



Office of the City Manager

ACTION CALENDAR  
October 10, 2023  
(Continued from October 3, 2023)

To: Honorable Mayor and Members of the City Council  
From: Dee William-Ridley, City Manager  
Submitted by: Sharon Friedrichsen, Budget Manager  
Subject: Status Report - Berkeley's Financial Condition (FY 2012 – FY 2021):  
Pension Liabilities and Infrastructure Need Attention

INTRODUCTION

On May 24, 2022, the City Auditor submitted a Financial Conditions audit report<sup>1</sup> to City Council with recommendations to build on the City's financial strengths in order to: (1) help address the City's unfunded capital and deferred maintenance needs and pension liabilities; (2) help the City prepare for unforeseen economic challenges by assessing the risk of the reserves, and ensuring that enterprise funds can balance and avoid recurring shortfalls and (3) to update the City's debt policy to help strengthen the City's ability to assess its general obligation debt capacity.

The purpose of this information item is to update City Council on the status of implementation of the audit report's recommendations. This is the second status report regarding this audit. We previously issued a report on December 13, 2022.<sup>2</sup>

CURRENT SITUATION AND ITS EFFECTS

The City Auditor's report included five recommendations. As of the writing of this report, two recommendations have been partly implemented and three recommendations have been started. Please see Attachment 1 for a detailed table of audit report recommendations and implementation progress. The next status report to Council is expected to be presented in May 2024.

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<sup>1</sup> Audit-Berkeley's Financial Condition (FY 2012 - FY 2021): Pension Liabilities and Infrastructure Need Attention: <https://berkeleyca.gov/sites/default/files/documents/2022-05-24%20Item%2018%20Berkeley%E2%80%99s%20Financial%20Condition.pdf>

<sup>2</sup> <https://berkeleyca.gov/sites/default/files/documents/2022-12-13%20Item%2024%20Status%20Report%20-%20Berkeley%20s%20Financial.pdf>

### BACKGROUND

The audit provides a high-level overview of the City's financial condition over 10 fiscal years. By broadening the scope of financial reporting to incorporate long-term financial trends, financial condition analysis can introduce long-term considerations into the budgeting process, clarify the City's fiscal strengths and weaknesses, and help highlight financial risks that the City needs to address including its unfunded capital and pension liabilities.

### ENVIRONMENTAL SUSTAINABILITY AND CLIMATE IMPACT

There are no identifiable environmental effects or opportunities associated with the subject of this report.

### POSSIBLE FUTURE ACTION

The City Manager's Office will continue to work on implementing the various recommendations, including conducting a risk assessment of the General Fund reserve and developing recommendations regarding fund balance for the various enterprise funds. The Finance Department will continue to assess the debt capacity threshold and update the debt management policy. In addition, the City Manager's Office will continue to assess Council fiscal policies and make recommendations regarding long-term funding strategies to address the City's pension and capital infrastructure liabilities.

### FISCAL IMPACTS OF POSSIBLE FUTURE ACTIONS

The audit recommendations are intended to build on the City's financial strengths and help mitigate risks associated with the City's unfunded liabilities.

### CONTACT PERSON

Sharon Friedrichsen, Budget Manager, 510.981.7000

### Attachments:

1. Audit Findings, Recommendations, and Status Updates

Audit Title: Berkeley's Financial Condition (FY 2012-FY 2021): Pension Liabilities and Infrastructure Need Attention				
Issue Date: May 5, 2022				
Finding	Recommendation	Department	Status of Audit Recommendations, Corrective Plan, and Progress Summary	Previous status update
The COVID-19 pandemic slowed the City's progress toward its 2027 reserve funding goal.	1.1 To better prepare the City for unforeseen economic challenges, we recommend that the City Manager complete the risk assessment required by the City's reserve policy as scheduled and propose to the City Council a plan to replenish the Stability and Catastrophic Reserves based on the results of the assessment. This may include revising the funding goal for 2027 to align with the City's financial reality and projected risk level.	City Manager	<u>Started:</u> Staff have entered into a contract with the Government Finance Officers Association (GFOA) for technical assistance with the analysis of the reserves policy. GFOA has developed a distinctive risk-based approach to analyzing reserves that considers specific risk conditions faced by a local government. This includes the use of "probability management technology" to assess risk and develop models regarding appropriate reserve levels. The consultant at the GFOA is currently building the model for the City's exposure to extreme events, such as floods, earthquakes, fires, high heat, and landslides, and developing a range of potential financial impacts from extreme events that would influence the reserves.	Started
All of the City's enterprise funds faced at least one annual shortfall between FY 2016 and FY 2021.	1.2 To ensure the City's enterprise funds can balance and avoid recurring annual shortfalls, we recommend the City Manager assess the appropriate fund balance for each of the City's enterprise funds, report findings to the City Council and explore financial policy options to manage enterprise fund balances.	City Manager	<u>Started:</u> City staff are conducting research and formed an internal working group to discuss current approaches utilized by departments and best practices as the first step in developing fund balance policies.	Started

<p>The City's limit for general obligation bond debt is set at 15 percent of total assessed property value.</p>	<p>2.1 To strengthen the City's debt management, we recommend that the Finance Department update the Debt Management Policy. The Finance Department may consider revising its current general obligation bond threshold of 15 percent of assessed property value or building upon the City's existing general obligation bond debt limit by considering additional debt capacity factors such as debt per capita, debt to personal income, and/or debt service payments as a proportion of General Fund revenues.</p>	<p>Finance Department</p>	<p><u>Started:</u> The Finance Department has been working on updating the debt management policy, especially in light of current interest rates promulgated by the Federal Reserve Board. The updated debt management policy is scheduled to be considered by Council on June 27, 2023.</p>	<p>Started</p>
<p>The City has taken steps to increase pension funding.</p>	<p>3.1 To maximize the benefit of the Section 115 Trust, we recommend that the City Manager present a plan for adoption by the City Council to assure sufficient contributions to the Trust. This may include taking the steps proposed by the Budget and Finance Committee to increase contributions to the Trust. It may also include a strategy to ensure that the City is able to meet its yearly contribution goals, such as allocating contributions at the beginning of the budget cycle.</p>	<p>City Manager</p>	<p><u>Partly Implemented:</u> The City budgeted funds for the Section 115 Trust and adopted fiscal policies to fund the Section 115 Trust as part of the FY 2023/24 biennial budget process. The City's actuary has recommended maintaining the target contribution goal of \$5.5 million.</p>	<p>Partly Implemented</p>
<p>The City reported \$1.2 billion in unfunded capital and deferred maintenance needs in FY 2021.</p>	<p>4.1 To address rising costs for unmet capital needs, we recommend that the City Manager collaborate with the Department of Public Works to implement a funding plan aimed at 1) reducing the City's unfunded capital and deferred maintenance needs, and 2) ensuring regular maintenance of city assets to prevent excessive deferred maintenance costs in the future. This may include prioritizing capital assets that generate the highest deferred maintenance costs.</p>	<p>City Manager</p>	<p><u>Partly Implemented:</u> The City has updated its fiscal policies to include strategies, such as the use of investment revenues over the baseline budget, to increase funding for unfunded capital and deferred maintenance needs.</p>	<p>Partly Implemented</p>