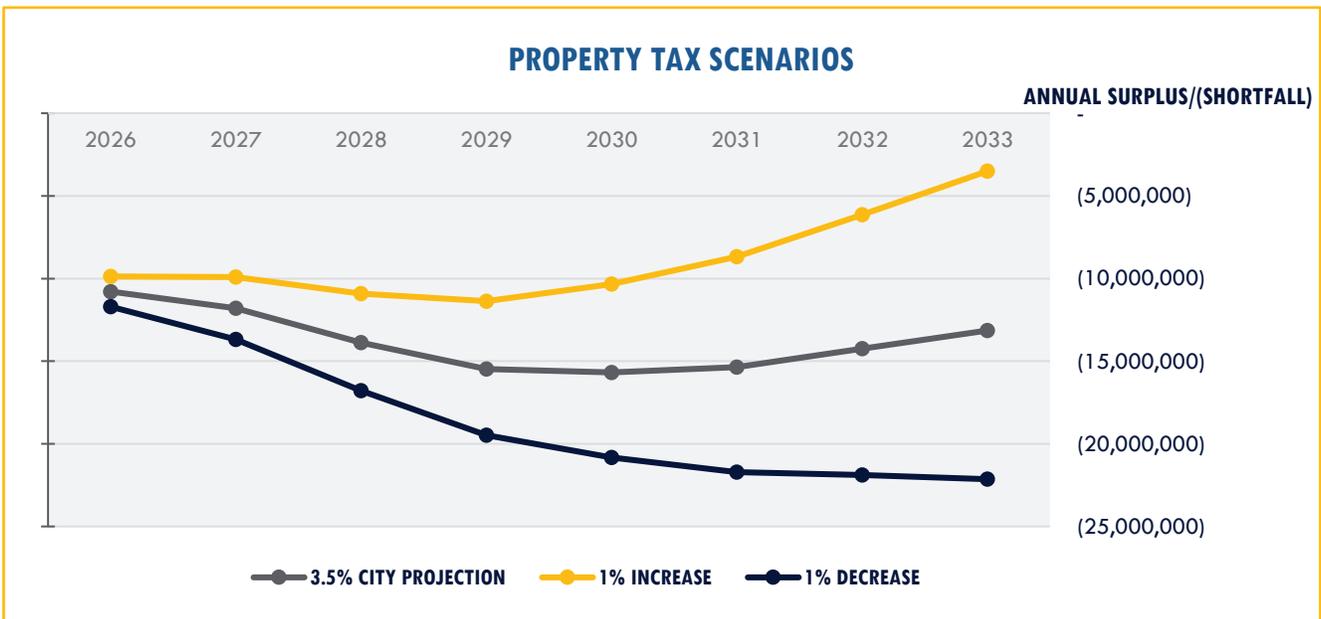
NO.	OBSERVATION	DISCUSSION
4	<p>The City previously budgeted new revenue with uncertain timing related to the recently opened Costco store.</p>	<p>As a best practice, budgeting for revenues related to projects that are speculative or under construction should be avoided, as delays in the projects then require mid-year reductions to the revenue budget. If there are no delays and the revenue is realized as expected, then a positive mid-year adjustment to the revenue budget can be initiated.</p> <p>However, it is also prudent when preparing a financial forecast to include known, likely future revenue sources or revenue reductions in the revenue forecast. Ideally these should be included in a scenario analysis rather than in the baseline scenario, but awareness of the positive and negative impacts of these possible changes in revenues (or expenditures) is critical and appropriate.</p>
5	<p>Funding needs for infrastructure, facilities, vehicles, and equipment are not currently presented to stakeholders with detail by fiscal year and by fund/funding source.</p>	<p>Although the Draft Infrastructure Plan effectively reflects the total cost estimate for necessary improvements, it does not differentiate between the funding sources for the anticipated \$900 million need. Additionally, illustrating the peaks and valleys in funding requirements by year can more effectively illustrate the variable funding needs in each year.</p>

SENSITIVITY ANALYSIS

Per the City’s request, we conducted a limited sensitivity analysis to highlight the impact of modifying certain key assumptions contained in the City’s current financial forecast. This analysis is provided for illustrative purposes only and does not reflect alternative scenarios that we believe to be viable or appropriate based on the information examined. Where appropriate, we have provided observations regarding each data element presented below to assist in interpreting the information provided in each scenario.

Property Taxes. Property taxes are the City’s largest General Fund revenue source, which in our view is a positive. Generally speaking, cities that have large percentages of their revenue derived from property taxes are better insulated from the impacts of economic downturns and revenue variability. Forecasting property tax growth, particularly in the short-term, is also more straightforward and can be significantly enhanced through the use of an expert consultant such as the consultant utilized by the City. In our experience, utilizing these consultants is a best practice and cities generally take the consultant’s forecast at face value and utilize it without adjustment due to the time involved in the consultant’s work and their significant expertise in the nuances of this revenue source.

The table below highlights our sensitivity analysis for property tax revenue, reflecting the impact on the projected structural deficit that would result from a change in the projected 3.5% growth rate of plus or minus one percent.

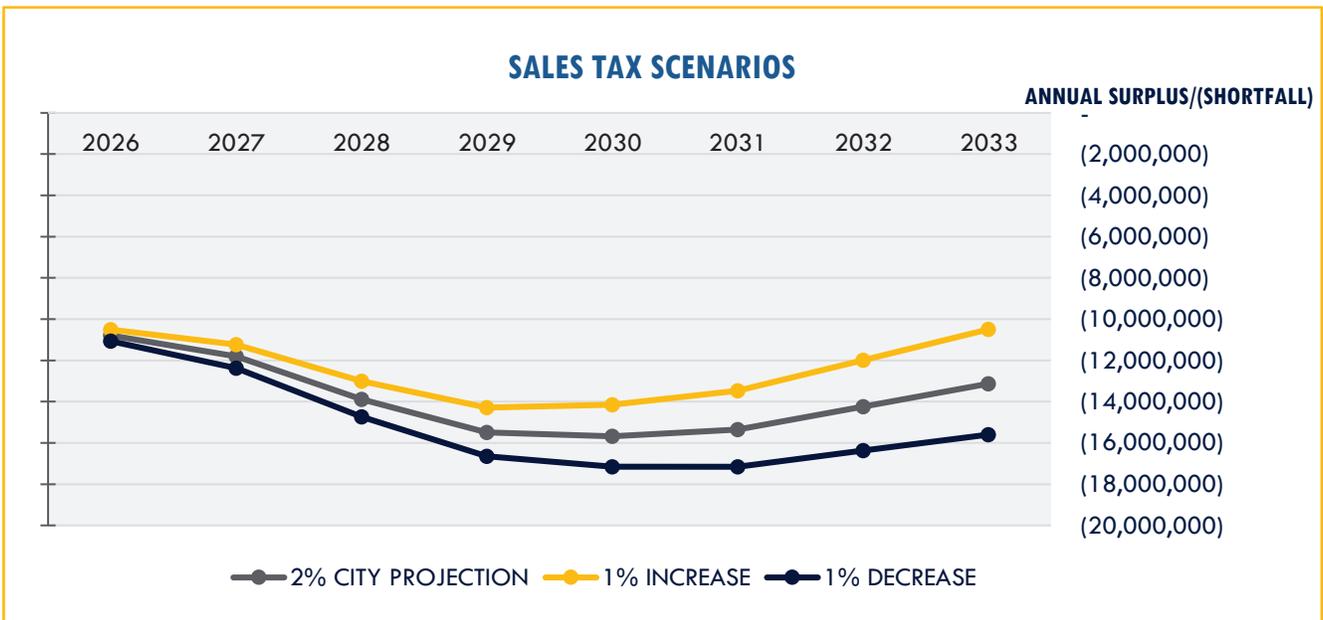


As can be seen in the chart, and as is expected given the size of the City’s property tax revenues, a 1% change in the property tax growth rate has an increasingly significant impact as the growth compounds over the period covered by the forecast. However, it is important to recognize that even in the best of the three scenarios shown above, a deficit persists, and one that does not yet include all of the known long-term costs that the City’s General Fund is facing such as infrastructure replacement. Absent any additional information not previously considered by the City’s property tax consultant, we have not observed any reason to deviate from the City’s existing assumptions for property tax revenue other than to implement our recommendation of using the consultant’s exact projection for each year rather than a rounded or averaged number for all years. Should any additional

information be identified, we recommend that it be communicated to the City’s property tax consultant so that they can evaluate its impact on their growth projection and revise their forecast, if appropriate.

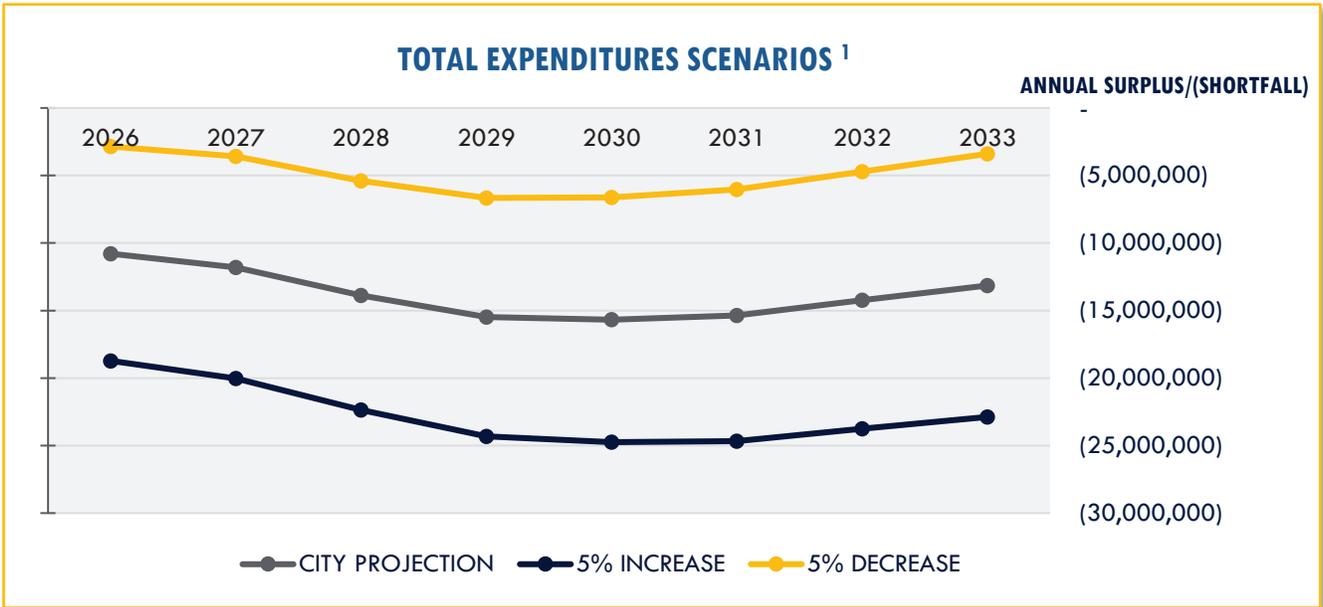
➤➤➤ **Sales Taxes.** Sales taxes are the City’s second largest General Fund revenue source. Sales tax revenues are generally more volatile than property tax revenues and are more challenging to accurately forecast in the long-term. However, forecasting sales tax, particularly in the short-term, can be significantly enhanced through the use of an expert consultant such as the consultant utilized by the City.

The table below highlights our sensitivity analysis for sales tax revenue, reflecting the impact on the projected structural deficit that would result from a change in the projected 2.0% growth rate of plus or minus one percent.



As can be seen in the chart, a 1% change in the sales tax growth rate does have an increasingly significant impact as the growth compounds over the period covered by the forecast. However, the impact is small in comparison to the overall size of the structural deficit. As we discussed earlier in the report, we recommend using the consultant’s exact projection rather than a rounded or averaged number for all years, as well as using the consultant’s statewide consensus growth factors for years beyond the City-specific forecast absent more agency-specific information. However, the City has discussed the projection for these years with the consultant and they have arrived at the 2% growth factor shown in the City’s existing financial forecast. Absent any additional information not considered by the City’s sales tax consultant, we have not observed any reason to deviate from the City’s existing assumptions for sales tax revenue. Should any additional information be identified, we recommend that it be communicated to the City’s sales tax consultant so that they can evaluate its impact on their growth projection and revise their forecast, if appropriate.

➤➤➤ **Total Expenditures.** Forecasting expenditures is generally more difficult than forecasting revenues due to the complexity of the data involved and the significantly larger number of line items involved. Although the scope of our work and the time allotted did not allow for a detailed examination of the City’s expenditure forecast, we observed no concerns in the short-term expenditure assumptions other than the opportunity to provide greater detail in the expenditure projections in the future. The table below highlights our sensitivity analysis on total General Fund expenditures, reflecting the impact on the projected structural deficit that would result from a change in the total projected expenditures of plus or minus five percent.



¹ The 5% adjustments to total expenditures illustrated are to the total amount of expenditures excluding transfers.

As can be seen in the chart, a 5% change in the total expenditures in future years' expenditure growth rate has an expected and consistent positive or negative impact on the forecast in future years. As has been discussed, the fundamental nature of a financial forecast is to utilize the information available to make the best estimates of future variables that can and will be influenced by factors beyond the City's control such as recessions, changes in external costs, and changes in labor costs. Absent any additional information not considered by the City's Finance Department to date that merits consideration now, the further refinement of the expenditure forecast in the year ahead can explore a greater level of detail and validate the trends shown in the current forecast or identify where adjustments may be required. During the course of our analysis, we observed no data or information that suggests that the City's current projection is not informed by the City staff's best professional judgment at this time given the information available and the level of detail contained in the current financial forecast.

RECOMMENDATIONS

Although our observations are split into two sections – the financial forecast observations and the financial management practices observations, our recommendations detailed in the table below are comprehensive and relate to both categories of observations. We acknowledge that City staff are actively addressing certain of our recommendations and that others require a phased approach to implementation given limited staff resources.

NO.	RECOMMENDATION	DISCUSSION
1	<p>The City's financial forecast should be updated to reflect, as appropriate, our observations.</p>	<p>The City has taken critical steps toward comprehensive long-term financial planning and financial management. In the year ahead, focused attention on the observations included in this report relative to the forecast will help to facilitate an even more accurate and beneficial forecast that can continue to inform the City's discussion about future budgetary decisions. In particular, modeling additional scenarios in the financial forecast that reflect changes to the City's key revenues and flat or reduced expenditures would increase the understanding of these variables by stakeholders and provide additional context for future budgetary decision-making.</p>
2	<p>The City should revise its approach to presenting complex financial information to employ compelling presentations, succinct staff reports, and appropriate supporting documentation to enhance the understandability and usability of information provided to the City Council and the public.</p>	<p>For agencies that are projecting structural deficits, it can be challenging for stakeholders less intimately familiar with the figures to differentiate between the components of the City's budget that are controllable or fixed, recurring or one-time, and discretionary or mandatory. To improve budget communication, it is essential to present budget information concisely and to focus on key issues for consideration.</p> <p>Further, simplifying the presentation and highlighting key trends will make it easier for all stakeholders, including those without a financial background, to grasp the essential information and trust in the comprehensiveness and accuracy of the City's budget and financial forecast. We recommend that the City revise its communication approach to address these concerns and provide additional focused education to stakeholders to enhance their foundational knowledge.</p>
3	<p>The City should develop a multi-year plan to prioritize and complete the remaining elements of its plan to catalog and eventually address its long-term funding needs.</p>	<p>The City is concurrently working on a series of critical infrastructure assessments and funding plans. It is important to prioritize and address the most pressing issues first. Immediate concerns, such as evaluating and addressing any short-term deficit should be reviewed first. Other issues such as long-term pension and infrastructure funding, interfund subsidies, and enterprise funds rates and infrastructure funding should be regularly and incrementally addressed as staff resources permit. We recommend that the City develop a written multi-year financial management work plan to tackle these important issues so that an appropriate pace of progress is maintained within the bandwidth of the staff resources that are available.</p>

NO.	RECOMMENDATION	DISCUSSION
4	<p>The City should develop a plan to draw down its pension and OPEB trust funds for pension and OPEB costs, as appropriate, and incorporate those drawdowns into the baseline scenario of the financial forecast.</p>	<p>The ultimate purpose of the funds set aside in the City’s pension and OPEB trusts is to fund long-term pension and OPEB costs. As the City’s plans mature, drawing down these funds to offset pension and OPEB costs is appropriate. As a component of the City’s broader long-term financial planning process, we recommend that the City evaluate an appropriate, measured approach to utilizing these funds to offset pension and OPEB costs as part of its baseline financial forecast.</p> <p>This approach should be informed by an analysis generating a long-term plan to draw the funds down in consultation with the City’s actuarial consultants. It is worth noting that the period of time over which it is appropriate to gradually draw down on these funds will likely well exceed the ten-year period covered by the financial forecast. As these funds are currently and significantly exceeded by the City’s unfunded liabilities, continued focus on utilizing these funds only for funding long-term pension and OPEB costs related to the City’s unfunded liabilities is appropriate.</p>
5	<p>Once the City’s infrastructure funding plan, and any other funding plans, are complete the City should revise its reserve policy to reflect Internal Service Fund reserve minimum balances based on a cash flow analysis of future needs.</p>	<p>It is recommended that the reserve policy relative to the Internal Service Funds be reassessed to incorporate a funding policy based on needs rather than minimum balances. Infrastructure, facility, vehicle, and equipment replacement needs are not linear in nature, and significant peaks and valleys to funding needs will occur over the lifecycle of these assets. It is therefore critical to assess the long-term funding needs across a multi-year period to ensure that funds on hand will be adequate in years where needs are greater.</p> <p>Note: We do not anticipate that this policy change will result in the availability of resources currently contained in these funds for other purposes.</p>
6	<p>Once the City’s infrastructure funding plan, and any other funding plans, are complete the City should develop a presentation illustrating these needs across infrastructure, facilities, vehicles, and equipment.</p>	<p>As a best practice, funding plans for infrastructure, facilities, vehicles, and equipment should be comprehensive and regularly updated, presenting future needs by year to illustrate the seasonality of the related cash flows. We recommend that the City prepare a single analysis and presentation illustrating, at a high level, all of these needs so that the City Council and the public can effectively appreciate and evaluate the sizable long-term budgetary requirements associated with fully funding these needs.</p>

APPENDIX A

The documents examined during this engagement are listed below.

NO.	DOCUMENT
1	Long Range Financial Forecast model and related assumptions
2	HdL forecasts for property tax and sales tax revenues
3	Adopted Budgets and Mid-Term Updates from fiscal years 2014-15 through 2024-25
4	Annual Comprehensive Financial Reports for the fiscal year ended June 30, 2022, through the year ended June 30, 2024
5	Capital Improvement Program for fiscal years 2023-24 to 2026-27
6	Supporting documentation related to Ballot Measure PP
7	State Auditor data regarding the financial health of California cities for 2016-17 through 2020-21
8	Draft 10-Year Infrastructure Plan
9	Actuarial reports for pension and retiree medical plans and related data for the City's trusts
10	March 19, 2024, mid-term reallocation and forecast presentation City Council meeting materials
11	May 21, 2024, Section 115 trust City Council meeting materials
12	September 17, 2024, budget update City Council meeting materials
13	January 9, 2025, budget update City Council workshop and meeting materials
14	City financial policies, including the reserve policy
15	2024 Cost Allocation Plan
16	Current memoranda of understanding for the City's bargaining units
17	Water System Management Plan