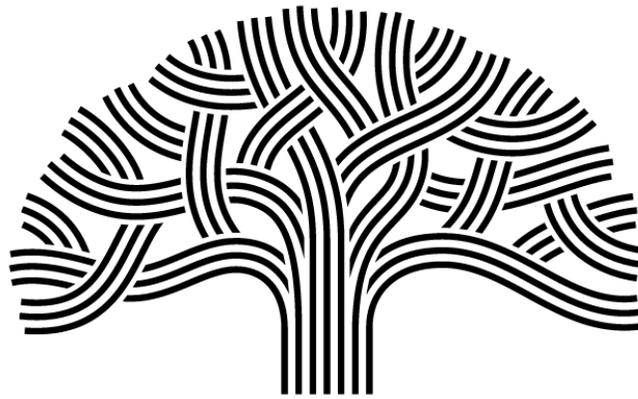


**City of Oakland
Budget Advisory Commission**

**Report on the City of Oakland's
Biennial 2019-21 Budget Cycle**



September 25, 2019

Pursuant to the Consolidated Fiscal Policy (“CFP”) (13279 C.M.S.), the Budget Advisory Commission (“BAC” or “Commission”) submits this Report on the City of Oakland’s Biennial 2017-19 Budget Cycle. The Report was approved by the BAC at a meeting held on September 25, 2019.

Executive Summary

This report contains the BAC’s comments and recommendations related to the 2019-21 budget.

With regard to process, the CFP has been in use now for three budget cycles, and the BAC believes that it has generally worked to improve transparency and increase the predictability and reliability of the budget process for the public. However, based on our observations, and in accordance with the BAC’s mandate to look for “opportunities for improving the process in future years,” now is a good time to make adjustments and improvements to the process and to the policies that guide the development and adoption of the biennial budget.

Following is a summary of our recommendations, some of which are new, and some of which are carried forward from the BAC’s September 2017 and May 2019 report to the Mayor and Council (marked with an asterisk (*) below). A more detailed discussion of each recommendation follows this summary.

1. Adopt a 5- to 10-year formula to provide full funding of the Vital Services Stabilization Fund.
2. Establish a new and adequate funding source for the Landscape and Lighting District. *
3. Continue to explore the revenue side of the budget, as recommended in our prior reports. *
4. Provide transparent, clear, and understandable information about the City's debts and obligations.
5. Attach all relevant reports regarding the City’s Other Post-Employment Benefits (OPEB) liability to the budget and disclose the difference between the City’s OPEB contribution for the year and its Actuarially Determined Contributions (ADC). *
6. Include the BAC in the Five-Year Forecast process as performed by staff to promote BAC feedback and input.
7. Consult with any City Commission that has a responsibility to make recommendations on spending of a particular revenue source to minimize the risk of diverging priorities. *
8. Adopt a Policy Directive to create transparency and reporting of departmental spending for overtime, in addition to requirements in the recently amended CFP.

9. Adopt a budget schedule which prioritizes early decision making and avoids excessive compression late in the budget cycle (see charts, discussion, and specific recommendations below).
10. Work to improve Council-Staff working relationships.
11. Staff review the overall sequencing/timing of events in regard to consideration of the President's budget and provide a report to the Council for consideration within the next 6 Months.
12. Expand the Budget Ambassador Program as a means of providing more budget information to Oaklanders. *
13. Continue to improve Community Budget engagement as detailed on pp 2-4 of the BAC report of May 30, 2019 and contained in Attachment A to this report with specific reference to meeting ground rules, elected officials as policymakers and accommodations for non-English speaking and hearing-impaired residents. *
14. Continue to strengthen the centralized budget page on the City website and develop other electronic methods to communicate budget information such as Facebook, Nextdoor, etc.
15. Support establishment of performance management program which should include sufficient staff for implementation, and personnel vacancy rates should be considered as part of such a program.*

A detailed explanation of the BAC's Comments and Recommendations follows:

1. Adopt a 5- to 10-year formula to provide full funding of the Vital Services Stabilization Fund.

The Council, in the CFP, has established a Vital Services Stabilization Fund (VSSF) with a target funding of 15% of the General Purpose Fund revenues. The purpose of the VSSF is to protect Oakland against service cuts and layoffs when the inevitable economic downturn occurs. The VSSF is funded from excess Real Estate Transfer Tax revenues or other one-time revenues. Using the current budget as a standard, the VSSF could have a balance of \$102 million, yet it only contains \$14,423,168, or 14% of optimal funding levels. This means that, when an economic downturn occurs, there will be very limited protection against service cuts and layoffs. The current budget added only \$100,440 to the VSSF.

We recommend that the Council make funding of the VSSF a higher priority by adjusting the formula for allocation of RETT funds to insure a minimum deposit of \$10 million per budget cycle or adopt a formula which will accomplish full funding of the VSSF over 5-10 years.

2. Establish a new and adequate funding source for the Landscape and Lighting District.

We fully support action by the Council to resolve this issue.

3. Continue to explore the revenue side of the budget, as recommended in our prior reports.

BAC has in the past recommended that more time be spent on reviewing the revenue side of the budget. In our prior reports, we have recommended seeking greater public engagement in revenue analysis and even-year in-depth examination of various revenue scenarios. These recommendations have included analyzing the equity impact of revenue-generating measures and measures under consideration (to assess communities within Oakland benefitting from these sources), analyzing novel revenue generation methods employed by other Charter cities, sponsoring public forums on various revenue sources, sharing independent analyses of revenue projections with the public, benchmarking Oakland's revenue performance to other jurisdictions and considering a split roll real estate transfer tax, among others. (See *BAC Report September 29, 2017.*)

3.1 Equity Analysis - For example, with respect to an equity analysis, the BAC notes that the City relies on a variety of revenue streams that range from progressive (e.g. graduated real estate transfer tax) to regressive (e.g. sales tax). To ensure that revenues are raised in an equitable manner, the BAC recommends that the budget analyze the demographics of who is actually paying the taxes and fees that fund City services. For example, the City could look at the demographics of who pays property tax, and how much they pay (e.g., x% is from commercial properties, y% is from residential properties, of the amount from residential properties, z% is from census tracts where the average household income was below \$50,000). Oakland should aim to have revenue streams that align with its values, and the first step in making that a possibility is to have current, credible and verifiable data to see where the money comes from.

3.2 Unfunded Liabilities - In addition, given the City's recent focus on tackling unfunded liabilities, the BAC recommends that the City explore additional revenue sources for unfunded OPEB and pension costs. The BAC notes that pension override tax revenues ("POTR"), which have been in place since 1976, are set to expire in 2026. Expiration of the POTR may offer an opportunity to institute a replacement revenue stream for addressing unfunded liabilities without increasing current tax burden.

3.3 Revenue Consultant and Polling - The City Council should instruct the City Administrator and Finance Director to consider retaining a consultant to assist both the Finance Staff and the Council in identifying alternative revenues and approaches as well

as reviewing revenue practices from other California Charter and League Cities. In addition to the CFP-required Public Opinion survey/poll on budget priorities, the City and Finance Staff should consider additional polling for acceptance of, and reactions to, alternatives for revenue generation. Now that impact fees, and other development-related sources are a part of the City's revenue repertoire, a review of effectiveness and options could augment the exploration of alternative revenue approaches.

3.4 Consultation with the BAC - The BAC further recommends that Finance Staff regularly seek advice and counsel on revenue and revenue approaches from the BAC and that it makes regular and timely reporting on its efforts once a consultant is retained, as well as during and after the recommended polling on acceptance of various revenue approaches.

3.5 Revenue Forecasting - This past two-year budget cycle had its curious revenue 'squabbling' and consideration of whether the City and Finance Staff is too conservative in its revenue forecasting and projections. In the mid-cycle, perhaps Staff and Council can work on an acceptable cadence and projection policy approach to avoid future 'squabbles' and to arrive in a more timely and early enough agreement on both 3rd Quarter Revenues and also in the longer-term revenue projections and estimates. And, though this Revenue focus of the BAC is a reiteration of prior recommendations, it may also be relevant to staff, the Mayor, and to the Council that some consideration and or process be construed that allows for revenue downturns and/or projections of possible recessionary impacts, unlike the current practice.

4. Provide transparent, clear, and understandable information about the City's debts and obligations.

The BAC commends the City for including an informative "Long-Term Liabilities" section starting on page E-127 of the Budget Presentation. The BAC also recommends that future Budget Presentations include the following disclosures:

4.1 Additional Attachments or References. The BAC recommends that the Budget Presentation include, either directly, via hyperlink, or by other reference, the Finance Department's most recent informational memoranda to the City Council - including any third-party actuarial analyses or attachments - regarding the City's unfunded liabilities, which include its California Public Employees' Retirement System ("CalPERS"), Other Post-Employment Benefits ("OPEB"), and Police and Fire Retirement System ("PFRS") obligations.

Currently, these memoranda are indexed online as part of City Council meeting minutes. They are difficult for the general public to find unless they know the specific meeting dates and agenda items involved. If attaching such memoranda and analyses adds too many

pages to the Budget Presentation, then the BAC suggests that the City provide a robust web portal for the Budget that includes clearly listed and organized hyperlinks to these documents.

4.2 CalPERS. Although the Budget Presentation discloses the City's expected contributions to CalPERS in the new budget cycle, the BAC also recommends that the Budget Presentation state that the City has little to no control over what it pays to CalPERS. In particular, future assessments depend on CalPERS's financial performance and on its use of discount rates, which is a subjective method of converting future expenses into today's dollars. Therefore, the true extent of future CalPERS payments is difficult to predict.

Incorporating valuations, analyses, or presentations from CalPERS or third parties into the Budget Presentation, either directly, by hyperlink, or by reference, would provide the public with clearer disclosure of the extent of the City's unfunded CalPERS liability and the uncertainty of the City's future CalPERS obligations.

4.3 PFRS/POTR. Although the Police and Fire Retirement System ("PFRS") has an unfunded balance, the BAC recommends that the Budget Presentation more clearly state, on page E-128 and elsewhere, that the PFRS has a dedicated source of revenue in the form of Pension Override Tax Revenues ("POTR"). These POTR are expected to resolve the City's unfunded PFRS balance by 2026, without any incremental impact on the GPF.

The BAC also recommends that the Budget Presentation spell out the uses of any excess POTR beyond what is required for PFRS debt service.

4.4 Debt Service. The BAC also recommends that the Budget Presentation provide a summary listing of the City's outstanding debt. While many debt issuances appear in the Budget Presentation under "Budget Terminology" beginning on page J-1 or as part of "Fund Sources and Descriptions" beginning on page E-37, a summary table that lists all debt issuances would be informative to members of the public.

The BAC notes that many tables and disclosures can be repurposed from the City's Comprehensive Annual Financial Report to minimize the extra work required of City staff in preparing the Budget Presentation.

4.5 Deferred Maintenance and Other Capital Needs. On page 10, the Budget Presentation notes that "deferred maintenance and other unfunded capital needs" combine "for a total of more than \$2 billion in the next five years." The BAC recommends that the City revisit this figure and the Budget Presentation provides a summary table estimating the City's deferred maintenance and capital needs, the extent to which such

needs are funded, and the sources of such funds. The BAC notes that relevant sections of the Capital Improvement Program could be repurposed as part of this disclosure.

4.6 GPF Balances. In accordance with the CFP, the BAC recommends that the Budget Presentation clearly state whether there are any unallocated GPF balances in the current or previous budget cycle, and how such balances are being used.

5. Attach all relevant reports regarding the City’s Other Post-Employment Benefits (OPEB) liability to the budget and disclose the difference between the City’s OPEB contribution for the year and its Actuarially Determined Contributions (ADC).

The BAC commends the Council and Mayor for implementing an OPEB policy in the new budget cycle. The BAC also recommends that the Budget Presentation disclose the difference between the City’s contributions to OPEB under its new policy and its actuarially determined contributions. The latter are the payments the City truly needs to make in order to make concrete progress towards fully funding its OPEB liabilities.

As mentioned previously, attaching the most recent Finance Department memoranda and third-party valuation regarding OPEB, either directly or by reference, would be informative to members of the public.

6. Include the BAC in the Five-Year Forecast process as performed by staff to promote BAC feedback and input.

The Five-Year Forecast (“Forecast”) is a critical work product, written primarily by City staff. It is updated regularly and is the basis for developing the City’s Budget every 2 years. Staff should present the Forecast to the BAC each year, to inform the Commission of key and important factors and trends that could affect the financial health of the City, and to obtain feedback from the BAC for ongoing improvement of the forecast process.

We recommend staff provide the BAC with an annual update presentation once the primary work of the Forecast is complete. The intent is to inform the BAC of key outputs of the Forecast and to engage the Commissioners, a group of professionals with experience in finance, operations and technology, in the continuous work of the Forecast. Since the Forecast represents the foundation for developing the City’s budget, BAC’s advisory capacity should be extended to the Forecast process as well.

7. Consult with any City Commission that has a responsibility to make recommendations on spending of a revenue source to minimize the risk of diverging priorities.

The BAC recommends that, where a City commission has within its charge to make recommendations on City spending, the Mayor’s Office and administration work

collaboratively with the commission far in advance of the budget cycle to minimize the risk of diverging priorities. If the budget does not adopt the recommendations of such commissions, it should so state.

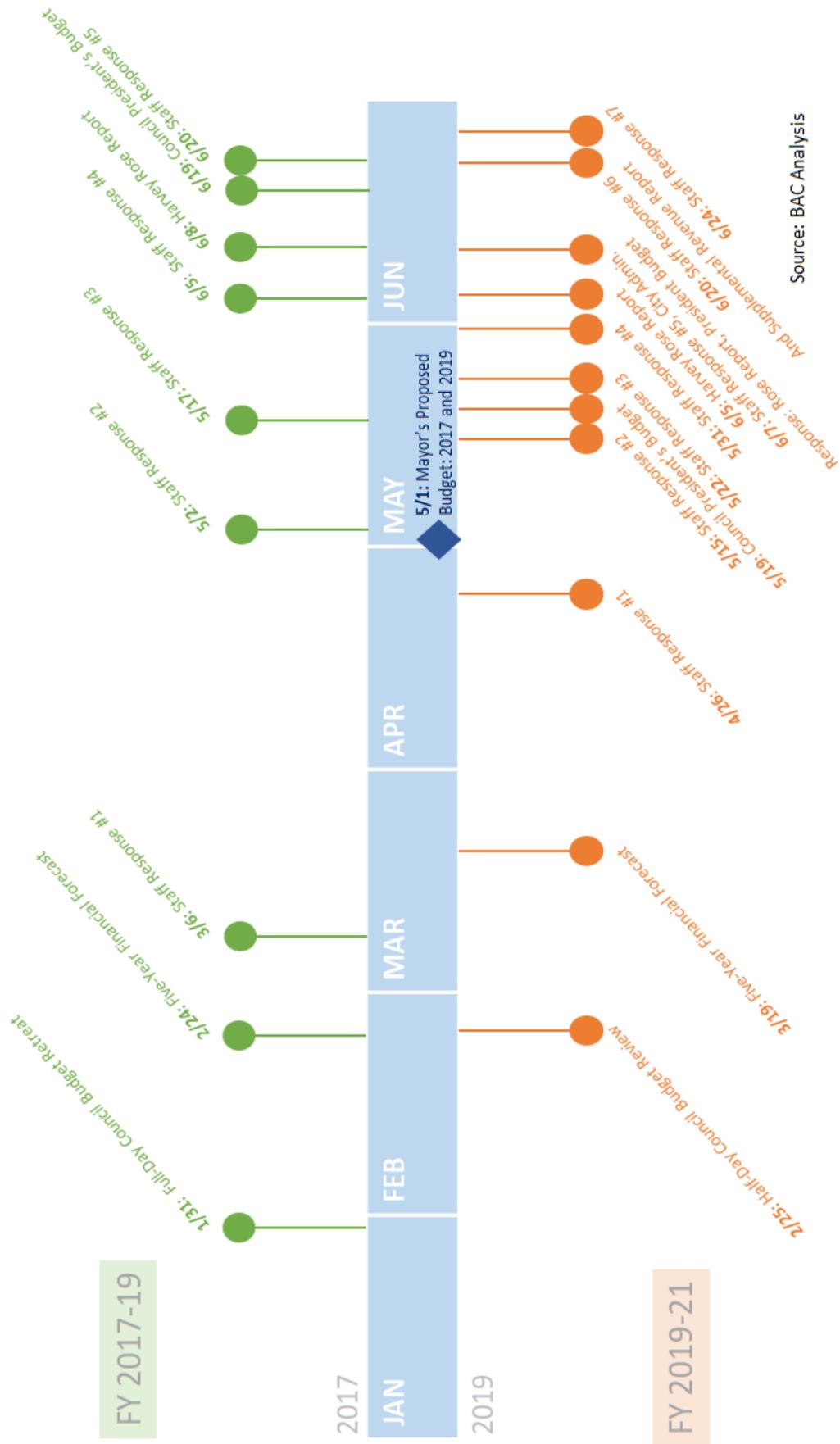
8. Adopt a Policy Directive to create transparency and reporting of departmental spending for overtime, in addition to requirements in the recently amended CFP.

The BAC recommends consistent enforcement of departmental requirements addressing overtime expenditures. The CFP currently requires that departments projected to overspend in the GPF by more than 1% develop a corrective action plan to bring their budget into balance in order to improve expenditure controls for personnel and non-personnel costs, including overtime. Additionally, the BAC recommends the corrective action plan include a detailed analysis of the top drivers of the overtime expenditure, justification for the deviation, and a list of the ten employees receiving the greatest dollar amount of overtime during that period.

9. Adopt a budget schedule which prioritizes early decision making and avoids excessive compression late in the budget cycle.

Adoption of the FY 2019-21 was characterized by SPUR as a “rancorous two-month long process.” (<https://www.spur.org/news/2019-07-30/time-rethink-how-oakland-passes-budgets>) We believe much of the conflict was the result of compressing the significant decision making into the last 30 days rather than the more measured process seen in prior budget deliberations. Following are charts which compare and illustrate this difference:

Comparison of Staff Input/Response Between FY2017-19 and FY2019-21 Budget Cycles



Comparison of Staff Responses Between FY2017-19 and FY2019-21 Budget Cycles

	Number of City Council Questions Addressed by Staff		Number of Pages of Staff Response Document	
	FY 2017-19	FY 2019-21	FY 2017-19	FY 2019-21
Staff Response #1	33	17	17	7
Staff Response #2	43	40	23	19
Staff Response #3	48	7	21	6
Staff Response #4	1	38	1	12
Staff Response #5	10	33	6	15
Staff Response #6	N/A	10	N/A	5
Supplemental Revenue Report	N/A	0	N/A	13
Staff Response #7	N/A	4	N/A	34
TOTAL:	135	149	68	111

Source: BAC Analysis

In order to avoid this in future budget deliberations we recommend the following:

1. Hold a full day Council Budget Retreat no later than February 1 and use that Council retreat to define Council Priorities.
2. Devote significant Council time to reviewing the Five-Year Forecast when it is released in mid-March. A major focus should be upon reviewing revenues and financial uncertainties.
3. Encourage early Council member submission of questions for staff review and response.
4. Receive a detailed report on 3rd Quarter revenues and expenditures in early May and adopt official revenue estimates no later than May 30th.

10. Work to improve Council-Staff working relationships.

We believe a professional relationship between the Council and Staff is essential to development and adoption of the Budget. We have noted several occasions in which budget participants have engaged in public criticism of one another. This is undesirable in that it: (1) undermines staff morale, (2) interferes with a sound working relationship between and Council and Staff, and (3) undermines public trust in the budget process overall.

We strongly recommend that means be developed to resolve such conflicts in a constructive manner and, as appropriate, in Executive Session.

11. Staff review the overall sequencing/timing of events in regard to consideration of the President's budget and provide a report to the Council for consideration within the next 6 Months.

The 2019-21 Budget deliberations were very different from past budget deliberations due to the introduction of a Council President's Proposed Budget, which proposed very significant changes to the Mayor's Proposed Budget. The result was to introduce a much more robust discussion of many aspects of the budget. Since this was the first time that such a discussion occurred, we do not know if this will be a continuing practice. However, if it is, then we believe the budget calendar may need to be significantly revised. Such revision must ensure that the Council, Staff, Consultants, and, most importantly, the Public can meaningfully participate. We recommend that Staff review the overall sequencing/timing of events and provide a report to the Council for consideration within the next 6 Months.

12. Expand the Budget Ambassador Program as a means of providing more budget information to Oaklanders.

The BAC commends the introduction of the Budget Ambassador Program this year, wherein the Mayor's office recruited and trained residents to conduct their own budget informational sessions (e.g. house parties) for fellow residents. The BAC recommends continuing and expanding this program by providing similar budget tools to Council Members, other City officials and employees.

13. Continue to improve Community Budget engagement as detailed on pp 2-4 of the BAC report of May 30, 2019 and contained in Attachment A to this report with specific reference to meeting ground rules, elected officials as policymakers and, accommodations for non-English speaking and hearing-impaired residents.

14. Continue to strengthen the centralized budget page on the City website and develop other electronic methods to communicate budget information such as Facebook, Nextdoor, etc.

15. Support establishment of performance management program which should include sufficient staff for implementation, and personnel vacancy rates should be considered as part of such a program.

The BAC first made this recommendation in its May 30, 2019 report to the Mayor and Council. The BAC recommends that Council adopts Policy Directives to ensure this program will be successfully implemented.