Internal

Office of the City Manager

REVISED
AGENDA MATERIAL
for Supplemental Packet 2

Meeting Date: May 24, 2022

Item Number: 18

Item Description: Berkeley's Financial Condition (FY 2012 – FY 2021): Pension Liabilities and Infrastructure Need Attention

Submitted by: Jenny Wong, City Auditor

When we published our report, our main source for our analysis of contributions to the Section 115 Trust was the FY 2022 Proposed Budget document.[1] We have since learned that the information in the budget does not directly reflect the staff report to City Council accompanying the legislation that established the Section 115 Trust.[2]

Based on the staff report submitted to Council on May 14, 2019, we interpret that the City made contributions to the Section 115 Trust starting in FY 2019. Additionally, we interpret the contribution goal for the first year the Trust was established to be $4 million dollars. The table below reflects our current understanding of the City's contributions to the Section 115 Trust compared to its contribution goals:

Table 11: Contributions to the Section 115 Trust, FY 2019 – FY 2021

Fiscal Year	Actual Contribution	Target Contribution	Difference
2019	$5,246,508	$4,000,000	$1,246,508
2020	$1,398,416	$5,500,000	($4,101,584)
2021	$1,470,134	$5,500,000	($4,029,866)

Source: Finance Department data on contributions and fund balance and May 14, 2019 staff report to City Council

[1] Proposed FY 2022 budget document, pg. 18 "Section 115 Trust Contributions" table

[2] See attachment, pg. 3

We plan to update our report once we are able to confirm the accuracy of this new information with the Department of Finance. This revision will have no impact on our recommendation with regard to the Section 115 Trust.

Office of the City Manager

CONSENT CALENDAR
May 14, 2019

To: Honorable Mayor and Members of the City Council

From: Dee Williams-Ridley, City Manager

Submitted by: Henry Oyekanmi, Director, Finance Department

Subject: Contract: Keenan Financial Services to Establish, Maintain and Invest for an IRS Section 115 Trust Fund

RECOMMENDATION

Adopt a Resolution authorizing the City Manager to execute a contract with Keenan Financial Services to establish a pension Section 115 trust that includes Keenan Financial Services providing trust administration, trustee/custodian, and investment advisory services for the Trust; and authorizing the City's Plan Administrator to execute the legal and administrative documents on behalf of the City and to take whatever additional actions are necessary to establish a Section 115 trust fund, establish the authority for the management of the Section 115 investments, develop investment policies for the Section 115 trust fund, and Select an initial model investment portfolio, from the choices provided.

FISCAL IMPACTS OF RECOMMENDATION

Approving the vendor to establish and maintain the Trust and make investments for the Section 115 pension trust fund should result in better investment returns than those available using the investment policies for the City's pooled investments.

BACKGROUND

At the November 28, 2017 Council meeting, the City Manager was directed to bring back to Council a proposal to establish an Irrevocable Supplemental Pension Trust and other options as proposed by staff.

At the June 26, 2018 Council meeting, the City Council adopted a Resolution appointing the City Manager as the Plan Administrator and authorizing the City Manager to take the necessary steps to negotiate and execute the documents to establish a Section 115 Trust Fund to use as a pension rate stabilizing fund, and delegate authority for managing the Section 115 Trust Fund investments.

Compensation packages for the City of Berkeley employees include California Public Employees Retirement System (CalPERS) pensions, a Police Retirement Income Benefit Plan and three retiree medical plans (Miscellaneous Retiree Health Premium

Assistance Plan; Police Retiree Premium Assistance Plan; and Fire Employees Retiree Health Plan), referred to as other post-employment benefits (OPEB).

Recent changes in rate smoothing strategies by CalPERS have increased volatility in employer contribution rates in pensions. Monies set aside in a Section 115 Trust can be used to ease budgetary pressures resulting from unanticipated spikes in employer contribution rates. For example, a CalPERS employer who has extra money after making their current CalPERS contribution might set aside some or all of the surplus to use in future years when the required contribution is less affordable. The City wants to take steps to better manage and reduce its pension and other post-employment benefit liabilities. These actions will represent best practices for financial management, slowing the increases in the City's annual pension costs, and positioning the City to achieve retiree medical cost savings into the future.

Steps already taken by the City to address pension costs include implementing pension reform by establishing second-tier pension plans for all new employees. PEPRA miscellaneous will be enrolled in a 2% at 62 plan and PEPRA safety members (police and fire) will be enrolled in a 2.7% at 57 plan. PEPRA members are required to pay half the normal cost of their plans.

However, changes by CalPERS, and past investment market losses by CalPERS have led to rapidly increasing pension rates and costs. The related ramp up in annual costs will continue for the next several years.

The City wants to take steps to better manage and reduce its pension and other post-employment benefit liabilities.

Until recently, the City's only option for reducing the unfunded actuarial accrued liability was to commit additional funds to CalPERS. Unfortunately, these funds would be subject to the same market volatility as the CalPERS investment policy, and the funds are not accessible to the City for other pension expenses. In the last couple of years, a private letter ruling was received from the IRS that establishes that under Section 115 of the Internal Revenue Code, public agencies or municipalities could create a separate trust to "pre-fund" its CalPERS unfunded liability. This will provide an alternative to sending the funds to CalPERS, and will provide greater local control over the assets and investment portfolio management.

A League of California Cities' Retirement System Sustainability Study and Findings (January 2018) revealed the following:

1. Rising pension costs will require cities over the next seven years to nearly double the percentage of their General Fund dollars they pay to CalPERS. Between FY 2018-19 and FY 2024-25, cities' dollar contributions will increase by more than 50 percent. For example, the impact would be the following for the City of Berkeley if CalPERS payments increased by 50 percent, as the League expects.

Estimated Employer Contribution	FY 19 Adopted Budget	FY 24-25 Based on California League of Cities Estimate
Miscellaneous	$29.96M	$44.54M
Police	$14.57M	$19.69M
Fire	$7.33M	$10.18M

2. For many cities, pension costs will dramatically increase to unsustainable levels;
3. Many cities face difficult choices that will be compounded in the next recession.
4. Tangible savings resulting from PEPRA will not have a substantial effect on city budgets for decades.

According to the League, some things cities can do today are the following:

1. Develop and implement a plan to pay down the city's Unfunded Actuarial Liability (UAL). Possible methods include shorter amortization periods and pre-payment of cities UAL.
2. Consider local ballot measures to enhance revenues
3. Create a pension rate stabilization program: Establishing and funding a local Section Trust Fund can help offset unanticipated spikes in employer contributions.
4. Change service delivery methods and levels of certain public services
5. Use procedures and transparent bargaining to increase employee pension contributions
6. Issue a pension obligation bond (POB). However, financial experts including the Government Finance Officers Association (GFOA) strongly discourage local agencies from issuing POBs. Moreover, this approach only delays and compounds the inevitable financial impacts.

On April 4, 2017, the City Manager presented to Council a report titled Projections of Future Liabilities - Options to Address Unfunded Liabilities Tied to Employee Benefits (https://www.cityofberkeley.info/Clerk/City_Council/2017/04_Apr/City_Council__04-04-2017_-_Special_Meeting_Agenda.aspx) which provided a thorough overview of the City's long term expenditure obligations. On that same date, the City's actuary presented to Council a presentation titled Pension and OPEB Funding Study which identified options to address the City's unfunded liabilities tied to post-employee benefits.

One of the recommendations made by the City's actuary is the establishment of an irrevocable supplemental (Section 115) pension trust with an initial "seed" deposit of $3 million as a "start up" contribution. Going forward the City should set aside approximately 3% of payroll which is about $4 million in year 1 and 4% of payroll which is approximately about $5.5 million in year 2 and for the foreseeable future.

This Council report deals with the recommendation from both the League and the City's actuary which is to establish a local Section 115 Trust Fund to help offset future spikes in employer contributions.

CURRENT SITUATION AND ITS EFFECTS

The City identified three agencies that provide professional Trust administrative, trustee/custodial, and investment advisory or management services: Public Agency Retirement Services (PARS), PFM Asset Management LLC (PFM), and Keenan, and Requests for Proposals (RFP) were sent out. In their responses to the RFP, they identified their team of companies to provide the Trust services as follows:

PARS team:

- Trust Administrator-PARS
- Trustee/Custodian-US Bank
- Investment Manager-Highmark Capital Management

PFM team:

- Trust Administrator-PFM
- Trustee/Custodian-Wells Fargo Bank
- Investment Manager-PFM

Keenan Financial Services team:

- Trust Administrator-Keenan
- Trustee/Custodian-Benefit Trust Company
- Investment Manager-Morgan Stanley

The RFPs were evaluated by a review committee consisting of the Director of Finance, the Treasury Manager and an outside consultant for the City.

The RFPs were evaluated using the following criteria:

1. Firm's integrity and competence 20%
2. Price Proposal 20%
3. Qualifications to do the project 50%
4. Socially Responsible investing 10%

Following is the RFP Rating Sheet:

RFP RATING SHEET OF VENDORS

	Keenan Financial Services	PFM Asset Management LLC	Public Agency Retirement Services (PARS)
Firm's integrity and competence	20	20	20
Price proposal	20	11	10

Qualifications to do the project	50	50	50
Socially responsible investing	10	0	10
Total	100	81	90

All three firms have significant experience establishing and maintaining Section 115 trusts and providing investment options and investment advisory services. All three reviewers gave Keenan Financial Services the highest rating based on the above criteria. Staff recommends establishing a pension Section 115 trust with Keenan Financial Services.

It should be pointed out that PFM would not sign the City's socially responsible investing forms and gave the following reason for not doing so:

"While PFM as a firm may comply with some of these criteria, we have no way to consistently research, analyze, and confirm compliance on an ongoing basis. Therefore, PFM, as a firm and investment advisor, is not able to document, disclose, or confirm compliance with the social responsibility criteria listed above adopted by the City."

After the City Council approves the resolution to approve a contract with Keenan Financial Services establish, maintain and invest for an IRS Section 115 trust, the following next steps need to be taken:

1. Sign Board of Authority Member Agreement
2. Sign Pension Stabilization Trust for California Municipalities Participation Agreement, and appoint two individuals as authorized representatives
3. Develop investment policies for the Section 115 Trust, to be approved by the City Council
4. Select an initial model investment portfolio, from the choices provided.
   Staff recommends the Moderate portfolio consisting of 33% equity securities and 67% fixed income securities. The City may change the designation of the model portfolio in the future by executing an amendment to section 9 of the Participants' Agreement.
5. Make the deposits into the Section 115 Trust
   The current plan is as follows:
   a. Immediately deposit the nearly $4 million that is currently in the PERS Savings fund.
   b. Immediately deposit the $4 million allocated by Council during the budget process
   c. Deposit the $1.1 million discount the City saved by prepaying the FY 2019 unfunded liability payments required by CalPERS, by June 30, 2019.

6. Keenan is to provide quarterly and annual investment reports to Council.

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

RATIONALE FOR RECOMMENDATION
An adequately funded Section 115 Trust can be used to help offset future spikes in CalPERS employer retirement contributions. In addition, establishing the trust fund should result in better investment returns than those available using the investment policies for the City's pooled investments.

CONTACT PERSON
Henry Oyekanmi, Director, Finance Department, 981-7300

Attachments:
1: Resolution
  Exhibit A: Board of Authority Member Agreement
  Exhibit B: Pension Stabilization Trust for California Municipalities Participation Agreement
  Exhibit C: Keenan Financial Services Investment Portfolio Options

RESOLUTION NO. ##,###-N.S.

CONTRACT: KEENAN FINANCIAL SERVICES TO ESTABLISH, MAINTAIN AND INVEST FOR AN IRS SECTION 115 TRUST FUND

WHEREAS, it is determined to be in the best interest of the City to set aside funds for the pre-funding of its CalPERS pension obligation to be held in trust for the exclusive purpose of making future contributions of the City's required pension contributions and any employer contributions in excess of such required contributions at the discretion of the City; and

WHEREAS, a tax-exempt trust performing an essential governmental function within the meaning of Section 115 of the Internal Revenue Code (as amended) and the Regulations issued thereunder, and is a tax-exempt trust under the relevant statutory provisions of the State of California; and

WHEREAS, the City's establishment and operation of the Section 115 trust has no effect on any current or former employee's entitlement to post-employment benefits; and

WHEREAS, an RFP was sent to all firms with significant experience establishing and maintaining Section 115 trusts and providing investment options and investment advisory services; and

WHEREAS, the responses to the RFP were evaluated by a committee consisting of the Director of Finance, the Treasury Manager, and an outside consultant for the City; and

WHEREAS, all three reviewers gave Keenan Financial Services the highest rating based on the criteria outlined in the RFP.

NOW THEREFORE, BE IT RESOLVED by the Council of the City of Berkeley that the City Manager is authorized to execute a contract, and any amendments, with Keenan Financial Services to establish an IRS Section 115 Trust Fund, to include trust administrative, trustee/custodian, and investment advisory services.

BE IT FURTHER RESOLVED that the City's Plan Administrator is hereby authorized to execute the legal and administrative documents on behalf of the City and to take whatever additional actions are necessary to establish a Section 115 trust fund, establish the authority for the management of the Section 115 investments, develop investment policies for the Section 115 trust fund, and Select an initial model investment portfolio, from the choices provided.

Exhibit A

PENSION STABILIZATION TRUST FOR CALIFORNIA MUNICIPALITIES

BOARD OF AUTHORITY MEMBER AGREEMENT

WHEREAS, the Board of Authority of the Pension Stabilization Trust for California Municipalities (the "PST") adopted the Trust; and

WHEREAS, the PST allows up to one Member of the Board of Authority to be appointed by each Adopting Entity; and

WHEREAS, the Member must sign a written acceptance and agree to administer the PST; and

WHEREAS, the Member's written acceptance must be in a form satisfactory to the Board of Authority;

NOW, THEREFORE, the Adopting Entity, the Member and the Board of Authority agree as follows:

Section 1:

Appointment as Member: The Board hereby confirms the appointment by ___________ of ______________________, as Member, pursuant and subject to the terms and conditions of the PST.

Section 2:

Acceptance as Member: _______________________ hereby accepts his or her appointment as Member pursuant and subject to the terms and conditions of the PST and agrees to administer the PST.

IN WITNESS WHEREOF, the duly authorized parties hereto have executed this Agreement as of_________________, 2017.

Adopting Entity:

____

____

Signature: ______________________________

Name: ______________________________

Title: ______________________________

CHAIRMAN OF THE BOARD OF THE PENSION STABILIZATION TRUST FOR CALIFORNIA MUNICIPALITIES

Signature: ______________________________

Name: ______________________________

Title: ______________________________

ACCEPTANCE AS MEMBER

Signature: ______________________________

Name: ______________________________

PENSION STABILIZATION TRUST FOR CALIFORNIA MUNICIPALITIES

PARTICIPATION AGREEMENT

THIS PARTICIPATION AGREEMENT is entered into by the undersigned California public entity (the "Adopting Entity") and Benefit Trust Company, a Kansas corporation, as Trustee (the "Trustee") of the Pension Stabilization Trust for California Municipalities (the "Trust"), effective as of the date specified on the signature page (the "Effective Date"), with reference to the following:

A. The Board of Authority (the "Board") of the Trust has established the Trust to help California Municipalities stabilize the funding of their pension benefit liabilities by creating a secure vehicle to hold assets pending their contribution to a pension plan in satisfaction of a public entity's funding obligation. The Trust is intended to qualify as a trust arrangement that is tax exempt under applicable guidance and procedures under Section 115 of the Internal Revenue Code.

B. The Adopting Entity has adopted a pension plan for its eligible employees (the "Plan") to which the Adopting Entity is required to make regular contributions. To the extent the Adopting Entity may from time to time have excess funds, a portion of which can be used to pre-fund contributions to the Plan, the Adopting Entity desires to have a secure trust to which it may contribute such funds and to have the trust hold such pre-funding contributions.

C. In order to participate in the Trust, the Adopting Entity must be a public entity in the State of California and must enter into this Participation Agreement (the "Agreement").

NOW, THEREFORE, the Adopting Entity and the Trustee agree as follows:

1. **Participation.** The undersigned Adopting Entity agrees to all of the provisions, terms and conditions of the Trust and agrees to participate in the Trust in accordance with the terms of this Agreement. The Adopting Entity agrees to cooperate in providing any information reasonably required by the Trustee or the Board to administer the Trustee properly.

2. **Representations of Adopting Entity**. The Adopting Entity makes the following representations and warranties, and acknowledges that the Trustee is relying on these representations in entering into this Agreement:

(a) The Adopting Entity is a public entity within the State of California under the California Constitution and applicable sections of the Government Code.

(b) By executing this Agreement, the Adopting Entity acknowledges that it has determined that the Trust is appropriate for the pre-funding of a portion of its pension liabilities under the Plan.

(c) The Plan has been adopted by all necessary action of the governing body of the Adopting Entity and remains in full force and effect, in compliance with all applicable legal requirements.

(d) The adoption of this Agreement has been approved by all necessary action of the Adopting Entity's governing body and the person signing this Agreement on its behalf is authorized to do so.

(e) Neither the execution and delivery of this Agreement by the Adopting Entity, nor compliance by the Adopting Entity with any of the provisions hereof, nor the consummation of the transactions contemplated hereby, will result in a default, or give rise to any right of termination, cancellation or acceleration, under any term, condition or provision of any agreement or other instrument or obligation to which the Adopting Entity is a party or by which it or any of its properties or assets may be bound.

(f) The Adopting Entity has received a copy of the Pension Stabilization Trust Agreement (the "Trust Agreement"), is aware of the terms and conditions thereof and agrees that in the event of any conflict between the terms of the Trust and this Agreement, the terms of the Trust will control.

(g) The Adopting Entity has not received any legal, accounting or investment advice from the Trustee, the Board or their representatives. The Adopting Entity acknowledges that it has had the opportunity to consult with independent legal counsel regarding this Agreement and the Trust.

3. **Administration Fees.** The Trustee will allocate reasonable fees for administration to each Adopting Entity's account in the Trust in accordance with the fee schedule established from time to time with the Board. Such fees shall not exceed 0.30% (30 basis points) per annum on the value of the assets held in the account. Fees will be collected monthly directly from the account.

4. **Responsibility for Legal Compliance.** The Adopting Entity acknowledges that the Trustee will not be responsible for compliance with any obligations or to enforce any obligations the Adopting Entity may have under the Plan. All such compliance shall be the responsibility of the Adopting Entity.

5. **Indemnification.** The Adopting Entity agrees to indemnify and hold harmless the Trust, the Trustee and the Board from any and all liabilities and losses, including attorneys' fees, arising out of the claim by any person for damages caused by or resulting from the failure of the Adopting Entity to comply with the provisions of the Plan, the Trust or applicable requirements of federal or state law.

6. **Amendment and Termination.**

(a) This Agreement and the Declaration of Trust constitute the entire agreement of the parties concerning the Adopting Entity's participation in the Trust. This Agreement may be amended only through a written document executed by the Trustee and the Adopting Entity.

(b) The Agreement may be terminated by the Adopting Entity by providing 90 days written notification of its intent to terminate its participation in the Trust; provided that upon such a termination, none of the assets held in the Trust for contribution to the Plan shall be returned or otherwise made available to the Adopting Entity for any purpose.

(c) The Trust may be terminated in accordance with the provisions of the Trust Agreement.

(d) The Adopting Entity's rights and obligations under this Agreement cannot be assigned without the written consent of the Trustee.

7. **Right to Rely.**

(a) The Adopting Entity acknowledges that the Trustee will rely upon any representations that it or any of its authorized representatives make to the Board.

(b) The Adopting Entity hereby designates the persons identified on the signature page of this Agreement as the persons authorized to represent the Adopting Entity in connection with matters regarding the Adopting Entity's participation in the Trust and the disbursement of funds from the Trust (the "Authorized Representative"), and agrees that the Board and the Trustee may rely upon the representations of the Authorized Representative until and unless notified in writing that this person is no longer authorized to represent the Adopting Entity in this manner. Any such notice must identify a new person who will serve as the Adopting Entity's Authorized Representative.

8. **General Provisions.**

(a) Any notice required under this Agreement shall be in writing and shall be furnished to the recipient at the addresses provided separately by the parties, unless the recipient has provided the sender with notice of a change of address.

(b) This Agreement shall be governed by the laws of the State of California.

(c) The failure of the Trustee to seek redress for violation of or to insist upon the strict performance of any provision of the Agreement shall not be deemed a waiver and will not prevent a subsequent act, which would have originally constituted a violation, from having the effect of an original violation. The rights and remedies provided in this Agreement are cumulative and the use of any right or remedy does not limit the Trustee's right to use any or all other remedies. All rights and remedies in this Agreement are in addition to any other legal or equitable rights that the Trustee may have.

(d) Every provision of the Agreement is intended to be severable. If any term or provision hereof is invalid for any reason whatsoever, its invalidity will not affect the validity of the remainder of the Agreement.

(e) This Agreement may be executed in any number of counterparts with the same effect as if all parties hereto had all signed the same document. All counterparts shall be construed together and shall constitute one agreement.

(f) Unless the context requires otherwise, the use of a feminine pronoun includes the masculine and the neuter, and vice versa, and the use of the singular includes the plural, and vice versa.

(g) The headings used in this Agreement are provided for convenience and are not intended to be a part of this Agreement or to influence the interpretation of the terms of this Agreement. This Agreement shall not be construed on the basis of which party drafted the Agreement or a particular provision thereof.

9. **Selection of Model Portfolio.** The Adopting Entity has reviewed its tolerance for risk and its requirements for the investment of the Account, and has also reviewed the model portfolios offered by the Trustee. Solely and by virtue of this review, the Adopting Entity hereby directs the Trustee to invest the assets of the Account in accordance with the following model portfolio with its commensurate approximate target asset allocation, understanding that the target asset allocation will vary from time to time based upon market fluctuations, and that with the exception of Fixed Income, model portfolio asset allocations may be adjusted +/- 5% from time to time at the discretion of the Trustee:

CHECK ONE:

- ☐ Fixed Income (100% fixed income securities)
- ☐ Conservative (16% equity securities, 84% fixed income securities)
- ☐ Moderate (33% equity securities, 67% fixed income securities)
- ☐ Moderate Growth (45% equity securities, 55% fixed income securities)
- ☐ Growth (61% equity securities, 39% fixed income securities)
- ☐ Aggressive Growth (76% equity securities, 24% fixed income securities)

The Adopting Entity understands and agrees that the Trustee shall be under no duty to question the prudence of the model portfolio the Adopting Entity directs, and shall have no liability for any loss of any kind which may result by reason of the inherent volatility of the asset allocation directed. Once the Adopting Entity has directed the Account to be invested pursuant to a model portfolio as listed above the Trustee will assume discretionary authority and responsibility for its management.

The Adopting Entity may change the designation of the model portfolio to be utilized by executing an amendment to this section 9 of the Participation Agreement. Said amendment will go into effect upon the acknowledgement of receipt by the Trustee.

10. List two Individuals appointed as Authorized Representatives:

____

____

IN WITNESS WHEREOF, the parties have executed this Agreement as of ___________, 2018.

Adopting Entity:

____

Signature: ____________________________

Name: ____________________________

Title: ____________________________

BENEFIT TRUST COMPANY, TRUSTEE FOR THE PENSION STABILIZATION TRUST FOR CALIFORNIA MUNICIPALITIES

By: _________________________________
Scott W. Rankin, Senior Vice President

Exhibit C

EXHIBT D

KENNAN FINANCIAL SERVICES
INVESTMENT OPTIONS

	Style	Ticker	Expenses	Fixed Income	Conservative	Moderate	Moderate Growth	Growth	Aggressive Growth
Total Equities				0.00%	16.00%	33.00%	45.00%	61.00%	75.00%
Total Bonds				100.00%	84.00%	67.00%	55.00%	39.00%	25.00%
Total				100.00%	100.00%	100.00%	100.00%	100.00%	100.00%
Domestic equities:									
1. Large Cap domestic equities:									
a. Alger capital appreciation focus	Large growth	ALGYX	0.65%	0%	1%	3.5%	6%	6%	8%
b. Columbia contrarian core	Large blend	COFYX	0.66%	0%	2%	3%	4%	5%	7%
c. Oakmark select	Large value	OANLX	0.82%	0%	2%	4%	4%	6%	7%
2. Small/Mid cap domestic equities:									
a. Hartford midcap	Mid growth	HMDYX	0.76%	0%	0%	1%	2%	4%	6%
b. Alger small cap focus	Small growth	AGOZX	0.90%	0%	1%	3%	4%	5%	6%
c. Undiscovered managers' behavioral value	Small blend	UBVFX	0.79%	0%	1%	1%	2%	4%	5%
3. Real Estate Investment Trusts:									
a. Cohen &Steers Real Estate securities	Real Estate	CSZIX	0.88%	0%	1%	2%	2%	3%	4%
b. PGIM Global Real Estate	Real Estate	PGRQX	0.80%	0%	0%	1%	2%	2.5%	3%
Total Domestic Equities & REITs				0	8%	19%	26%	35.5%	46.0%
International/ Global Equities:									
a. John Hancock International Growth	Int'l growth	JIGTX	0.93%	0%	2%	2%	3%	4%	4%
b. Brandeis International small cap	Int'l SMID	BISRX	1.00%	0%	1%	1.5%	2%	3%	4%
c. American Funds New Perspectives Fund	Global growth	ANWFX	0.55%	0%	1%	2%	2%	3%	4%
d. American Funds New World Fund	Emerging markets	NFFFX	0.76%	0%	1%	1%	1.5%	2%	3%
e. PGIM Jennison Global Opportunities	Global growth	PRJQX	0.84%	0%	0%	1%	1.5%	2%	3%
f. Oakmark International	Int'l value	OANIX	0.81%	0%	1%	2%	3%	3%	3%
g. Hartford International Value	Int'l value	HILYX	0.91%	0%	1%	2%	3%	4%	4%
h. Thornburg Investment Income Builder	Global Blend	TIBOX	0.85%	0%	1%	3%	3%	5%	5%
Total International/Global Equities				0%	8%	15%	19%	25.5%	30.0%
Fixed Income:									
a. BlackRock Total Return	Domestic Bond	MPHQX	0.39%	16%	14%	11%	9%	6%	4%
b. Guggenheim Investment Grade Bond	Domestic Bond	GIUSX	0.50%	16%	14%	11%	9%	6%	4%
c. PGIM Total Return Bond	Domestic Bond	PTRQX	0.46%	16%	14%	11%	9%	6%	4%
d. Western Asset Core Plus Bond	Domestic Bond	WAPSX	0.42%	16%	14%	11%	9%	6%	4%
e. Guggenheim Macro Opportunities	Domestic Bond	GIOIX	0.97%	16%	12%	11%	9%	6%	4%
f. Hartford World Bond	Global Bond	HWDYX	0.67%	8%	7%	4%	4%	3%	1%
g. Brandywine Global Opportunities Bond	Global Bond	GOBSX	0.56%	6%	5%	4%	3%	3%	1.5%
h. Brandywine Global Alternative Credit	Global Bond	LMAMX	1.25%	6%	4%	4%	3%	3%	1.5%
Total Bonds				100%	84%	67%	55%	39%	24%
Total Investments				100%	100%	100%	100%	100%	100%
Expected Return				4.50%	5.00%	6.00%	6.99%	7.69%	8.46%
Expected Standard Deviation				3.12%	4.26%	6.09%	7.41%	9.48%	11.89%

BERKELEY CITY AUDITOR

CONSENT CALENDAR
May 24, 2022

To: Honorable Mayor and Members of the City Council

From: Jenny Wong, City Auditor JW

Subject: Berkeley's Financial Condition (FY 2012 – FY 2021): Pension Liabilities and Infrastructure Need Attention

RECOMMENDATION
We recommend City Council request that the City Manager report back by November 2022, and every six months thereafter, regarding the status of our audit recommendations until reported fully implemented by the City Manager and Finance Department. They have agreed to our findings and recommendations. Please see our report for their complete response.

FISCAL IMPACTS OF RECOMMENDATION
The audit recommendations are intended to build on the City's financial strengths and address the risks identified in the report. If the City does not implement the recommendations, unfunded pension liabilities and infrastructure needs will continue to grow and may put pressure on other spending priorities in the future. The City may also be less prepared for unforeseen economic challenges if it does not assess the risk of the reserves, and ensure that enterprise funds can balance and avoid recurring shortfalls. Additionally, the City may overlook important considerations in determining a manageable level of debt if it does not update its debt policy.

CURRENT SITUATION AND ITS EFFECTS
We used various financial indicators to analyze the City's financial condition between FY 2012 and FY 2021. While the City's near-term financial outlook was mostly positive, the financial indicators related to the City's long-term outlook revealed some challenges.

Near-Term

- **Revenues and Expenses:** The City's revenues have increased since FY 2012 and outpaced expenses most years. Governmental activities expenses exceeded revenues in FY 2020 due to the economic impacts of COVID-19, but the City took balancing measures to address the revenue shortfall in FY 2021.
- **Demographic and Economic Indicators:** Indicators related to the economic stability of the Berkeley community, including assessed value of property and personal income per capita, showed sustained strength over the audit period.
- **Net Position, Liquidity, and Reserves**: The City's net position has been negative due to unfunded pension and other post-employment benefit (OPEB) liabilities. The City maintained a strong liquidity ratio despite setting aside funds in the Stability and Catastrophic reserves. While the reserves helped address the shortfall caused by the pandemic, without a risk assessment of the reserves and plan for how to replenish them, the City may be less prepared for unforeseen economic challenges. Most enterprise funds have met the City's

requirement to balance since FY 2016, but the City does not have a policy outlining the target fund balance necessary for the funds to balance and avoid recurring annual shortfalls.

Long-Term

- **Long-Term Debt (excluding pension and OPEB):** Long-term liabilities have increased, but compared to benchmark cities, Berkeley's long-term liabilities per resident are in the middle range. General obligation bond debt has remained low compared to total taxable assessed property value, but general obligation debt per resident has increased and the City's debt policy does not have robust criteria to assess its debt capacity.
- **Pension and OPEB Liabilities:** Berkeley's unfunded liabilities for retiree benefits continue to pose a financial risk to the City. The City established a Section 115 Trust to pre-fund pension obligations, but has consistently fallen short of the annual contribution goal. Without a plan to ensure sufficient funding of the Section 115 Trust, the City may not be prepared to make its required CalPERS contributions.
- **Capital Assets:** The City is facing a reported $1.2 billion unfunded capital and deferred maintenance need as of FY 2021. Without a funding plan to reduce these needs, the City cannot address the current problem or prevent future unfunded capital needs.

BACKGROUND

This audit provides Berkeley residents, businesses, city management, and public officials with 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.

ENVIRONMENTAL SUSTAINABILITY

Our office manages and stores audit workpapers and other documents electronically to significantly reduce our use of paper and ink. Our audit recommendation to implement a funding plan to reduce the City's unfunded capital and deferred maintenance needs could also support more resilient and sustainable infrastructure and help advance the Vision 2050 effort.

RATIONALE FOR RECOMMENDATION

Implementing our recommendations will help the City address its unfunded capital and deferred maintenance needs and unfunded pension liabilities. Our recommendations will also help the City prepare for unforeseen economic challenges by assessing the risk of the reserves, and ensure that enterprise funds can balance and avoid recurring shortfalls. Additionally, our recommendation to update the City's debt policy will strengthen the City's ability to assess its general obligation debt capacity.

CONTACT PERSON

Jenny Wong, City Auditor, City Auditor's Office, 510-981-6750

Attachment: Audit Report: Berkeley's Financial Condition (FY 2012 – FY 2021): Pension Liabilities and Infrastructure Need Attention

Audit Report
May 5, 2022

Berkeley's Financial Condition (FY 2012-FY 2021): Pension Liabilities and Infrastructure Need Attention

BERKELEY CITY AUDITOR

Jenny Wong, City Auditor
Caitlin Palmer, Senior Auditor
Pauline Miller, Auditor I

Promoting transparency and accountability in Berkeley government

Berkeley's Financial Condition (FY 2012-FY 2021): Pension Liabilities and Infrastructure Need Attention

Report Highlights

May 5, 2022

Themes & Findings

Overall, Berkeley's near-term financial position is strong. However, the financial indicators related to the City's long-term outlook reveal some challenges that need to be addressed.

Near-Term

Revenues and Expenses: Since Fiscal Year (FY) 2012, revenues have grown and exceeded expenses in eight of the last ten fiscal years. Although expenses exceeded revenues in FY 2020 due to the COVID-19 pandemic, the City took budgetary actions to address the revenue shortfall.

Demographic and Economic Indicators: The Berkeley community showed sustained economic health overall. The taxable assessed value of property and personal income of Berkeley residents increased since FY 2012.

Net Position, Liquidity, and Reserves: The City has maintained a strong liquidity ratio, though the City's net position has been negative due to unfunded pension and other post-employment benefit (OPEB) liabilities. The City established the Stability and Catastrophic Reserves, and used a portion of those reserves to cover the General Fund deficit caused by the COVID-19 pandemic. All of the City's enterprise funds have experienced at least one annual shortfall over the past five years.

Long-Term

Long-Term Debt and Liabilities: Berkeley's long-term liabilities have increased since FY 2012, but compared to benchmark cities, Berkeley's long-term liabilities per resident are in the middle range. General obligation bond debt per resident has increased. Berkeley's general obligation bond debt has remained low compared to total taxable assessed property value, but the City's debt policy does not have robust criteria to assess debt capacity.

Net Pension and Other Post-Employment Benefits Liabilities: Like other California cities, Berkeley's unfunded liabilities for retiree benefits continue to pose a financial risk to the City. The California State Auditor considers Berkeley's pension funding ratio to be high risk. The City started setting aside resources dedicated to prefunding pension obligations in a Section 115 Trust, but has not met its annual contribution goals.

Continued on next page.

Objective

Our objective was to assess Berkeley's financial condition using indicators for the following categories:

1. Revenues and Expenses
2. Demographic and Economic Indicators
3. Net Position, Liquidity, and Reserves
4. Long-Term Debt and Liabilities
5. Net Pension and Other Post-Employment Benefit (OPEB) Liabilities
6. Capital Assets

Why This Audit Is Important

Financial condition analysis simplifies complex financial information to make it more accessible. By incorporating 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. This audit is especially relevant as the COVID-19 pandemic has underscored the importance of financial flexibility. During fiscal year 2021, the City faced a $40 million General Fund deficit and made difficult decisions to balance the budget.

BERKELEY CITY AUDITOR

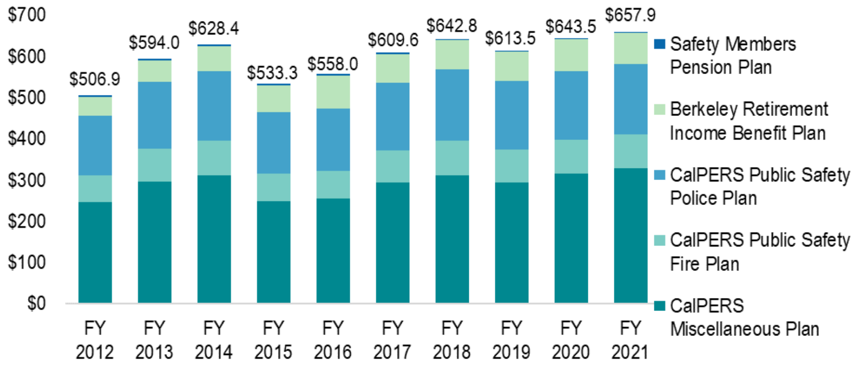
For the full report, visit: https://berkeleyca.gov/your-government/city-audits

Report Highlights

May 5, 2022

Themes & Findings

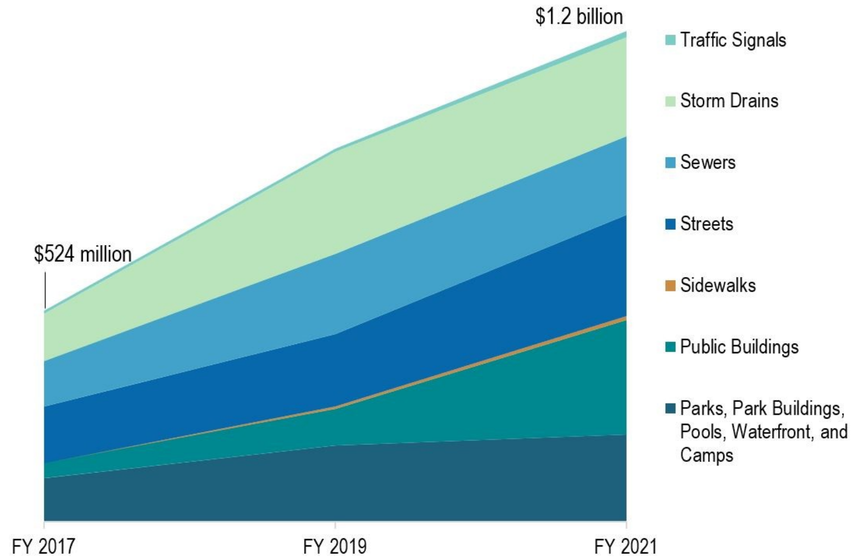
Net Pension Liability Per Plan (in millions, adjusted for inflation)



Source: Department of Finance data

Capital Assets: The City's underinvestment in infrastructure has led to a reported $1.2 billion unfunded capital and deferred maintenance need. Without sufficient investment now, these liabilities will continue to grow.

Unfunded Capital and Deferred Maintenance Needs FY 2017 to FY 2021 (adjusted for inflation)



Source: Berkeley's unfunded liability reports

Recommendations

To better prepare the City for unforeseen economic challenges, we recommend that the City Manager complete the risk assessment required by the City's reserves policy as scheduled and propose a plan to City Council to replenish the reserves.

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.

To strengthen the City's debt management, we recommend that the Finance Department update the Debt Management Policy.

To maximize the benefit of the Section 115 Trust for prefunding pension obligations, we recommend that the City Manager present a plan for adoption by the City Council to assure sufficient contributions to the Trust.

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 reducing the City's unfunded capital and deferred maintenance needs and ensuring regular maintenance of city assets to prevent excessive deferred maintenance costs in the future.

BERKELEY CITY AUDITOR

For the full report, visit:
https://berkeleyca.gov/your-government/city-audits

Table of Contents

Introduction

This audit provides Berkeley residents, businesses, city management, and public officials with a high-level overview of the City's long-term financial condition over 10 fiscal years (FY), from FY 2012 to FY 2021. 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. This report is designed to be easy to understand for readers without a background in finance.

Overall, Berkeley's near-term financial outlook is strong. However, in the long term, Berkeley faces difficult decisions related to future costs for employee pensions, other post-employment benefits (OPEB), and capital assets. Due to Berkeley's strong near-term financial condition, the City was able to address recent unexpected declines in revenues. In coming years, it will be important for the City to balance its near-term needs and long-term financial obligations.

Throughout the report, we compared some of Berkeley's financial indicators to other California cities with similar characteristics. Across almost all financial indicators that we benchmarked to peer cities, Berkeley is not an outlier and ranks at or near the middle of the range.

Objective, Scope, and Methodology

Our objective was to assess Berkeley's financial condition using financial indicators for the following categories:

1. Revenues and Expenses
2. Demographic and Economic Indicators
3. Net Position, Liquidity, and Reserves
4. Long-Term Debt and Liabilities
5. Unfunded Pension and Other Post-Employment Benefit (OPEB) Liabilities
6. Capital Assets

To meet our objective, we relied mainly on data from Berkeley's Annual Comprehensive Financial Reports (ACFRs).[1] For some indicators, we also analyzed other sources of city financial data. Where appropriate, we adjusted financial indicators for inflation using the Bay Area Consumer Price Index calculated by the U.S. Bureau of Labor Statistics to express values in 2021 dollars. We note where our findings are adjusted for inflation. We examined Berkeley's financial data for the past 10 fiscal years, from FY 2012 to FY 2021, except for a few indicators for which data was only available for limited years.

We used financial indicators included in the International City/County Management Association's (ICMA) *Evaluating Financial Condition* handbook for local governments. Additionally, we used one indicator developed by the California State Auditor's Office for their Fiscal Health of California Cities dashboard[2] as well as indicators used by peer cities in their financial condition audits. We do not provide an in-depth analysis of causes and impact, but we point out areas of financial risk for the City to evaluate further.

To better understand how some of Berkeley's financial indicators compared to peer cities, we benchmarked to California cities with some similar economic and social factors such as population, general fund expenditures per resident, services provided, and presence of a large university. We selected Davis, Long Beach, Oakland, Pasadena, Santa Clara, and Santa Monica because these cities are similar to Berkeley across one or more criteria. Due to variation in availability of comparison cities' FY 2021 ACFRs, we used FY 2020 data for the comparisons.

For more information on our methodology and data reliability assessment, see page 39.

[1] Berkeley's Annual Comprehensive Financial Reports are available on the Department of Finance website: https://berkeleyca.gov/your-government/financial-information/financial-reports-and-policies
[2] Fiscal Health of California Cities: https://www.auditor.ca.gov/local_high_risk/dashboard-csa

Background

According to the ICMA, a government's financial condition broadly refers to its ability to finance its services on an ongoing basis. Financial condition also refers to a government's ability to maintain current service levels, withstand unexpected economic downturns, and meet the changing needs of residents.

This audit considers Berkeley's many unique characteristics. Berkeley has the highest population density of any city in the East Bay. Berkeley's economy is shaped by the presence of the University of California, Berkeley campus, the high assessed value of property, relatively high personal income per capita, and a diverse tax base. The City provides residents a full range of services beyond those offered by most similarly-sized cities in California. The City offers its own public safety services; sanitation, sewer, and waste management services; parks, recreation, and the Berkeley Marina; health, housing, and community services, including city-funded health clinics and mental health services; animal control; public improvements; planning and zoning; general and administrative services; and library services. Berkeley is also a relatively older city and faces inherent challenges with aging infrastructure.

Financial Reporting Terms

Governmental and Business-Type Activities. *Governmental activities* are government functions that are supported mostly by taxes and intergovernmental revenues. Governmental activities fund city operations serving all Berkeley residents, including general government, public safety, transportation, community development, and culture and leisure. *Business-type activities* are the programs that operate like businesses, and are intended to cover all or a significant portion of their costs with user fees and charges for service. Examples of business-type activities include the Berkeley Marina, Zero Waste services, and the Permit Service Center. These services are supported by enterprise funds established to finance and account for the operation and maintenance of business-type activities. This audit report discusses business-type activities but mainly focuses on governmental activities.

Governmental Funds. For financial reporting purposes, most of the City's basic services are reported in its various governmental funds. The *General Fund* is the largest of all governmental funds and is the City's primary operating fund which pays for general services provided by the City. Other governmental funds include the General Grants Fund, the Library Fund, and the Capital Improvement Fund that are designated for specific purposes.

Financial Policies

City Council has developed guidelines to inform the budgeting process, and the Department of Finance has developed citywide financial management policies. An in-depth analysis of the City's compliance with fiscal policies was outside of the scope of this audit.

Council Guidelines:

1. Focusing on the long-term fiscal health of the City by adopting a two-year budget and conducting multi-year planning;
2. Building a prudent reserve;
3. Developing long-term strategies to reduce unfunded liabilities;
4. Controlling labor costs while minimizing layoffs;
5. Allocating one-time revenue for one-time expenses;
6. Requiring enterprise and grant funds to balance and new programs to pay for themselves;
7. Requiring new revenue or expenditure reductions along with any new expenditure;
8. Using Transfer Tax in excess of $12.5 million as one-time revenue for the City's capital infrastructure needs;
9. As the General Fund subsidy to the Safety Members Pension Fund declines over the next several years, using the amount of the annual decrease to help fund the new Police Employee Retiree Health Plan; and
10. Allocating short-term rental tax revenues exceeding the amount needed to pay for staffing to the Affordable Housing Trust Fund (66.7 percent) and the Civic Arts Grant Fund (33.3 percent).

Citywide Financial Management Policies:[3]

1. Investment Policy: Pooled Cash and Investment Policy
2. Investment Policy: Retiree Medical Plan Trust Funds
3. Debt Management and Disclosure Policy
4. General Fund Reserve Policy
5. With regard to spending, the City's policy is to spend restricted fund balances before spending unrestricted fund balances. This refers to expenditures incurred for which both restricted and unrestricted funds are available, and excludes cases in which a city ordinance or resolution specifies the fund balance.

[3] The City's policies related to investment, Retiree Medical Plan Trust funds, reserves, and debt management are available on the Finance Department's webpage: https://berkeleyca.gov/your-government/financial-information/financial-reports-and-policies

Revenues and Expenses

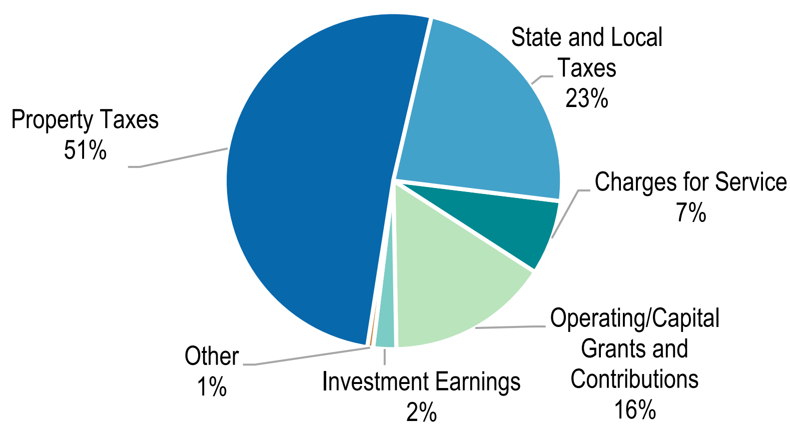
Revenues

Revenues refer to money available for appropriation during the fiscal year, including the money the City receives over the course of the year (new revenues) and balances carried over from prior years. Revenues determine the City's capacity to provide services. Ideally, revenues should come from stable and diverse sources, and should grow at the same rate or faster than inflation and expenses.

Where do revenues for Berkeley's governmental activities come from?

Taxes make up the majority of revenues used to fund governmental activities. In FY 2021, the largest source of revenues was property taxes. State and local taxes were the second largest source (Figure 1). Some of the City's tax revenues are set by other jurisdictions, which limits the City's ability to increase those taxes. For example, the City receives only 32.6 percent of Real Property Tax revenues collected by Alameda County. The rest is distributed between the county, schools, and special districts.

Figure 1. Revenues for Governmental Activities by Source, FY 2021

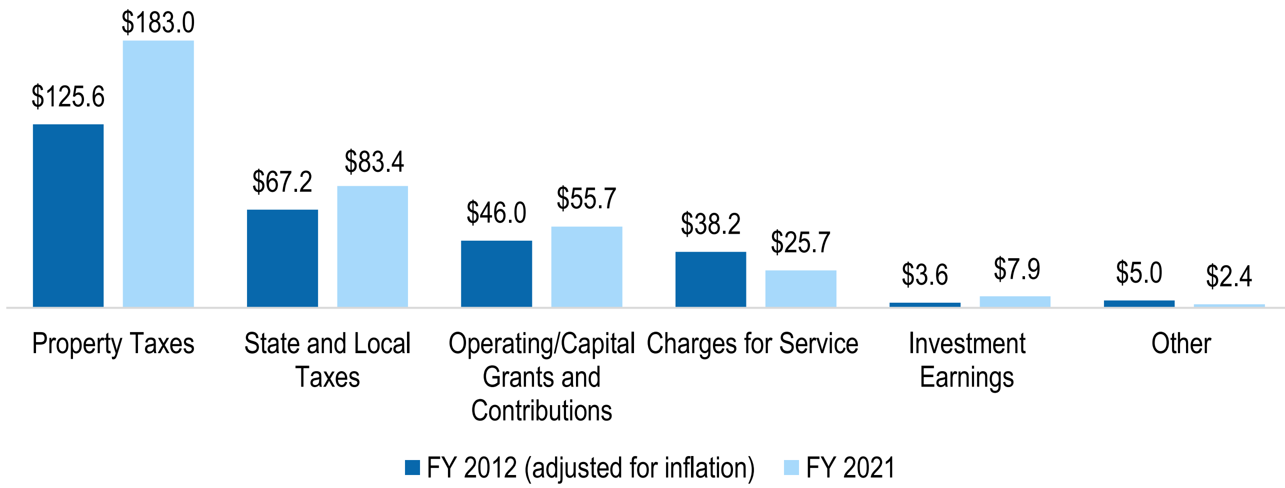


Note: "Other" includes revenues from contributions not restricted to specific programs, revenues (or losses) from the gain or loss on the sale of capital assets, miscellaneous revenues, and revenues from other unrestricted state subventions.

Source: Berkeley FY 2021 ACFR

Of all revenue streams, revenues from property taxes grew the most between FY 2012 and FY 2021, adjusted for inflation (Figure 2). Revenues from charges for services declined the most between FY 2012 and FY 2021.

Figure 2. Revenues for Governmental Activities by Source (in millions, adjusted for inflation)

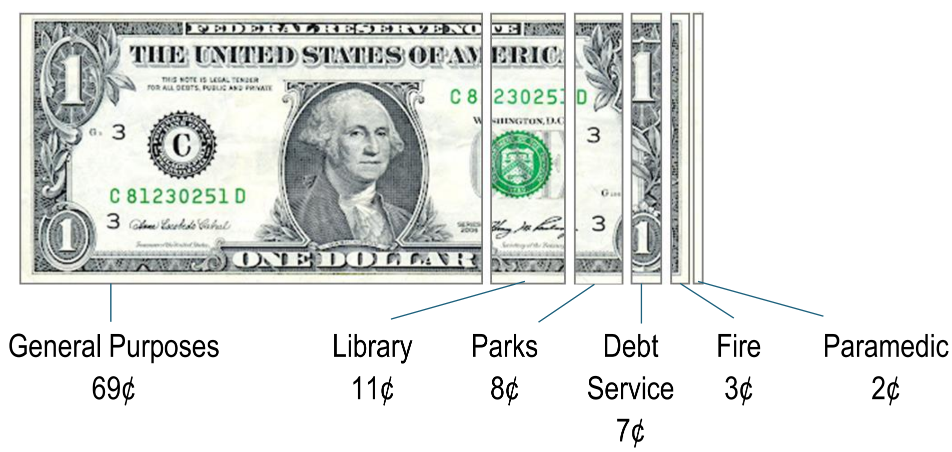


Note: "Other" includes revenues from contributions not restricted to specific programs, revenues (or losses) from the gain or loss on the sale of capital assets, miscellaneous revenues, and revenues from other unrestricted state subventions.

Source: Berkeley ACFRs

For every dollar of property tax revenue the City received in FY 2021, a portion was designated to general purposes, library services, city parks, debt service for voter-approved bond measures,[4] fire department services, and paramedic services (Figure 3).

Figure 3. Breakdown of Berkeley's Property Tax Revenues, FY 2021



Note: Figure 3 represents the portion of property taxes the City received, and does not account for taxes allocated to other jurisdictions.

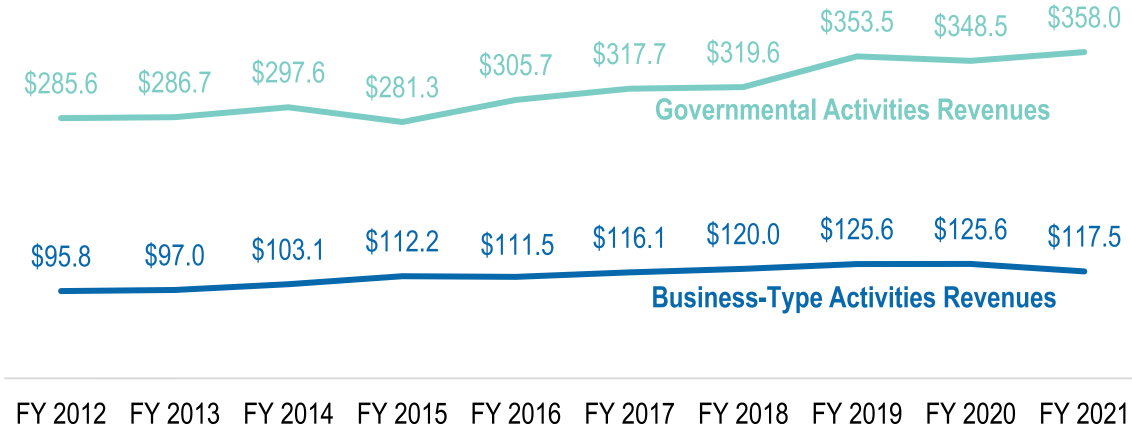
Source: Berkeley FY 2021 ACFR

[4] Bond measures include Measure FF, Measure M, Measure T1, Measure O, and Refunding Bonds.

Governmental activities revenues increased by 25 percent.

When adjusted for inflation, governmental activities revenues increased by 25 percent, from $285.6 million in FY 2012 to $358.0 million in FY 2021. Business-type revenues increased by 23 percent, from $95.8 million to $117.5 million (Figure 4). The City's total revenues grew by 25 percent.

Figure 4. Revenues (in millions, adjusted for inflation)

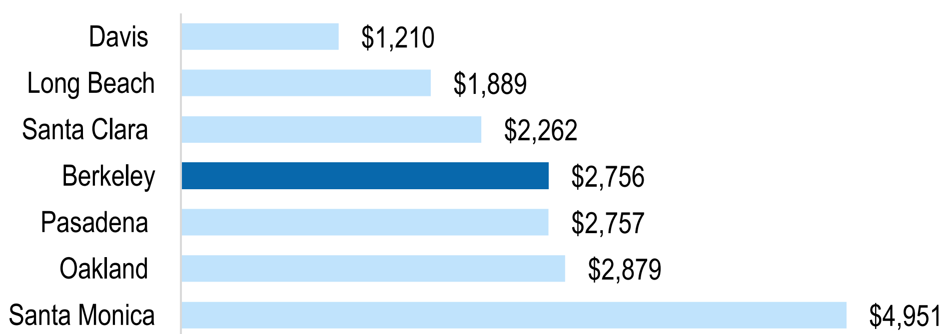


Source: Berkeley ACFRs

According to ICMA, as the population of a city increases, revenues should grow proportionately, resulting in near constant revenues per resident over time. A decline in revenues per resident would suggest that the City is unable to maintain service levels using existing revenues, but Berkeley's governmental activities revenues per resident have increased by 23 percent since FY 2012, adjusted for inflation.

Compared to benchmark cities, Berkeley's governmental activities revenues per resident were in the middle of the range at $2,756 per resident (Figure 5).

Figure 5. Revenues for Governmental Activities per Resident, FY 2020



Source: Cities' FY 2020 ACFRs

UC Berkeley has provided economic stability and revenue.

Berkeley is home to the main campus of the University of California (UC Berkeley), which provides a high degree of economic stability for the City. During the audit period, UC Berkeley brought an average of about 40,000 students to Berkeley each year. It was also one of the City's largest employers, employing an average of about 14,000 people each year. UC Berkeley students, employees, and visitors contribute to the local economy, though the COVID-19 pandemic caused UC Berkeley to temporarily stop in-person classes. Additionally, UC Berkeley has spurred growth in the technology and biotechnology sectors, which contribute to the diversity of the City's economy and helped lessen the economic impacts of the pandemic. The university presence also generates expenses for the City of Berkeley. In 2021, UC Berkeley agreed to pay the City $82.6 million over 16 years to support city expenses, including fire and other city services.

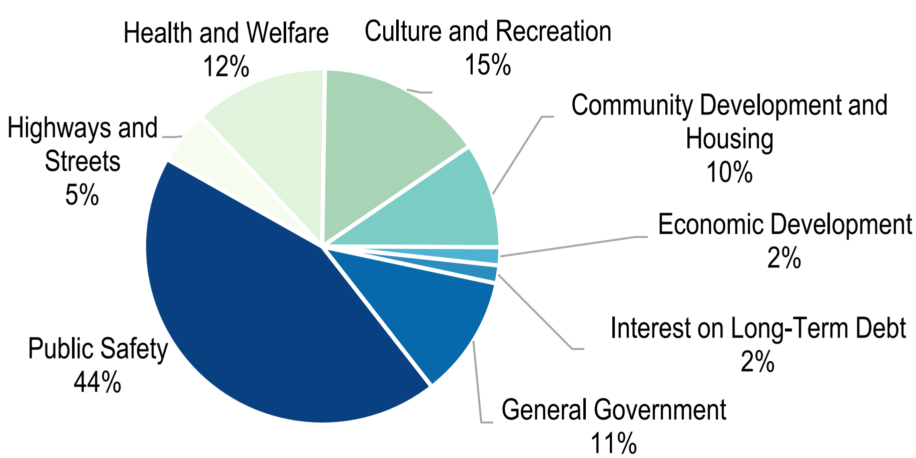
Expenses

Expenses refer to money the City records as spent each year. Expenses are a rough measure of the City's service output. Generally, the more services a city provides, the greater the city's expenses. Expense growth rates are a critical measurement of a city's ability to operate within its revenue constraints.

What does Berkeley spend on governmental activities?

In FY 2021, public safety, culture and recreation, and health and welfare represented the City's largest expenses by function (Figure 6).

Figure 6. Expenses for Governmental Activities by Function, FY 2021

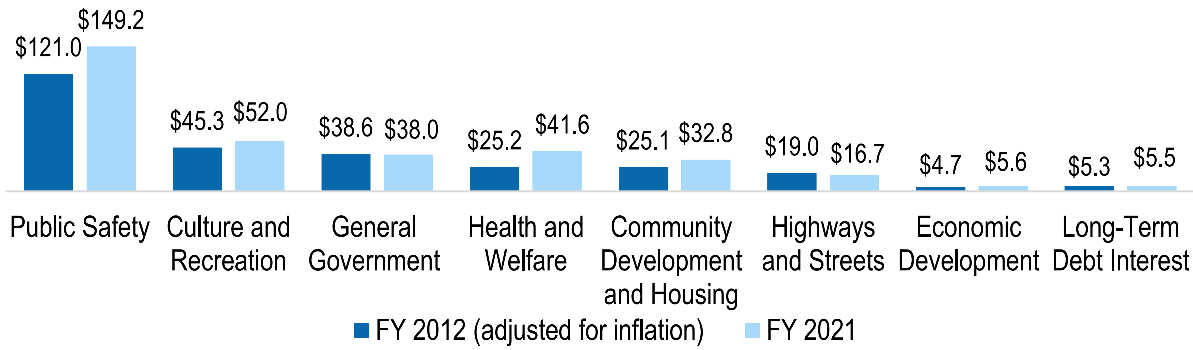


Source: Berkeley FY 2021 ACFR

The largest increase in spending for governmental activities was for public safety.

Between FY 2012 and FY 2021, the city functions with the largest increases in spending were public safety and health and welfare, when adjusted for inflation. Conversely, spending on highways and streets and general government decreased (Figure 7).

Figure 7. Expenses for Governmental Activities by Function (in millions, adjusted for inflation)

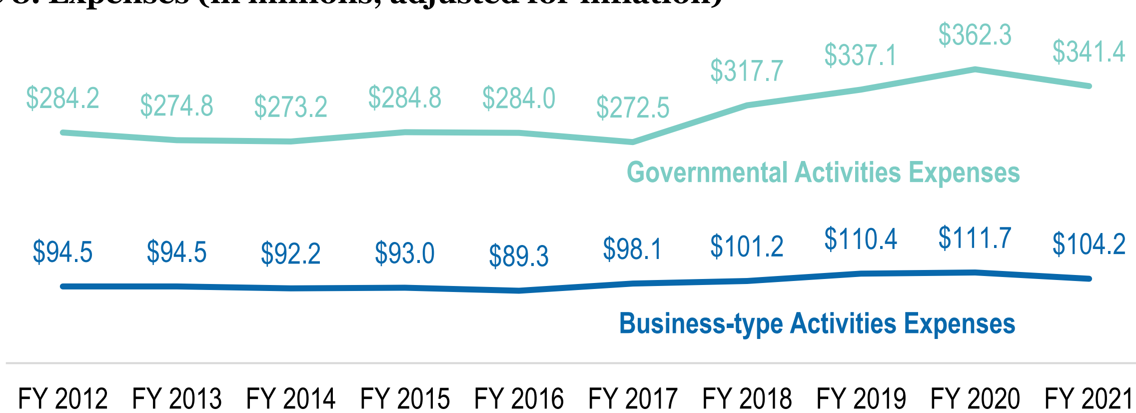


Source: Berkeley ACFRs

Governmental activities expenses increased by 20 percent.

Between FY 2012 and FY 2021, governmental activities expenses increased by 20 percent from $284.2 million to $341.4 million, adjusted for inflation. Expenses for business-type activities increased by 10 percent from $94.5 million to $104.2 million (Figure 8). The City's total expenses grew by 18 percent.

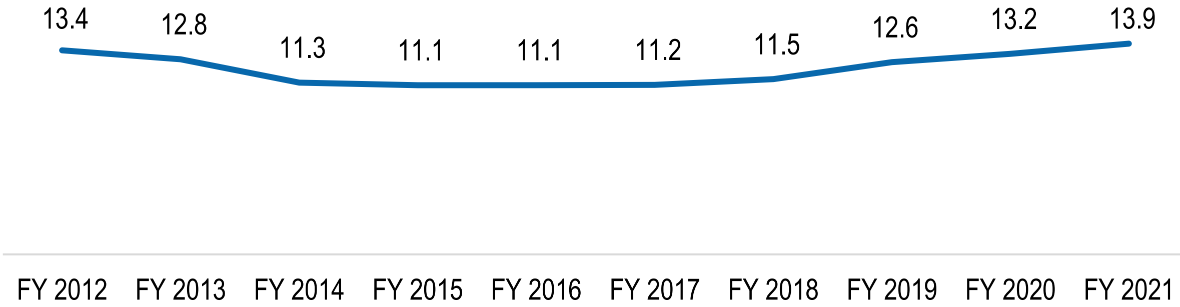
Figure 8. Expenses (in millions, adjusted for inflation)



Source: Berkeley ACFRs

According to ICMA, because personnel costs are a major portion of a local government's operating budget, tracking changes in the number of employees per capita is a good way to measure changes in costs. Between FY 2012 and FY 2021, the number of full-time equivalent employees per 1,000 residents increased slightly from 13.4 to 13.9, as shown in Figure 9.

Figure 9. Full-Time Equivalent City Employees per 1,000 Residents

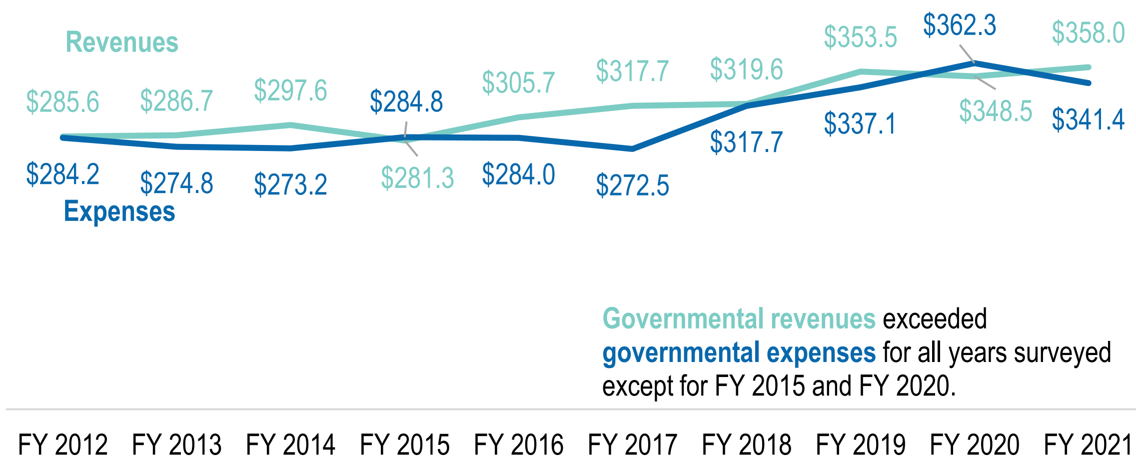


Source: Berkeley FY 2021 ACFR

The City's governmental activities revenues generally outpaced expenses.

According to ICMA, it is important to track whether governmental expenses grow faster than revenues to ensure that the City is able to fund all of its programs and services at the current level. Between FY 2012 and FY 2021, revenues for governmental activities exceeded expenses eight out of ten years (Figure 10).

Figure 10. Governmental Activities Revenues and Expenses (in millions, adjusted for inflation)



Source: Berkeley ACFRs

Governmental activities expenses exceeded revenues by the greatest amount in FY 2020, when the City issued the COVID-19 Risk Reduction Order. Expenses related to governmental activities exceeded diminished revenues by $13.7 million, adjusted for inflation. To address the revenue shortfall in FY 2021, the City took a number of actions including a hiring freeze, delaying spending on capital, reducing non-personnel expenditures, drawing on emergency reserves, reducing transfers to internal service funds, and suspending the Council policy to allocate Property Transfer Tax revenues in excess of $12.5 million to the Capital Improvement Fund.

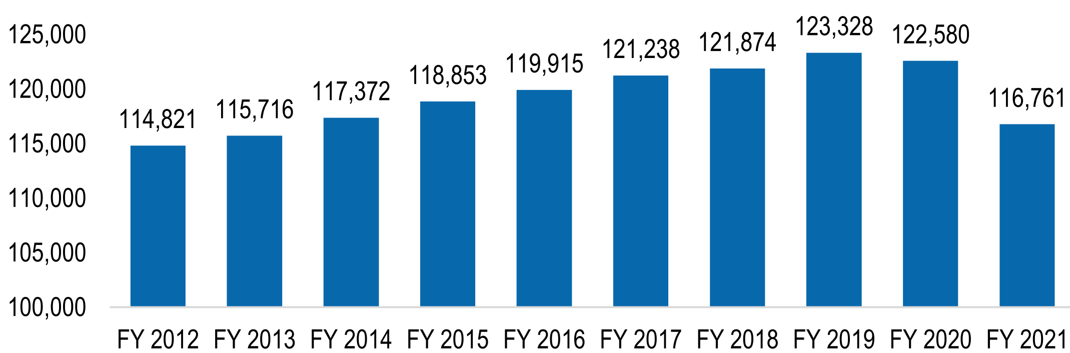
Demographic and Economic Indicators

Demographic and economic factors such as population, personal income, and taxable assessed property values reflect the strength of the City's tax base and residents' overall ability to contribute to city revenues through taxes. Similarly, the unemployment rate sheds light on the local economy and the strength of the City's revenue base. These factors also affect the types of city services the community needs.

Population

For the most part, Berkeley's population increased during the audit period. However, in fiscal years 2020 and 2021, the population declined (Figure 11). This decrease coincided with the COVID-19 pandemic and may be due to temporary relocation of students or other Berkeley residents.

Figure 11. Population



Source: Berkeley FY 2021 ACFR

The City's Unemployment rate improved in FY 2021.

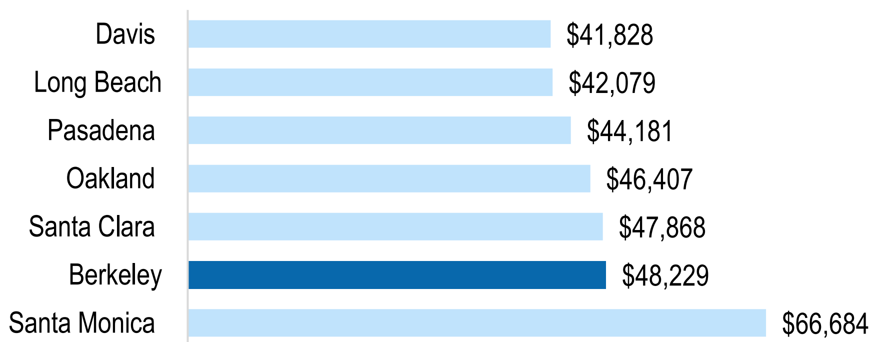
The City's unemployment rate reflects changes in personal income, which affect the community's ability to generate tax revenues. Berkeley's unemployment rate declined from 9.0 percent in FY 2012 following the 2007-2009 recession to 3.1 percent in FY 2019. By FY 2020, the City's unemployment rate increased to 13.5 percent. This spike in unemployment is due to the COVID-19 pandemic beginning in March 2020 and risk reduction orders that limited economic activity. Unemployment is expected to decrease as the economy recovers. According to the California Employment Development Department (EDD), Berkeley's unemployment rate in June 2021 was 5.5 percent, a sign of economic recovery. For comparison, the Oakland-Hayward-Berkeley metropolitan area unemployment rate as of June 2021 was 6.8 percent.

Personal income per resident has grown since FY 2012.

Personal income per resident is a key component of a City's financial condition because it is a measure of a community's ability to pay taxes. Between FY 2012 and FY 2021, the average personal income of Berkeley residents increased 11 percent from $45,794 per resident to $50,619 per resident, adjusted for inflation.

In FY 2020, Berkeley's personal income per resident was higher than all but one benchmark city (Figure 12).

Figure 12. Personal Income per Resident, FY 2020



Note: Oakland's 2020 ACFR uses a personal income figure based on the San Francisco-Oakland-Hayward Metropolitan Statistical Area. We used the most recent census data available to estimate Oakland's personal income per resident.

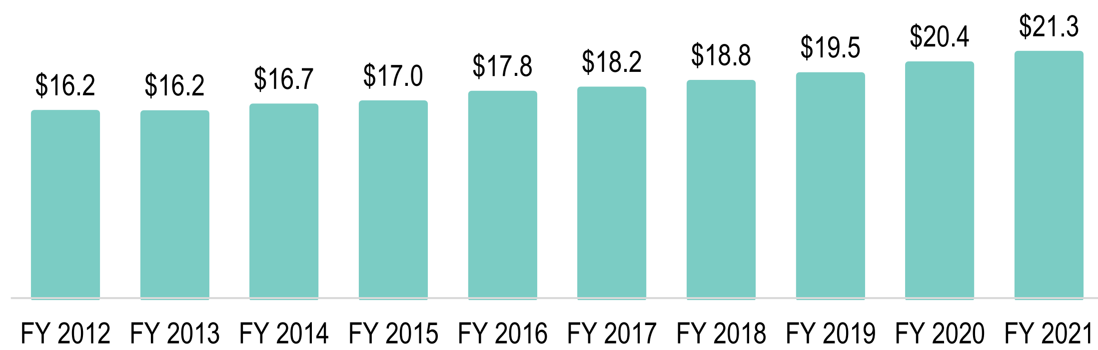
Source: Cities' FY 2020 ACFRs, Santa Monica FY 2021 ACFR, U.S. Census Bureau

Property values have been a strong and growing source of city revenues.

Property values are integral to Berkeley's overall financial health. Growth in taxable assessed property value corresponds to growth in property tax revenues because property taxes are based on a percentage of the assessed value of property.

Berkeley has benefited from growing taxable assessed property values. Between FY 2012 and FY 2021, the assessed value of taxable property in Berkeley increased by 32 percent, from $16.2 billion to $21.3 billion, adjusted for inflation (Figure 13).

Figure 13. Total Taxable Assessed Property Value (in billions, adjusted for inflation)



Source: Berkeley FY 2021 ACFR

Berkeley's taxable assessed property values did not decrease during the 2007-2009 recession nor the COVID-19 pandemic, which suggests that Berkeley's taxable assessed property values have been generally less affected by economic downturns than some other cities. Additionally, Berkeley has a high collection rate for property taxes. Between FY 2012 and FY 2021, the collection rate for taxes levied on property fluctuated between 97 percent and 99 percent.

Net Position, Liquidity, and Reserves

Net position measures the difference between the City's assets (what it owns) and its liabilities (what it owes). Net position reflects a government's financial condition at a point in time, and can be thought of as the City's remaining resources after its debts are accounted for.

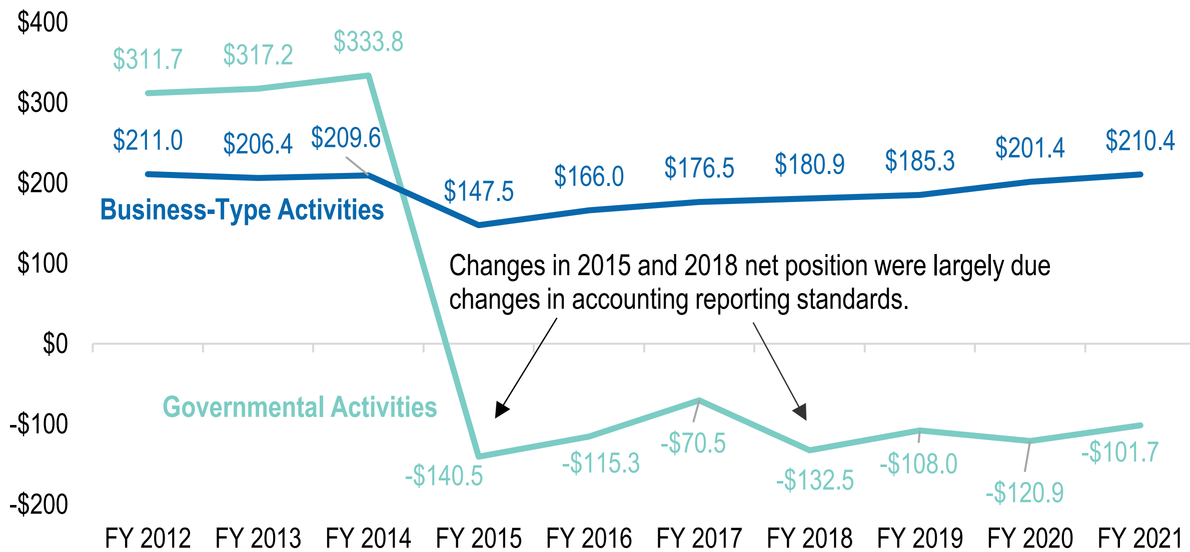
Liquidity measures a government's ability to balance its budget and pay its bills on time. It generally refers to the City's cash position, which includes cash on hand and in the bank, as well as other assets that can easily be converted into cash. Liquidity tells us about the City's ability to pay its short-term obligations, while net position represents a longer-term view of the City's financial condition because it includes assets not easily converted into cash. These concepts are connected because declining or low liquidity, or a cash shortage, may be the first sign that a government has overextended itself in the long run.

Reserves are funds set aside for future use and are built through the accumulation of operating surpluses. Strong reserves allow cities to weather economic downturns more effectively, manage the consequences of outside agency actions that may result in revenue reductions, and address unexpected emergencies like natural disasters and other catastrophic events such as pandemics.

The City's net position related to governmental activities has been negative due to unfunded liabilities.

Between FY 2012 and FY 2021, Berkeley's net position related to governmental activities changed from \$311.7 million to -\$101.7 million, adjusted for inflation (Figure 14). In FY 2015, a change in Governmental Accounting Standards Board (GASB) standards required government entities to report the total long-term cost of pension benefits as a liability in their annual financial reports. In FY 2018, another change in GASB accounting standards required government entities to also report the total long-term cost of other post-employment benefits (OPEB) as a liability in their annual financial reports. As a result of these changes in standards, Berkeley's reported net position declined significantly in those years.

Figure 14. Net Position (in millions, adjusted for inflation)



Source: Berkeley ACFRs

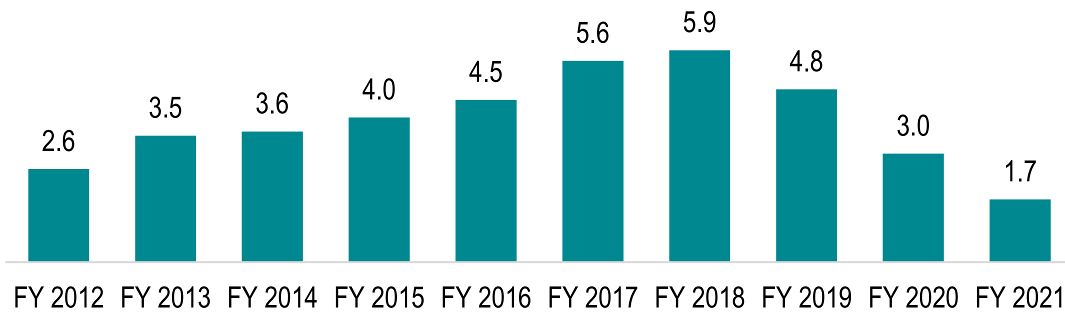
The accounting standards that changed in fiscal years 2015 and 2018 did not materially alter the City's financial condition. Rather, the City started including its pension and OPEB liabilities in its net position calculations in the ACFR. The City's net position will likely remain negative in coming years if the City's unfunded pension and OPEB liabilities continue to grow. Pension and OPEB liabilities are covered in more depth starting on page 28.

Berkeley's liquidity ratio is strong, but has declined since FY 2018.

The *liquidity ratio*, otherwise known as cash position, measures the City's ability to pay its short-term obligations. According to ICMA, the ratio is calculated by dividing cash and short-term investments (assets that can be easily converted to cash) by current liabilities (short-term obligations). A liquidity ratio of greater than one would indicate that cash and short-term investments exceed current liabilities. A ratio of one or less than one would be considered a cause for concern, particularly if this trend persists for more than three years.

Overall, Berkeley's liquidity ratio has remained positive from FY 2012 to FY 2021. Berkeley's liquidity ratio more than doubled from FY 2012 to FY 2018, then began to decline, from 5.9 in FY 2018 to 1.7 in FY 2021 (Figure 15).

Figure 15. Liquidity Ratio of Current Assets to Current Liabilities



Source: Berkeley ACFRs

According to the Department of Finance, the recent decline in the liquidity ratio is partly due to setting aside funds for reserves and a recent influx of federal funding. The City established reserves in FY 2017, which restricted a portion of funds and reduced the amount of available cash. Additionally, in FY 2021, the City received $33.3 million in federal aid through the American Rescue Plan, which was accounted for as an unearned revenue liability.

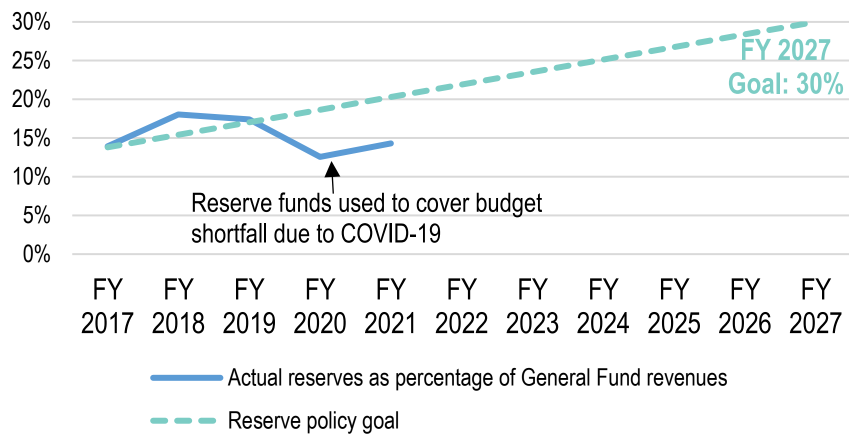
While the decrease in the liquidity ratio since FY 2017 suggests that Berkeley's capacity to pay its bills in the short-term has declined over time, the liquidity ratio does not capture all of the funds the City has to pay its bills.

The COVID-19 pandemic slowed the City's progress toward its 2027 reserve funding goal.

In FY 2017, the City created the Catastrophic Reserve and the Stability Reserve following a city audit of the General Fund reserve policy. The Catastrophic Reserve is intended to support General Fund operations in the event of a public emergency defined as extreme, one-time events, such as an earthquake, fire, flood, civil unrest, terrorist attack, public health emergencies, and pandemics. The Stability Reserve is intended to help the City maintain services and reduce financial risks associated with unexpected revenue shortfalls during a single fiscal year or prolonged period of recession.

Based on current trends, the City is not on track to meet the reserve balance goal of 30 percent of General Fund revenues by FY 2027 as set by the City's reserve policy. As shown in Figure 16, the City was meeting its reserve goals in FY 2017 through FY 2019. However, the City fell off track in FY 2020 because it borrowed from both reserves to balance a General Fund deficit caused by the impact of COVID-19 on city revenues.

Figure 16. Actual Reserves Compared to Reserve Goal



Note: The graph does not represent the policy's intermediate goal of 16.7 percent because the purpose is to show a possible path from the start of the reserves to the long-term goal.

Source: Year-End Results and First Quarter Budget Update Reports

To cover the General Fund deficit, the City borrowed $6.9 million from the Stability Reserve and $4.5 million from the Catastrophic Reserve. The City repaid $3.3 million dollars in FY 2021. The City does not currently have a plan for how to meet its FY 2027 reserve goal.

The General Fund reserve policy states that City Council may consider increasing or lowering the level of reserves based on a risk assessment to be updated at least every five years. Since the reserves were established in FY 2017, the first risk assessment would be due in FY 2022.

All of the City's enterprise funds faced at least one annual shortfall between FY 2016 and FY 2021.

Business-type activities include the City's enterprise funds. *Enterprise funds* are funds that the City uses to account for the operation and maintenance of facilities and services, and are mainly supported by user charges.

The City's budgets provide summaries of fund balances for all enterprise funds except for Building Purchases and Management.[5] The City Council's current policy states that enterprise funds are required to balance. Fund balances are the net of expenditures and revenues. For a fund to be considered balanced, revenues should be equal to or greater than expenditures.

[5] Ending fund balances for fiscal years 2016 through 2020 reflect actuals, while the ending fund balance for FY 2021 reflects the adopted budget amount from the FY 2022 budget.

This section presents an overview of summaries from city budgets. A detailed analysis of individual enterprise funds was outside of the scope of this audit. For an overview of the City's enterprise funds, see Appendix I.

The Permit Service Center Fund has faced annual shortfalls in three of the most recent six years (Table 1). The fund's recovery will depend on economic recovery from the COVID-19 pandemic.

Table 1. Permit Service Center Fund Balance, FY 2016 - FY 2021

	FY 2016	FY 2017	FY 2018	FY 2019	FY 2020	FY 2021
Beginning Balance	$12,617,224	$11,233,859	$11,516,323	$12,777,977	$12,643,651	$15,398,407
Ending Balance	$11,233,859	$11,516,329	$12,777,853	$12,643,651	$15,398,407	$12,070,511
Surplus/(Shortfall)	($1,383,365)	$282,470	$1,261,530	($134,326)	$2,754,756	($3,327,896)

Source: Berkeley's budgets

The Sanitary Sewer Fund has faced annual shortfalls in two of the most recent six years (Table 2). Factors that contribute to depressed revenues include drought conditions and water conservation efforts. Additionally, the upcoming Sanitary Sewer Master Plan will determine if future rate increases are needed.

Table 2. Sanitary Sewer Fund Balance, FY 2016 - FY 2021

	FY 2016	FY 2017	FY 2018	FY 2019	FY 2020	FY 2021
Beginning Balance	$7,897,389	$5,309,962	$9,203,590	$13,203,977	$26,027,896	$25,918,159
Ending Balance	$5,309,962	$9,203,575	$13,203,975	$26,027,896	$25,918,159	$29,898,141
Surplus/(Shortfall)	($2,587,427)	$3,893,613	$4,000,385	$12,823,919	($109,737)	$3,979,982

Source: Berkeley's budgets

The Zero Waste Fund faced one annual shortfall in FY 2021 (Table 3). A rate study is in progress to determine if increases are needed moving forward.

Table 3. Zero Waste Fund Balance, FY 2016 - FY 2021

	FY 2016	FY 2017	FY 2018	FY 2019	FY 2020	FY 2021
Beginning Balance	$5,566,976	$11,403,226	$13,664,122	$17,677,642	$20,079,053	$24,358,287
Ending Balance	$11,403,226	$13,677,397	$17,677,654	$20,079,053	$24,358,287	$22,996,702
Surplus/(Shortfall)	$5,836,250	$2,274,171	$4,013,532	$2,401,411	$4,279,234	($1,361,585)

Source: Berkeley's budgets

The Parking Meter Fund has faced annual shortfalls in two of the most recent six years (Table 4). The pandemic had an immediate and severe impact on parking meter revenues. Fund recovery will depend on the length of the pandemic and economic recovery.

Table 4. Parking Meter Fund Balance, FY 2016 - FY 2021

	FY 2016	FY 2017	FY 2018	FY 2019	FY 2020	FY 2021
Beginning Balance	$5,241,583	$5,379,078	$5,683,946	$3,270,420	$4,990,946	$3,208,091
Ending Balance	$5,379,078	$5,683,942	$3,270,432	$4,990,946	$3,208,091	$4,629,330
Surplus/(Shortfall)	$137,495	$304,864	($2,413,514)	$1,720,526	($1,782,855)	$1,421,239

Source: Berkeley's budgets

The Marina Fund faced annual shortfalls in three of the most recent six years (Table 5). The COVID-19 pandemic significantly worsened the fund's revenue outlook, as lease revenues from hotel, restaurant, and commercial tenants greatly decreased.

Table 5. Marina Fund Balance, FY 2016 - FY 2021

	FY 2016	FY 2017	FY 2018	FY 2019	FY 2020	FY 2021
Beginning Balance	$2,709,368	$3,640,031	$3,998,848	$3,058,152	$3,503,847	$3,151,777
Ending Balance	$3,640,031	$3,999,406	$3,058,161	$3,503,847	$3,151,777	$2,597,486
Surplus/(Shortfall)	$930,663	$359,375	($940,687)	$445,695	($352,070)	($554,291)

Source: Berkeley's budgets

The Off-Street Parking Fund faced annual shortfalls in two of the three most recent years (Table 6). The Center Street garage reopened in FY 2019 after two years of construction and was subsequently impacted by revenues losses associated with the pandemic. Fund recovery will depend on the length of the pandemic and economic recovery.

Table 6. Off-Street Parking Fund Balance, FY 2016 - FY 2021

	FY 2016	FY 2017	FY 2018	FY 2019	FY 2020	FY 2021
Beginning Balance	missing	missing	missing	$9,342,477	$2,235,776	($1,215,101)
Ending Balance	missing	missing	missing	$2,235,776	($1,215,101)	($106,157)
Surplus/(Shortfall)	missing	missing	missing	($7,106,701)	($3,450,877)	$1,108,944

Source: Berkeley's budgets

In fiscal years 2020 and 2021, the Off-Street Parking Fund was unable to balance, as reflected in the negative ending fund balance (Table 6). According to the Budget Office, if a shortfall exists, revenues can be supplemented with the existing fund balance, and if funds are unable to balance, they become a General Fund liability. The Budget Office stated that they work with departments that manage enterprise funds during the budget process and throughout the year to ensure the funds do not face recurring shortfalls. However, the City does not have a policy outlining the target fund balance necessary to balance enterprise funds and avoid recurring annual shortfalls. Without targets, it is difficult to assess the financial condition of each enterprise fund.

Recommendations

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.

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.

Long-Term Debt and Liabilities

Not Including Pension and Other Post-Employment Benefit Liabilities

Why do local governments take on long-term debt?

Debt financing can be a reasonable strategy for local governments, as it allows cities to borrow to pay for large infrastructure initiatives. Additionally, since infrastructure like streets and public buildings are used over multiple decades, borrowing spreads the cost burden over time so that taxpayers who will benefit from the asset now and in the future can help pay for it.

While financing projects through debt spreads costs over time, it commits the City to pay fixed debt service[6] costs for many years. Decisions around debt also affect the Berkeley community. Debt impacts homeowners and businesses who pay the cost of debt through taxes on property and renters who may face higher rents passed down as a result of increased taxes on property. Like many financial decisions local governments make, issuing long-term debt requires a careful review of tradeoffs. For Berkeley, unfunded capital and deferred maintenance needs are an important consideration, as deferred investments in infrastructure assets can mean higher costs down the line.

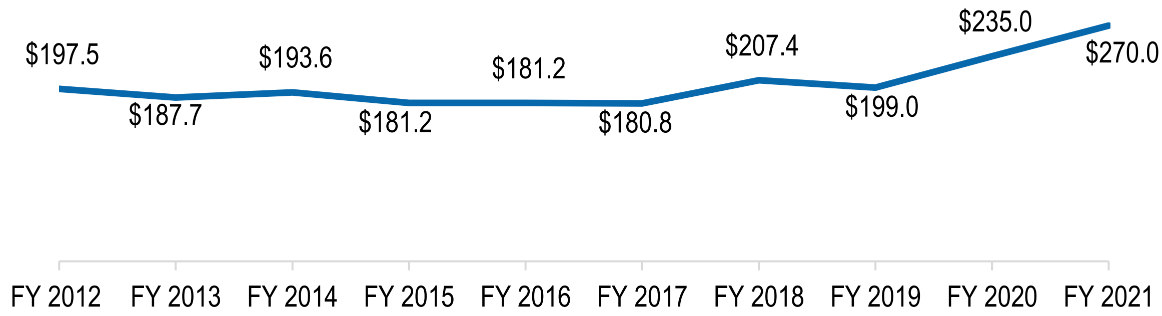
What are long-term liabilities?

An accounting *liability* is an obligation to make a payment in the future as a result of a past event. Long-term liabilities include debts, in addition to other long-term obligations like accrued vacation and sick leave, accrued workers' compensation claims and judgments, and accrued public liability claims and judgments. Long-term liabilities can include unfunded pension and other post-employment benefits (OPEB), but they are not included in this section and instead covered in depth on page 28.

Between FY 2012 and FY 2021, the City's total long-term liabilities (excluding pension and OPEB) increased from \$197.5 million to \$270.0 million, adjusted for inflation (Figure 17).

[6] *Debt service* is the set of payments including principal and interest that is required to be made through the life of the debt.

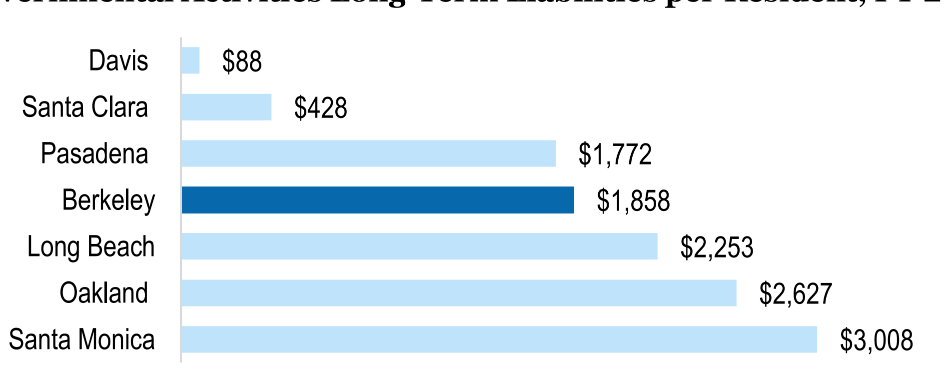
Figure 17. Governmental Activities Long-Term Liabilities (in millions, adjusted for inflation)



Source: Berkeley ACFRs

Compared to benchmark cities, Berkeley is not an outlier. Cities' total long-term liabilities for governmental activities ranged from $88 per resident to $3,008 per resident in FY 2020. Berkeley's long-term liabilities were in the middle of that range at $1,858 per resident (Figure 18).

Figure 18. Governmental Activities Long-Term Liabilities per Resident, FY 2020

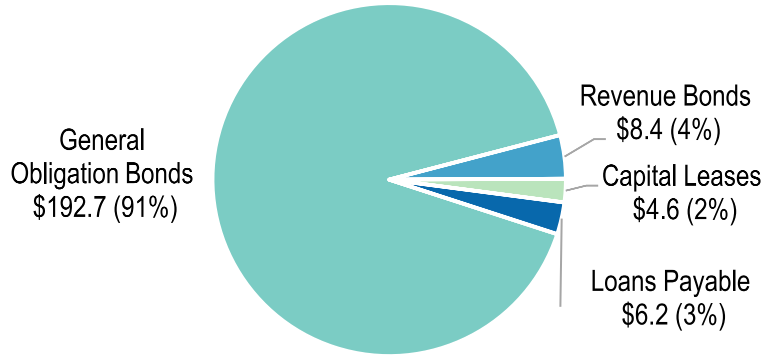


Source: Cities' FY 2020 ACFRs

Debt by Type

The City has a variety of debt instruments used primarily to finance acquisition and construction of capital facilities projects and equipment needs. Ninety-one percent of Berkeley's debt comes from general obligation bonds (Figure 19). These are bond measures that must have at least two-thirds voter approval to pass. The City's current general obligation bonds include Measure T1, a loan to fund infrastructure and facilities; Measure M, a loan to fund street paving and greening infrastructure projects; and Measure O, a loan to fund low income housing. The remaining nine percent of Berkeley's debt comes from revenue bonds, capital leases, and loans payable (Figure 19).

Figure 19. Governmental Activities Debt by Type, FY 2021



Source: Berkeley FY 2021 ACFR

Berkeley's general obligation bond ratings have been consistently favorable and improved in FY 2019.

The City's overall debt standing is reflected in its strong bond ratings. Bond ratings issued by credit agencies are a measure of the certainty that the City will pay all interest and principal owed to investors. The higher the bond rating, the lower the cost of borrowing; the lower the cost of borrowing, the more savings the City can pass on to taxpayers. The City's general obligation bond ratings from Standard and Poor's remained at its second highest rating of AA+ over the audit period. The City's general obligation bond ratings from Moody's were Aa2, the third highest bond rating offered by Moody's, before they increased to Aa1 in FY 2019 (Table 7).

Table 7. Berkeley's General Obligation Bond Ratings

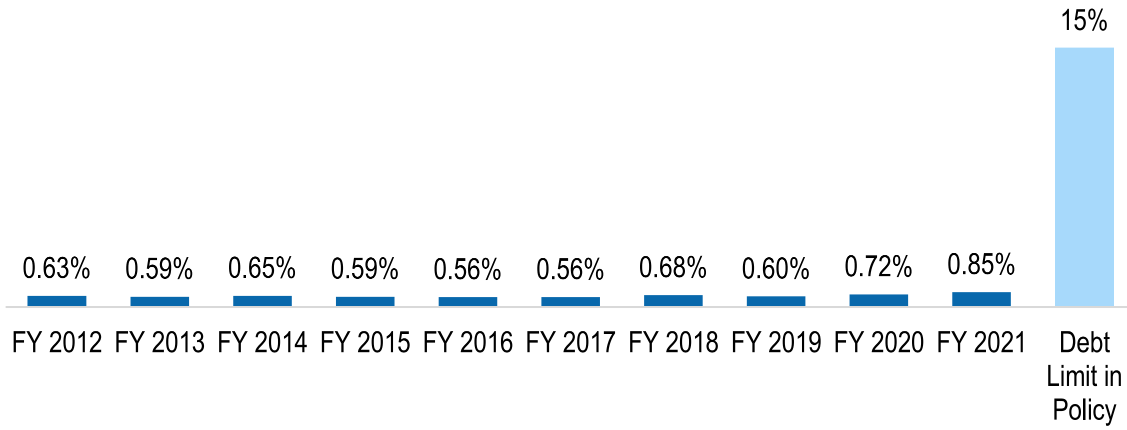
	FY 2012	FY 2013	FY 2014	FY 2015	FY 2016	FY 2017	FY 2018	FY 2019	FY 2020	FY 2021
S&P's Rating	AA+	AA+	AA+	AA+	AA+	AA+	AA+	AA+	AA+	AA+
Moody's Rating	Aa2	Aa2	Aa2	Aa2	Aa2	Aa2	Aa2	Aa1	Aa1	Aa1

Source: Berkeley ACFRs

The City's general obligation bond debt remained under one percent of taxable assessed property value.

In 2017, Berkeley established a debt policy that sets a debt capacity limit for its general obligation bonds at 15 percent of taxable assessed value of property. Over the audit period, the City's general obligation bond debt has remained below one percent of taxable assessed property value (Figure 20), which is significantly lower than the City's current threshold of 15 percent.

Figure 20. General Obligation Bond Debt as a Proportion of Taxable Assessed Property Value



Source: Berkeley FY 2021 ACFR

General obligation bond debt per resident has grown but payments for existing debt will peak in FY 2024.

Another way to track the burden of a City's debt is through the change in debt per resident over time. Most of Berkeley's bonded debt comes from general obligation bonds. General obligation bond debt is repaid through taxes on property.

Since FY 2012, Berkeley voters have passed three general obligation bond measures authorizing the City to borrow a total of $265 million. Of that authorized $265 million, the City currently has $117 million in unissued debt for Measure T1 and Measure O that it plans to issue in the coming years, which will be added to the City's total debt.

Between FY 2012 and FY 2021, the City's general obligation bond debt per resident increased from $893 to $1,559 per resident, adjusted for inflation (Table 8).

Table 8. Outstanding General Obligation Debt per Resident (adjusted for inflation)

Fiscal Year	General Obligation Bonded Debt per Resident	Debt Issued	Bond Measure
2012	$ 893		
2013	$ 830		
2014	$ 920	$ 15,000,000	Measure M
2015	$ 850		
2016	$ 832	$ 15,000,000	Measure M
2017	$ 848	$ 35,000,000	Measure T1
2018	$ 1,043		
2019	$ 951		
2020	$ 1,203	$ 38,000,000	Measure O
2021	$ 1,559	$ 45,000,000	Measure T1

Note: This figure does not include the $117 million authorized by voters but not yet issued by the City.

Source: Berkeley FY 2021 ACFR, Department of Finance data

According to projections in the FY 2021 ACFR, the amount of debt service for existing debt will peak in 2024 and decline until it is paid off in 2052 (Table 9). Residents of Berkeley also face debt obligations from other jurisdictions not administered by the City, including three current general obligation bonds issued by the Berkeley Unified School District.

Table 9. Remaining Scheduled Debt Service on Outstanding General Obligation Debt (in millions)

Fiscal Year	Scheduled Debt Service	Fiscal Year	Scheduled Debt Service
2022	$10.8	2038	$9.2
2023	$12.5	2039	$8.8
2024	$12.7	2040	$8.8
2025	$11.8	2041	$7.4
2026	$11.8	2042	$7.4
2027	$11.8	2043	$7.5
2028	$11.8	2044	$7.5
2029	$10.9	2045	$6.6
2030	$9.7	2046	$6.6
2031	$9.2	2047	$6.6
2032	$9.2	2048	$5.7
2033	$9.2	2049	$4.0
2034	$9.2	2050	$4.0
2035	$9.2	2051	$4.0
2036	$9.2	2052	$2.0
2037	$9.2		

Note: This table represents a snapshot of the City's debt service payments based on the amount of general obligation bond debt in FY 2021. This table does not include the $117 million in authorized general obligation bonds that the City plans to issue by 2026.

Source: Berkeley FY 2021 ACFR

According to the Finance Director, the City is planning to issue an additional $40 million in Measure O bonds in FY 2022. Once the City has issued this amount, the City will have a remaining balance of $77 million in unissued bond debt from Measure O and Measure T1. The City plans to issue this remaining authorized amount between FY 2024 and FY 2026. This additional debt will affect the amount of general obligation bond debt per resident and the schedule of future debt service payments.

The City's limit for general obligation bond debt is set at 15 percent of total assessed property value.

As of FY 2021, the estimated total taxable assessed value of property in Berkeley was $21.3 billion. Since the City sets its threshold for general obligation bond debt at 15 percent of assessed property value, the most recent general obligation bond debt limit was $3.2 billion dollars. Based on the current policy, the City is permitted to borrow a remaining $3.0 billion dollars in addition to its current debt.

According to the Government Finance Officers Association (GFOA), appropriate debt limits can have a positive impact on bond ratings, especially if they are adhered to over time. GFOA states that limits on debt can be set according to debt per capita, debt to personal income, debt to taxable property value, and debt service payments as a proportion of general fund revenues or expenditures. In its 2021 general obligation rating report, Standard and Poor's noted the City has a basic debt policy that includes some quantitative limits but does not include robust quantitative measures or benchmarks. While Berkeley's policy does consider the ratio of debt to taxable assessed value of property, it does not evaluate any additional factors used by some other cities to assess their debt capacity. For example, the City of Santa Monica's general obligation debt limit is based on two of GFOA's measures of affordability: debt per capita and debt as a percentage of assessed property value (Santa Monica sets this threshold at 10 percent). If Berkeley does not consider more robust quantitative metrics to assess its general obligation debt capacity, the City may overlook important considerations in determining a manageable level of debt.

Recommendations

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.

Net Pension and Other Post-Employment Benefit (OPEB) Liabilities

What is a net pension or OPEB liability?

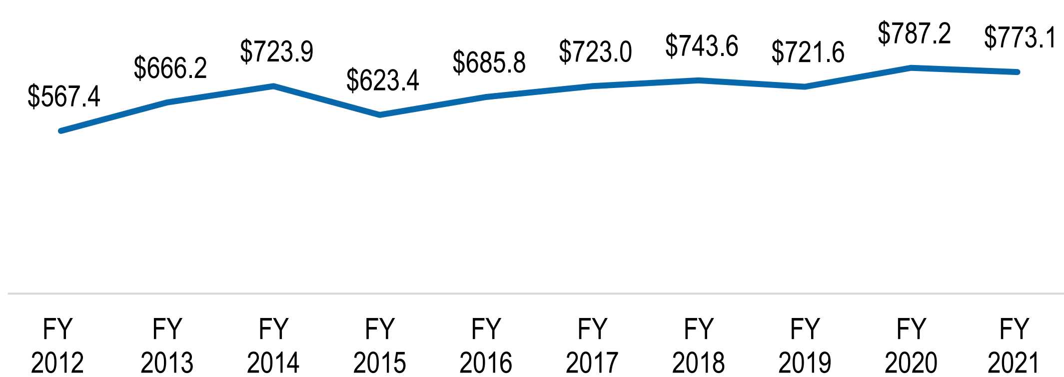
Berkeley contributes to various employee retirement benefit plans including the California Public Employees Retirement System (CalPERS). These benefits are earned by employees each year to be paid out after they retire. If the estimated cost of benefits exceeds the value of the assets that have been set aside to pay for those benefits, a net pension or net OPEB liability exists. The *net pension liability* or *net OPEB liability* as reported in the City's financial documents is the unfunded portion of the City's total pension or OPEB liability, also referred to as an unfunded liability.

Pension and OPEB contributions can place significant pressure on a city's budget. Additionally, some factors, such as yearly required contributions for CalPERS plans are set by CalPERS and are outside the City's control, posing a widespread challenge for California cities. Cities that do not have substantial funds set aside today will likely face impacts to their credit rating and have to make higher contributions to plans later, which could limit funding for other priorities.

The City's total unfunded liability for pension and OPEB commitments increased.

In total, the City's unfunded liability for pension benefits and OPEB grew by 36 percent, from $567.4 million in FY 2012 to $773.1 million in FY 2021, adjusted for inflation (Figure 21).

Figure 21. Combined Net Pension and OPEB Liabilities (in millions, adjusted for inflation)



Source: Department of Finance data

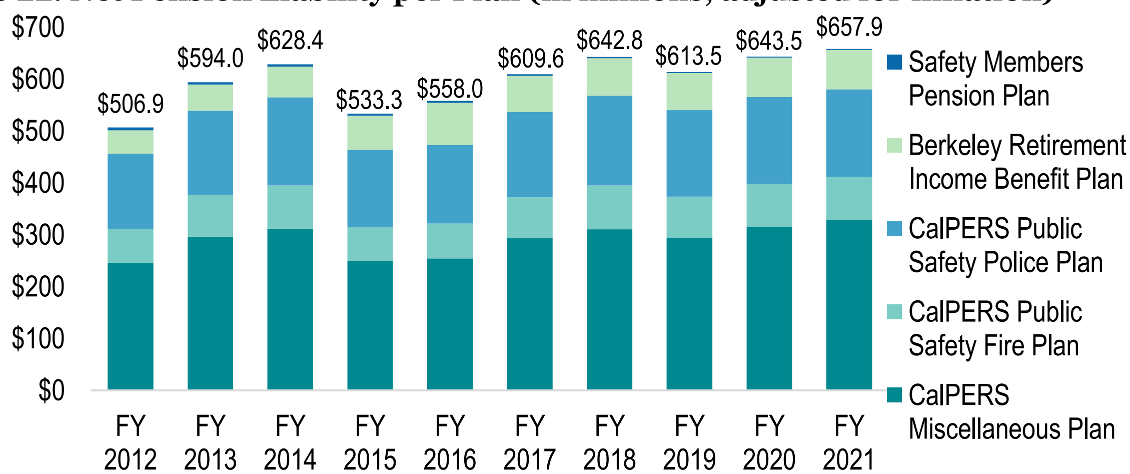
Further, the City's 2021 report on unfunded liability obligations and unfunded infrastructure needs (unfunded liability report) states that the City will face an estimated $42 million increase in pension costs over the next ten years.

Net Pension Liability

Berkeley has five defined benefit retirement plans. *Defined benefit retirement plans* include funds set aside over time by employees and their employer, and employees are guaranteed a certain amount of income upon retirement. Berkeley's three plans administered through the CalPERS are the Miscellaneous Plan, the Public Safety Fire Plan, and the Public Safety Police Plan. Berkeley also has two older city-sponsored plans that are closed to new members and being phased out: the Berkeley Retirement Income Benefit Plan[7] and Safety Members Pension Plan.[8]

Between FY 2012 and FY 2021, the City's total net pension liability grew by 30 percent, from $506.9 million to $657.9 million, adjusted for inflation (Figure 22).

Figure 22. Net Pension Liability per Plan (in millions, adjusted for inflation)



Source: Department of Finance data

Decisions made by the CalPERS Board between FY 2012 and FY 2021 increased the City's net pension liability and Berkeley's required pension contribution amount. These included CalPERS ramping up required pension funding rates to improve cities' chances of fully funding their plans within 30 years, as well as adopting new assumptions related to longer retiree lifespans and returns on investments.

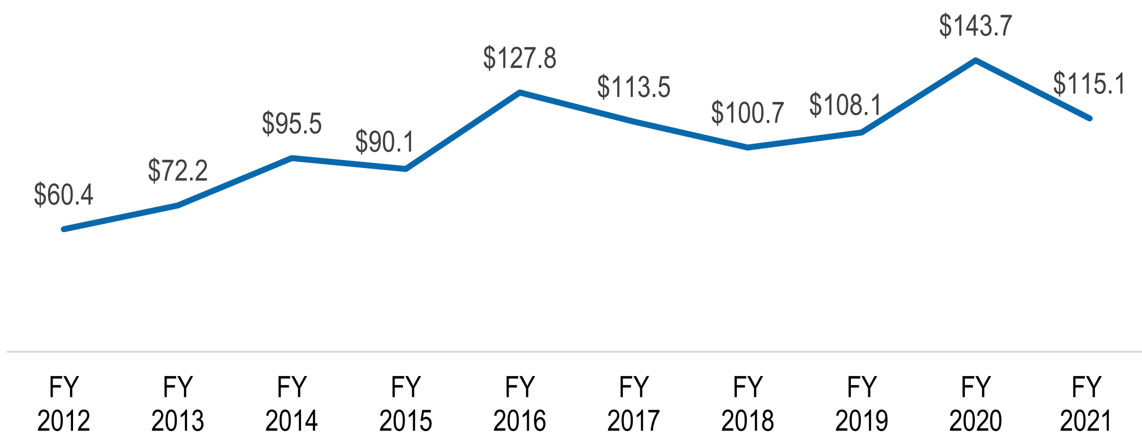
[7] The Berkeley Retirement Income Benefit Plan is a single-employer defined benefit pension plan offered to police employees with CalPERS pensions who retired with at least ten years of service on or after July 1, 1989 and before September 19, 2012. As of June 30, 2021, there were 147 remaining active employees covered by the plan.
[8] The Safety Members Pension Fund is a single-employer defined benefit pension plan for fire and police officers that retired before March 1973. As of June 30, 2020, there were eight remaining participants in the plan.

Net OPEB Liability

In addition to pensions, the City has unfunded liabilities related to *other post-employment benefits (OPEB)*, or earned compensation other than pensions provided to employees when they retire. In Berkeley, OPEB refers to retiree healthcare coverage.

Berkeley's net OPEB liability grew 91 percent between FY 2012 and FY 2021, from $60.4 million to $115.1 million, adjusted for inflation (Figure 23). According to the Director of Finance, Berkeley has paid less than its actuarially determined contributions for all of its OPEB plans since FY 2012.

Figure 23. Net OPEB Liability (in millions, adjusted for inflation)



Source: Department of Finance data

The California State Auditor considers Berkeley's pension funded ratio to be high risk.

The pension *funded ratio* compares the City's pension plan assets to its accrued pension liabilities. A funded ratio of 100 percent indicates that a city has set aside enough assets to pay for all pension benefits earned by its employees. If a city does not set aside adequate assets to fund its pension liability, its required contributions may become costlier in the future, which could impact its spending priorities down the line.

Based on the California State Auditor's assessment, Berkeley's pension funded ratio was considered high risk from FY 2017 to FY 2020, the years for which the California State Auditor has assessed this metric (Table 10).

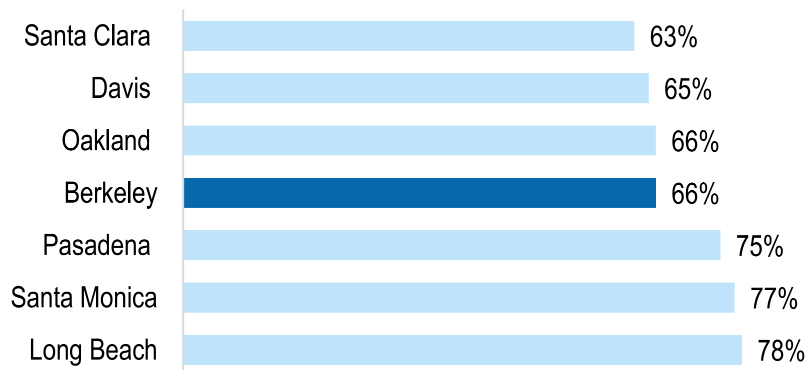
Table 10. Berkeley's Funded Ratio Risk Level, FY 2017 - FY 2020

Risk	Value of Pension Assets Compared to Accrued Pension Liabilities	FY 2017	FY 2018	FY 2019	FY 2020
High	0-70%	67%	67%	67%	66%
Moderate	71-80%				
Low	81-100%				

Source: California State Auditor's Financial Health Dashboard

The funded ratio of benchmark cities ranged from 63 percent to 78 percent in FY 2020. The funded ratio of Berkeley's pension plans fell in the middle of that range at 66 percent (Figure 24).

Figure 24. Funded Ratio of Pension Plans, FY 2020



Source: California State Auditor's Financial Health Dashboard

The City has taken steps to increase pension funding.

Following a city audit of unfunded liabilities,[9] the City established an IRS Section 115 Trust Fund (Trust) in FY 2018 to help pre-fund its pension obligations. The Trust acts as a rainy-day fund that allows the City to set aside resources restricted for payment of pension obligations and is intended to prepare for and partially offset increases in contributions in the coming years.[10]

When the City established the Trust in 2018, the City already had some funds set aside for employee retirement benefits, so there was a starting balance of $3.8 million. The City's actuary indicated that the City should be investing a minimum of $4.0 million in the Trust annually. In FY 2018, the City's target contribution was $4.0 million. In FY 2019, the target contribution increased to $5.5 million. The City

[9] Employee Benefits: Tough Decisions Ahead: https://berkeleyca.gov/sites/default/files/2022-01/2010-11-16_Item_13_Employee_Benefits_Tough_Decisions_Ahead-Auditor%281%29.pdf

[10] According to the 2021 Unfunded Liabilities Report, employer contributions for the City's three CalPERS pension plans fluctuate from year to year based on an annual actuarial valuation performed by CalPERS. The rate CalPERS comes up with is the estimated amount necessary to finance the costs of benefits earned by employees during the year, with an additional amount to finance any unfunded accrued liability.

has made contributions to the Trust on a yearly basis since FY 2018, but has fallen short of its goals (Table 11).

Table 11. Contributions to the Section 115 Trust, FY 2018 - FY 2021

Fiscal Year	Actual Contribution	Target Contribution	Difference
2018	$150,058	$4,000,000	($3,849,942)
2019	$5,246,508	$5,500,000	($253,492)
2020	$1,398,416	$5,500,000	($4,101,584)
2021	$1,470,134	$5,500,000	($4,029,866)

Source: Office of Budget and Fiscal Management data, Department of Finance data

As of FY 2021, the Section 115 Trust balance was $12.1 million. The City is currently evaluating opportunities to invest more into the Trust, including by raising the Property Transfer Tax baseline by $2.5 million and allocating those funds to the Trust, and allocating savings generated by prefunding CalPERS plans to the Trust.

Recommendations

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.

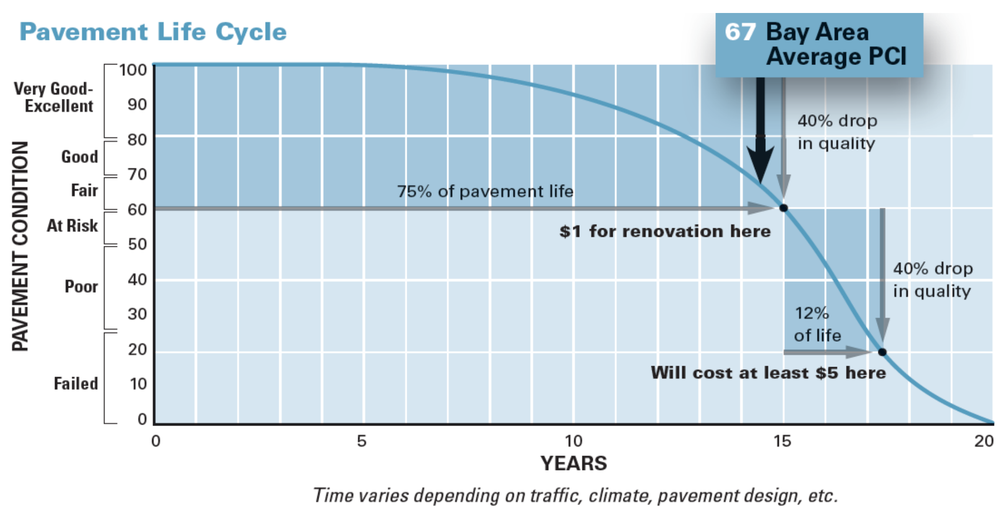
Capital Assets

How do the City's capital assets impact its financial condition?

Capital assets are assets that are used in city operations and have a life that extends beyond a single financial reporting period. Berkeley owns a wide range of capital assets, including public buildings, streets,[11] sidewalks, sewers and storm drains, traffic signals, and parking infrastructure. The City's responsibility for managing capital assets requires considerable resources and ongoing attention. As a relatively older city, Berkeley faces added challenges related to aging infrastructure. The City publishes a Capital Improvement Plan (CIP) that identifies anticipated financial needs over a five-year timeframe. However, the City's ability to fund the CIP is limited by its total available resources.[12]

If a city does not address regular maintenance on its capital assets, it can face deferred maintenance costs down the line. Addressing capital assets once their condition has severely deteriorated is often more expensive than regular preventative care or maintenance. According to the Metropolitan Transportation Commission, regular maintenance of roads is five to ten times cheaper than allowing roads to fail and then paying for the necessary rehabilitation (Figure 25).

Figure 25. Pavement Maintenance Costs



Source: Metropolitan Transportation Commission Pothole Report III 2018

[11] This includes streets and roads as defined in the City's FY 2017-FY 2021 reports on unfunded liability obligations and unfunded infrastructure needs.
[12] Funding sources for the Capital Improvement Plan include: the General Fund, special revenue funds, Measure T1, enterprise funds such as Zero Waste, the Marina, Sanitary/Sewer, Clean Storm Water, and Parking Meter; internal service funds such as the Equipment Replacement Fund; and federal, state and local funds and grants.

One way to track the status of capital assets is to examine growth in unfunded capital needs related to improving the condition of current assets and building or acquiring new assets. Similar to unfunded pension and OPEB liabilities, unfunded capital and deferred maintenance needs refer to the gap between the funding needs and the funds available to address those needs. The City's level of unfunded capital and deferred maintenance needs reflect the adequacy of the City's investment in this area over time. Without regular maintenance, the City accumulates large deferred maintenance costs required to improve the condition of its assets.

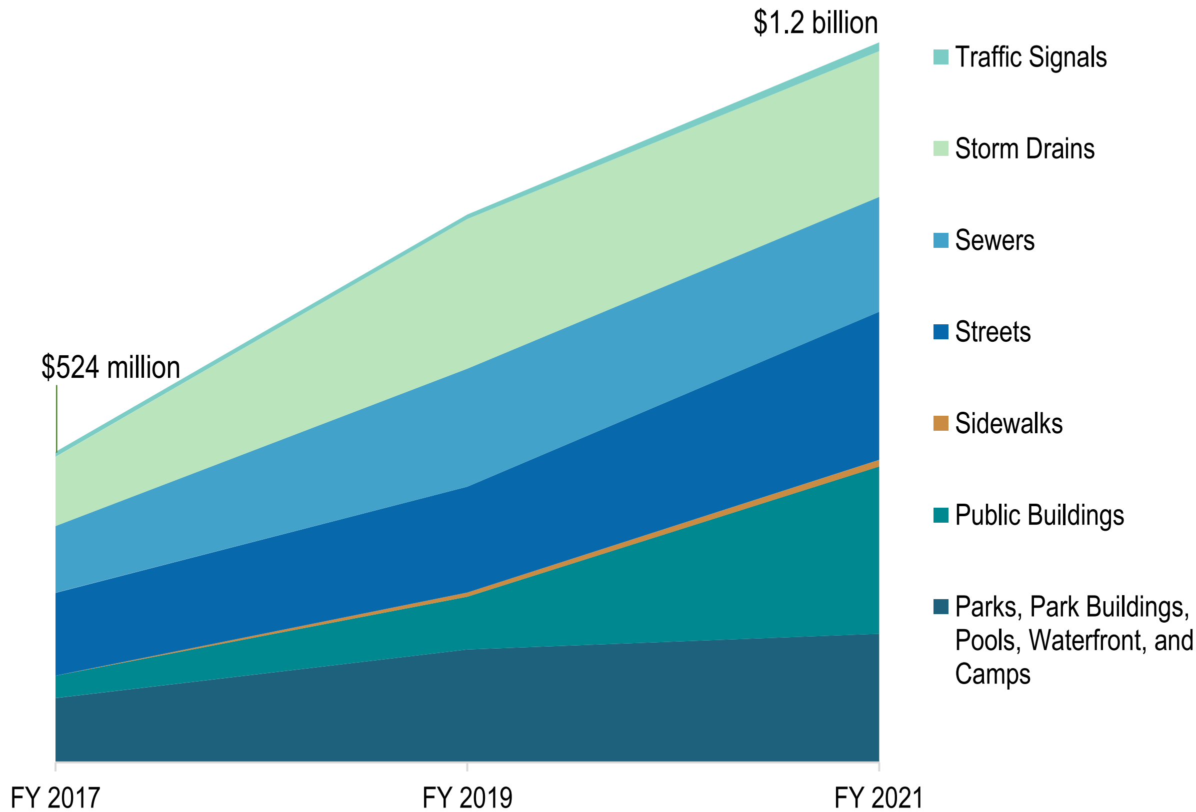
In FY 2012, the City Council adopted a resolution requiring the City Manager to develop and publish a biennial report of current liabilities and projections of future liabilities. The following section provides an overview of the City's reporting on unfunded capital and deferred maintenance needs.

The City reported $1.2 billion in unfunded capital and deferred maintenance needs in FY 2021.

Berkeley's unfunded capital and deferred maintenance needs[13] are growing. According to the City's unfunded liability reports, since FY 2017, these costs have grown from $524 million to $1.2 billion, adjusted for inflation (Figure 26). The Department of Public Works has stated that the estimated $1.2 billion in current capital and deferred maintenance needs is an undercount, as many city priorities are not included in that figure. Since FY 2017, the greatest increase in capital and deferred maintenance needs has been for public buildings, which has increased by nearly 648 percent, from $37.8 million to $282.3 million when adjusted for inflation.

[13] Capital and deferred maintenance needs refer to a broad range of necessary activities, including investment in new capital assets, improving existing capital assets, replacing existing capital assets, and repairing existing capital assets.

Figure 26. Unfunded Capital and Deferred Maintenance Needs, FY 2017 - FY 2021 (adjusted for inflation)



Note: The figure includes data from FY 2017 to FY 2021 because comprehensive data was not available prior to FY 2017. We did not include IT-related assets due to incomplete data, but these costs would not significantly change the capital and deferred maintenance needs outlook. Unfunded needs for sidewalks are included in the figure, but were only included as a separate asset category in the 2019 and 2021 reports. City staff update these estimates regularly.

Source: Berkeley's unfunded liability reports

According to the City's 2021 unfunded liability report, the key drivers of this growth in capital and deferred maintenance needs are aging infrastructure and limited resources allocated toward infrastructure. According to the Director of Public Works, other factors include new state mandates and surging material costs during the pandemic, and the $1.2 billion figure also reflects the City's efforts to more comprehensively assess all of its assets. More recently, the City deferred some spending on capital to offset the FY 2021 budget shortfall due to COVID-19. Although Berkeley voters have passed a number of infrastructure bond measures detailed in the long-term debt section, Measures M, T1, and O were steps in the right direction, yet insufficient to meet the growing risk. As noted in our 2020 streets audit, Measure M funding was lower than the unfunded need previously estimated by the City Auditor. As a result, the condition of Berkeley streets remained at risk, and the funds did not reverse the growing trend of unmet street infrastructure needs.

The rapid rise in Berkeley's unfunded capital asset needs suggests that the City has not allocated enough funding to adequately maintain key capital assets like public buildings, streets, and sidewalks. This trend presents a serious risk to the City's long-term financial health if these needs continue to grow. The City's streets in particular are projected to deteriorate further without a significant investment, leading to higher costs later.

In addition to rapid cost escalation, as capital and deferred maintenance needs grow, it may become more difficult for the City to balance providing services and paying for capital assets, especially if important infrastructure cannot function as intended. While a deeper analysis of the condition of the City's capital assets and the factors that have contributed to the size of capital needs was outside of the scope of this audit, there is more detailed information about the current status, causes, and potential effects related to the City's streets in our 2020 streets audit.[14]

The City is planning to take steps towards addressing the unfunded capital needs. One of the City's Vision 2050[15] strategies to support more resilient and sustainable infrastructure will focus on addressing inadequate funding of infrastructure by introducing a new revenue source.[16] In FY 2022, the City Council provided direction on the development of a significant revenue measure or measures focused on infrastructure, including streets and affordable housing. The Public Works Department is conducting community outreach to explore opportunities for revenue measures to offset the City's unfunded capital and maintenance needs.[17]

Recommendations

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.

[14] Rocky Road: Berkeley Streets at Risk and Significantly Underfunded: https://berkeleyca.gov/sites/default/files/2022-01/Rocky-Road-Berkeley-Streets-at-Risk-and-Significantly-Underfunded.pdf

[15] According to the 2018 voter information guide, Vision 2050 is a 30-year plan to ensure that the City has a long-range plan to achieve a more resilient and sustainable infrastructure system.

[16] See the staff report from January 2022: https://berkeleyca.gov/sites/default/files/city-council-meetings/2022-01-20%20Worksession%20Agenda%20-%20Council.pdf

[17] The City is considering an infrastructure bond, a parcel tax, or a sales tax.

Recommendations and Management Response

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.

Management Response: Agree

Proposed Implementation Plan: The result of the assessment should drive the policy change if there is a need for it. Replenishing reserves should always be a top priority of both management and the City Council.

Proposed Implementation Date: January 1, 2023

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 or reserve level for each of the City's enterprise funds, report findings to the City Council and explore reserve policy options for the enterprise funds.

Management Response: Agree

Proposed Implementation Plan: The City Manager, with collaboration with other departments including Public Works, PRW, Police, Planning, Finance, etc., will research and draft fund balance policies for department-managed enterprise funds. Departments will also look to operationalize the costing of the services so that the enterprises can recoup the cost of the services provided.

Proposed Implementation Date: September 30, 2022

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.

Management Response: Agree

Proposed Implementation Plan: The Finance Department will stress test the City's debt threshold and come up with a more appropriate yardstick for determining capacity. The City has hired GFOA to review its debt capacity. The result of that study will be instrumental in determining the appropriate debt threshold.

Proposed Implementation Date: September 30, 2022

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.

Management Response: Agree

Proposed Implementation Plan: Complete a long-term funding plan that can be integrated in the City's budgetary process on an annual basis. The strategies should focus on sustainable funding mechanisms.

Proposed Implementation Date: August 31, 2022

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.

Management Response: Agree

Proposed Implementation Plan: Pursue/pass Vision 2050 revenue measures, commit existing funding resources towards priority capital maintenance needs, request in annual budgets an increase in baseline allocations to capital and deferred maintenance needs from the General Fund.

Proposed Implementation Date: Whether voters get the opportunity, and then approve, a November 2022 ballot measure or measures focused on infrastructure will drive future CIP development. Annual Capital Budgets would be adjusted in the mid-biennial budget adjustment – adopted by June 30, 2023.

Methodology and Statement of Compliance

Methodology

We used financial indicators included in the International City/County Management Association's (ICMA) *Evaluating Financial Condition* handbook designed for local governments. Additionally, we used indicators developed by the California State Auditor's Office for their Fiscal Health of California Cities dashboard[18] as well as indicators used by peer cities in their financial condition audits.

We compared Berkeley's financial data to other California cities that are similar across economic and social factors including population, general fund expenditures per resident, services provided, and presence of a large university. We selected Davis, Long Beach, Oakland, Pasadena, Santa Clara, and Santa Monica because these cities are most similar to Berkeley across these criteria. Where appropriate, we adjusted financial indicators for inflation using the Bay Area Consumer Price Index calculated by the U.S. Bureau of Labor Statistics to express values in 2021 dollars.

To meet our objective, we reviewed the following:

- Berkeley's Annual Comprehensive Financial Reports (ACFRs)
- Budget Office reports (Unfunded Liability Obligations and Unfunded Infrastructure Needs reports, city budgets, and Year-End Results and First Quarter Budget Update reports)
- City Auditor reports on General Fund reserves, COVID-19, employee benefits, and streets
- City policies on reserves and debt management
- Santa Monica's policy on general obligation bond debt
- Council reports and presentations related to the City's finances and financial reporting
- Standard and Poor's 2021 General Obligation bond rating report
- Moody's 2021 Annual Comment Report

[18] Fiscal Health of California Cities: https://www.auditor.ca.gov/local_high_risk/dashboard-csa

We also conducted interviews with:

- The Director of Finance
- Staff from the Office of Budget and Fiscal Management responsible for overseeing the City's budget and spending
- Public Works staff responsible for overseeing city spending on capital assets and financial management of Enterprise funds
- The City of Oakland Auditor's Office
- The California State Auditor's Office
- Staff at Standard & Poor's and Moody's credit rating agencies that prepared recent rating reports for Berkeley
- Staff at the City's external financial auditing firm Badawi and Associates

We analyzed financial data from the sources below. For all indicators we adjusted for inflation, we used the inflation factor as of June 2021 from the Consumer Price Index: San Francisco-Oakland-Hayward Table, 2011-2021, U.S. Department of Labor, Bureau of Labor Statistics.

Report Sections and Indicators	Sources
Revenues and Expenses • **Revenue by Source** • **Property Tax Revenues** • **Revenues (trends)** • **Revenues per Resident** • **UC Berkeley Revenues** • **Revenues per Resident (Benchmark)** • **Expenses by Function** • **Expenses (trends)** • **Full-Time Equivalent Employees per 1,000 residents** • **Revenues and Expenses (trends)**	**Revenue by Source** • City of Berkeley FY 2012 and FY 2021 ACFRs, Government-wide Financial Statements, Statement of Activities **Property Tax Revenues** • City of Berkeley FY 2021 ACFR, Government-wide Financial Statements, Statement of Activities **Revenues (trends)** • City of Berkeley FY 2012 – FY 2021 ACFRs, Government-wide Financial Statements, Statement of Activities **Revenue per Resident** • City of Berkeley FY 2012 – FY 2021 ACFRs, Government-wide Financial Statements, Statement of Activities; City of Berkeley 2021 ACFR, Statistical Section: Demographic and Economic Statistics **UC Berkeley Revenues** • University of California website; University of California Berkeley: Office of the Vice Chancellor website **Revenue per Resident (benchmark)** • City of Berkeley, Davis, Long Beach, Pasadena, Santa Clara, and Santa Monica FY 2020 ACFRs, Management's Discussion and Analysis – Statement of Activities Summary; Statistical Section: Demographic and Economic Statistics **Expenses by Function** • City of Berkeley FY 2012 and FY 2021 ACFRs, Government-wide Financial Statements, Statement of Activities **Expenses (trends)** • City of Berkeley FY 2012 – FY 2021 ACFRs, Government-wide Financial Statements, Statement of Activities

Report Sections and Indicators	Sources
	Full-Time Equivalent Employees per 1,000 residents • City of Berkeley FY 2021 ACFR, Statistical Section: Demographic and Economic Statistic; Statistical Section: Full-time Equivalent City Governmental Employees by Function/Program **Revenues and Expenses (trends)** • City of Berkeley FY 2012 – FY 2021 ACFRs, Government-Wide Financial Statements, Statement of Activities
Demographics • **Population** • **Unemployment** • **Personal Income per Resident** • **Personal Income per Resident (Benchmark)** • **Assessed Property Value**	**Population** • City of Berkeley FY 2021 ACFR, Statistical Section: Demographic and Economic Statistics **Unemployment** • City of Berkeley FY 2020 ACFR, Statistical Section: Demographic and Economic Statistics • State of California Employment Development Department – Local Area Unemployment Statistics **Personal Income per Resident** • City of Berkeley FY 2016, FY 2020, and FY 2021 ACFRs, Statistical Section: Demographic and Economic Statistics **Personal Income per Resident (Benchmark)** • City of Berkeley, Davis, Long Beach, Pasadena, and Santa Clara FY 2020 ACFRs, City of Santa Monica FY 2021 ACFR, Statistical Section: Demographic and Economic Statistics • U.S. Census Bureau population estimates, July 1, 2019, City of Oakland **Assessed Property Value** • City of Berkeley FY 2021 ACFR, Statistical Section: Assessed Value and Estimated Values of Taxable Property
Financial and Operating Position • **Net Position** • **Liquidity Ratio** • **General Fund Reserves** • **Enterprise Fund Balance**	**Net Position** • City of Berkeley FY 2012 - FY 2021 ACFRs, Government-Wide Financial Statements: Statement of Net Position **Liquidity Ratio** • City of Berkeley FY 2012 - FY 2021 ACFRs Government-Wide Financial Statements: Statement of Net Position **General Fund Reserves** • City of Berkeley, Office of Budget and Fiscal Management, Year-End Results and First Quarter Budget Update Reports, FY 2017- FY 2021 **Enterprise Fund Balances** • City of Berkeley budgets: FY 2018 and FY 2019, FY 2020 and FY 2021, and proposed FY 2022 budgets
Long-Term Debt • **Governmental Activities Long-term Liabilities** • **Governmental Activities Long-term Liabilities per Resident (Benchmark)** • **Debt by Type** • **Bond Ratings** • **General Obligation Bond debt**	**Governmental Activities Long-Term Liabilities** • City of Berkeley FY 2012 – FY 2021 ACFRs, Notes to Basic Financial Statements: Governmental Activities Long-Term Liabilities Summary **Governmental Activities Long-Term Liabilities per Resident (benchmark)** • City of Berkeley, Davis, Long Beach, Pasadena, Santa Clara, and Santa Monica FY 2020 ACFRs, Government-Wide Financial Statements: Statement of Net Position

Report Sections and Indicators	Sources
as a Proportion of Assessed Property Value • **General Obligation Bond Debt per Resident** • **General Obligation Debt Service**	**Debt by Type** • City of Berkeley FY 2021 ACFR, Notes to Basic Financial Statements: Governmental Activities Long-Term Liabilities Summary **Bond Ratings** • City of Berkeley FY 2012 - FY 2021 ACFRs, Introductory Section • Standard and Poor's Ratings Guide; Moody's Rating Definitions **General Obligation Bond Debt as a Proportion of Assessed Property Value** • City of Berkeley FY 2021 ACFR, Statistical Section, Ratios of General Bonded Debt Outstanding; Statistical Section: Assessed Value and Estimated Values of Taxable Property • City of Berkeley Debt Management and Disclosure Policy **General Obligation Bond Debt per Resident** • City of Berkeley FY 2021 ACFR, Statistical Section, Ratios of General Bonded Debt Outstanding; Statistical Section: Demographic and Economic Statistics • Department of Finance data on General Obligation bond issuance **General Obligation Debt Service** • City of Berkeley FY 2021 ACFR, City of Berkeley General Obligation and General Fund Obligations Continuing Disclosure Annual Report Information
Unfunded Pension and OPEB Liabilities • **Combined Unfunded Pension and OPEB Liability** • **Net Pension Liability** • **Net OPEB Liability** • **Funded Ratio Risk Level** • **Funded Ratio Risk Level (Benchmark)** • **Section 115 Trust Fund**	**Combined Unfunded Pension and OPEB Liability** • Department of Finance data **Net Pension Liability** • Department of Finance Data **Net OPEB Liability** • Department of Finance data **Funded Ratio Risk Level** • California State Auditor Financial Health Dashboard and risk level methodology **Funded Ratio Risk Level (Benchmark)** • California State Auditor Financial Health Dashboard **Section 115 Trust Fund** • City of Berkeley, Office of Budget and Fiscal Management documentation of Section 115 goals; City of Berkeley, Department of Finance data on Section 115 contributions
Capital Assets • **Pavement Maintenance Costs** • **Unfunded Capital and Maintenance Need**	**Pavement Maintenance Costs** • Metropolitan Transportation Commission, The Pothole Report: Bay Area Roads at Risk, September 2018 **Unfunded Capital and Deferred Maintenance Needs** • City of Berkeley Unfunded Liability Reports (2017, 2019, 2021)

Throughout the report, we use the terms *expenses* and *expenditures*. Government-wide financial statements (including governmental and business-type activities) use the accrual basis of accounting and refer to expenses. The accrual basis of accounting reports revenues and expenses in the period in which the underlying event occurs, regardless of the timing of cash flows. This means that revenues are recorded when earned and expenses are recorded when the liability is incurred, instead of when cash is actually received or disbursed. Governmental fund financial statements (including the General Fund) use the modified accrual basis of accounting and refer to expenditures. Under the modified accrual basis of accounting, revenues are recorded when measurable and available, and expenditures are recorded when the liability is incurred, except for interest on long-term debt, judgments and claims, workers' compensation, and compensated absences, which are recorded when paid.

Risk Assessment and Internal Controls

We reviewed information for reasonableness and consistency, and we researched data that needed additional explanation. We did not, however, audit the accuracy of all source documents or the reliability of the data in computer-based systems. As nearly all financial information presented is from the City's ACFRs, we relied on the work performed by the City's external financial auditors.

We specifically assessed internal controls significant to the audit objectives. This included a review of selected policies and procedures, interviews with staff in the Department of Finance and the Budget Office, and reports on city finances and budget. In performing our work, we identified concerns that the City does not currently have a plan for how to meet its FY 2027 reserve funding goal, the debt management policy does not have sufficient criteria to assess the City's debt capacity, the City has not been meeting its Section 115 contribution goals, and the City does not yet have a plan to address its unfunded capital needs.

We performed a risk assessment of the City's financial condition within the context of our audit objectives. This included a review of selected policies and procedures, as well as interviews with subject matter experts and Department of Finance and the Budget Office staff.

Statement of Compliance

We conducted this performance audit in accordance with Generally Accepted Government Auditing Standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Appendix I. Enterprise Funds

Most of the City's Enterprise funds and activities are housed within the Department of Public Works, except for the Marina Fund which falls under the Parks, Recreation and Waterfront Department, and the Permit Service Center, which falls primarily under the Planning Department.

1. The **Zero Waste Fund** uses fees for disposal of waste at the City's transfer station and refuse fees charged to Berkeley property owners to provide commercial refuse, recycling and compost collection services, and residential refuse and compost collection services to Berkeley residents.

2. The **Marina Fund** uses fees generated from vessels that berth at the Marina, commercial building and ground leases, and special events to fund operations at the Berkeley Waterfront.

3. The **Sanitary Sewer Fund** uses fees charged to the users of the City's sanitary system to fund the operation, maintenance, rehabilitation, and improvement of the City's sanitary sewer collection system and comply with Environmental Protection Agency requirements.

4. The **Clean Storm Water Fund** uses fees from property taxes to fund the maintenance and improvement of the City's storm water drainage system and reduce pollutants in storm water from entering local creeks and the Bay.

5. The **Permit Service Center Fund** uses zoning fees, building fees, and plan check fees to fund the processing and issuance of building, electrical, mechanical, plumbing, fire, zoning, and Public Works permits.

6. The **Off-Street Parking Fund** uses parking fees to support capital, operation, and maintenance of three off-street parking facilities owned by the City: the Center Street Garage, the Oxford Garage, and the Telegraph Channing Garage.

7. The **Parking Meter Fund** uses payments made by hourly parkers to fund the maintenance, collection, capital, and enforcement of city parking meters.

8. The **Building Purchases and Management Fund** accounts for the purchase and management of the building at 1947 Center Street. According to the Department of Public Works, although the Building Purchases and Management fund is considered an enterprise fund for the purposes of the City's financial reporting, it functions more as an internal service fund because most of the fund's customers are internal city departments.

Mission Statement
Promoting transparency and accountability in Berkeley government.

Audit Team
Caitlin Palmer, Senior Auditor
Pauline Miller, Auditor I

City Auditor
Jenny Wong

Office of the City Auditor
Phone: (510) 981-6750
Email: auditor@cityofberkeley.info
Website and reports: https://berkeleyca.gov/your-government/city-audits

BERKELEY CITY AUDITOR