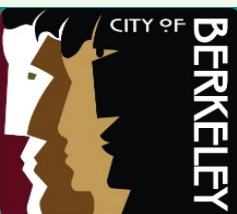# Berkeley's Financial Condition (FY 2012 - FY 2021): Pension Liabilities and Infrastructure Need Attention

Budget and Finance Committee Meeting
May 12, 2022

BERKELEY CITY AUDITOR

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

Overview

- Objectives

- Background and Findings

- Recommendations

- Management's Response

BERKELEY CITY AUDITOR

Why we did this audit:

- In our 2022 Audit Plan, we identified the City's financial condition as an area for objective and independent analysis.

- Financial condition analysis can reveal trends and highlight financial strengths and risks that the City needs to address. It can also inform budget deliberations.

- We wanted to make complex financial information easier to understand.

☞ *This report is informational and a high-level overview. It does not include an in-depth analysis of the causes of all financial trends.*

BERKELEY CITY AUDITOR

Objectives:

We assessed financial condition using indicators for:

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

Audit Scope:
FY 2012 – FY 2021

BERKELEY CITY AUDITOR

What we found:

Near-term indicators are generally positive:

- Revenues and Expenses

- Demographic and Economic Indicators

- Net Position, Liquidity, and Reserves

Long-term indicators reveal some challenges:

- Long-Term Debt and Liabilities

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

- Capital Assets

Methodology

- Relied on the City's Annual Comprehensive Financial Reports (ACFR), and other sources of financial data.

- Benchmarked some indicators to comparable cities with similar characteristics to Berkeley using most recent data available (FY 2020).

- Adjusted for inflation where appropriate using Bay Area Consumer Price Index for June 2021.

What we found:

Near-term indicators are generally positive:
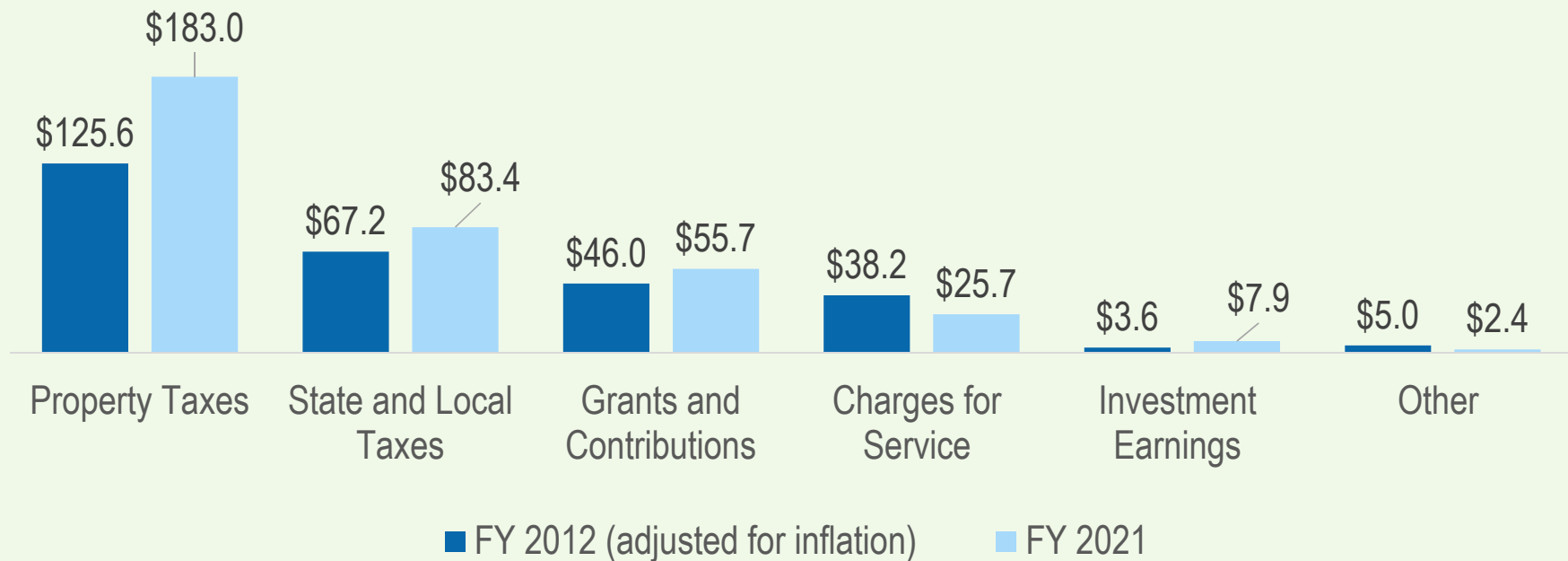
- **Revenues and Expenses**

- Demographic and Economic Indicators

- Net Position, Liquidity, and Reserves

Long-term indicators reveal some challenges:

- Long-Term Debt and Liabilities

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

- Capital Assets

Revenues from property taxes *increased* the most and revenues from charges for services *declined* the most.

Revenues for Governmental Activities, FY 2012 to FY 2021
(in millions, adjusted for inflation)

	FY 2012 (adjusted for inflation)	FY 2021
Property Taxes	$125.6	$183.0
State and Local Taxes	$67.2	$83.4
Grants and Contributions	$46.0	$55.7
Charges for Service	$38.2	$25.7
Investment Earnings	$3.6	$7.9
Other	$5.0	$2.4

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

**Expenses for Governmental Activities, FY 2012 to FY 2021
(in millions, adjusted for inflation)**

Category	FY 2012 (adjusted for inflation)	FY 2021
Public Safety	$121.0	$149.2
Culture and Recreation	$45.3	$52.0
General Government	$38.6	$38.0
Health and Welfare	$25.2	$41.6
Community Development and Housing	$25.1	$32.8
Highways and Streets	$19.0	$16.7
Economic Development	$4.7	$5.6
Long-Term Debt Interest	$5.3	$5.5
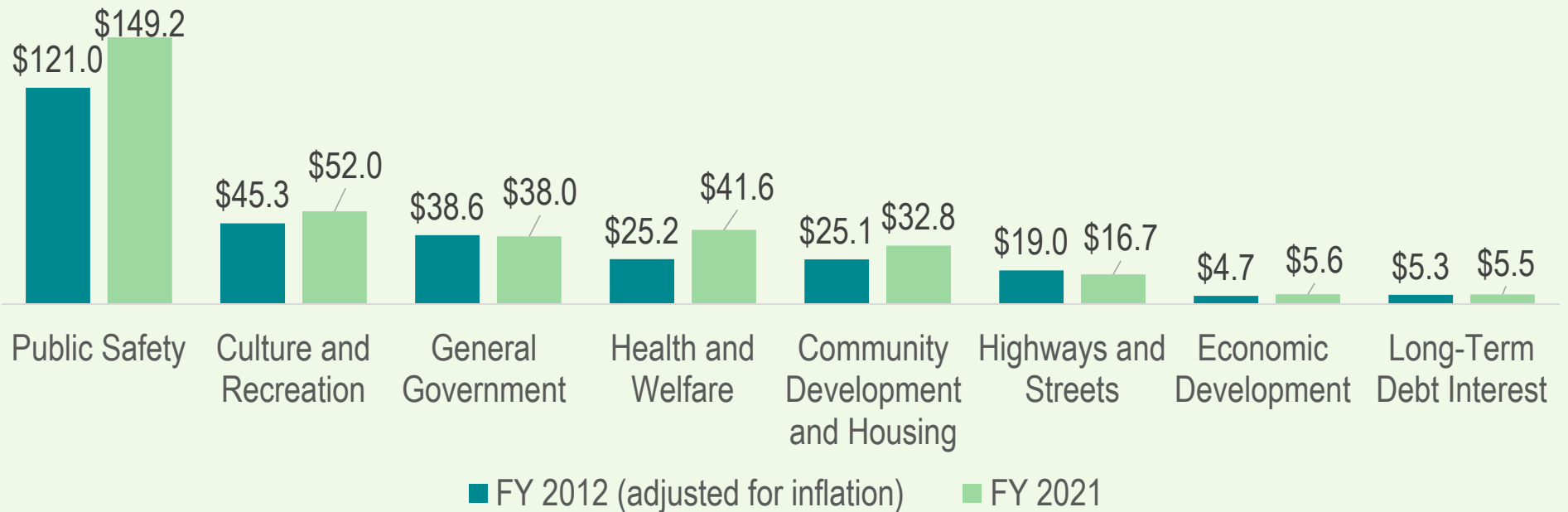
The City's governmental activities revenues generally outpaced expenses.

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

Revenues

Expenses

$285.6 $286.7 $297.6 $284.8 $305.7 $317.7 $319.6 $353.5 $362.3 $358.0

$284.2 $274.8 $273.2 $281.3 $284.0 $272.5 $317.7 $337.1 $348.5 $341.4
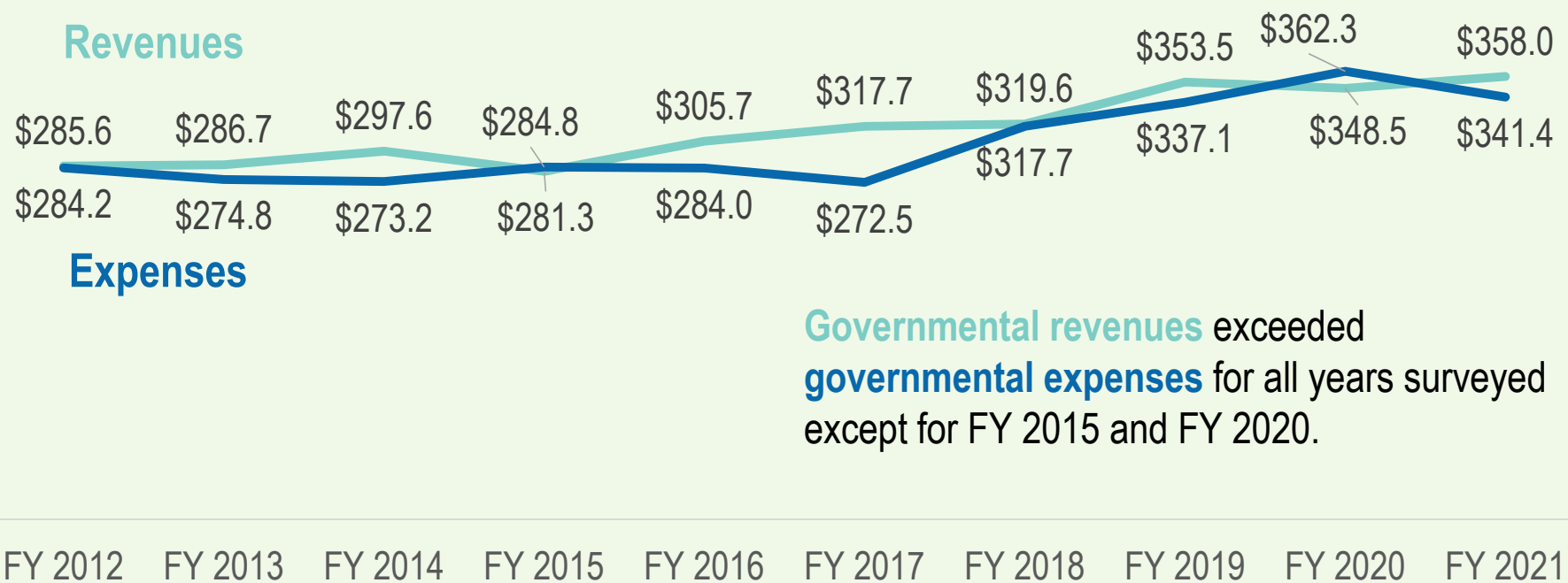
Governmental revenues exceeded **governmental expenses** for all years surveyed except for FY 2015 and FY 2020.

FY 2012   FY 2013   FY 2014   FY 2015   FY 2016   FY 2017   FY 2018   FY 2019   FY 2020   FY 2021

Source: Berkeley ACFRs, Figure 10 in report

Berkeley's revenues per resident were in the middle of the range compared to benchmark cities in FY 2020.

Revenues for Governmental Activities per Resident, FY 2020

City	Revenue
Davis	$1,210
Long Beach	$1,889
Santa Clara	$2,262
Berkeley	$2,756
Pasadena	$2,757
Oakland	$2,879
Santa Monica	$4,951
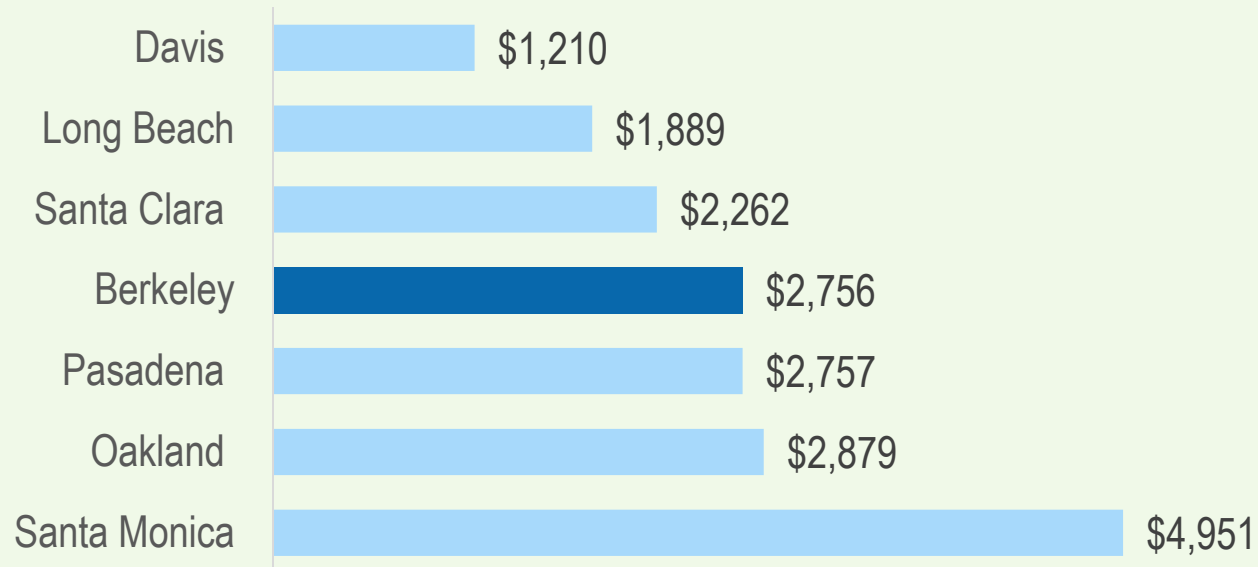
Source: Cities' FY 2020 ACFRs, Figure 5 in report

What we found:

## Near-term indicators are generally positive:

- Revenues and Expenses

- **Demographic and Economic Indicators**

- Net Position, Liquidity, and Reserves

Long-term indicators reveal some challenges:

- Long-Term Debt and Liabilities

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

- Capital Assets

Berkeley's population mostly increased during the audit period but declined in FY 2020 and FY 2021.
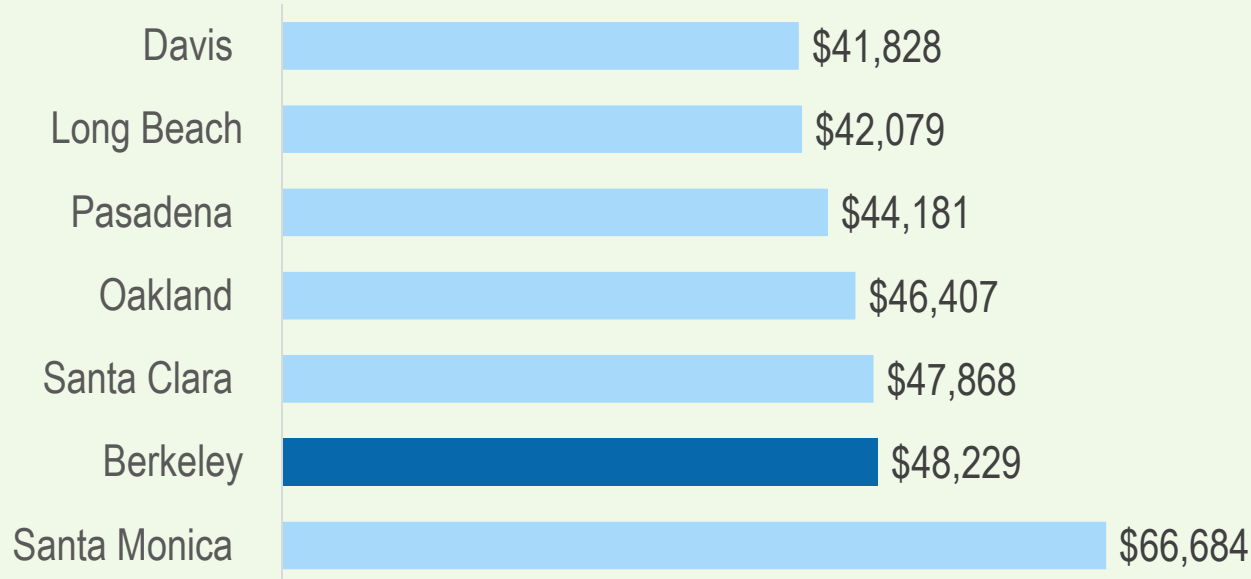
Population

Source: Berkeley ACFRs, Figure 11 in report
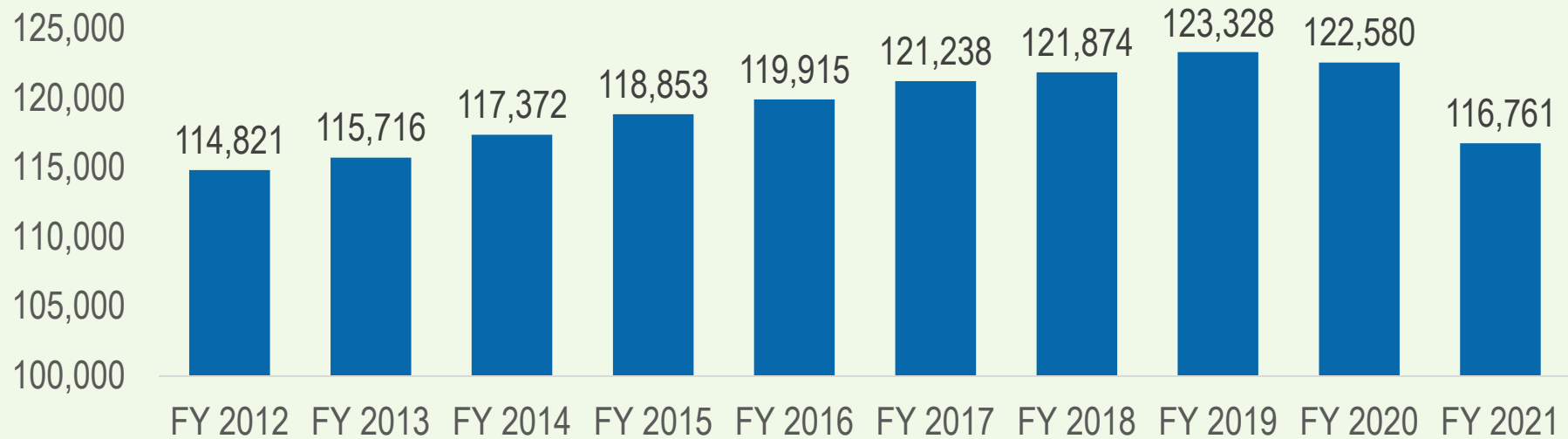
- Population decline coincides with COVID-19 pandemic, may be due to relocation of students or other residents.

Berkeley's personal income per resident was high compared to benchmark cities in FY 2020.

Personal Income per Resident, FY 2020

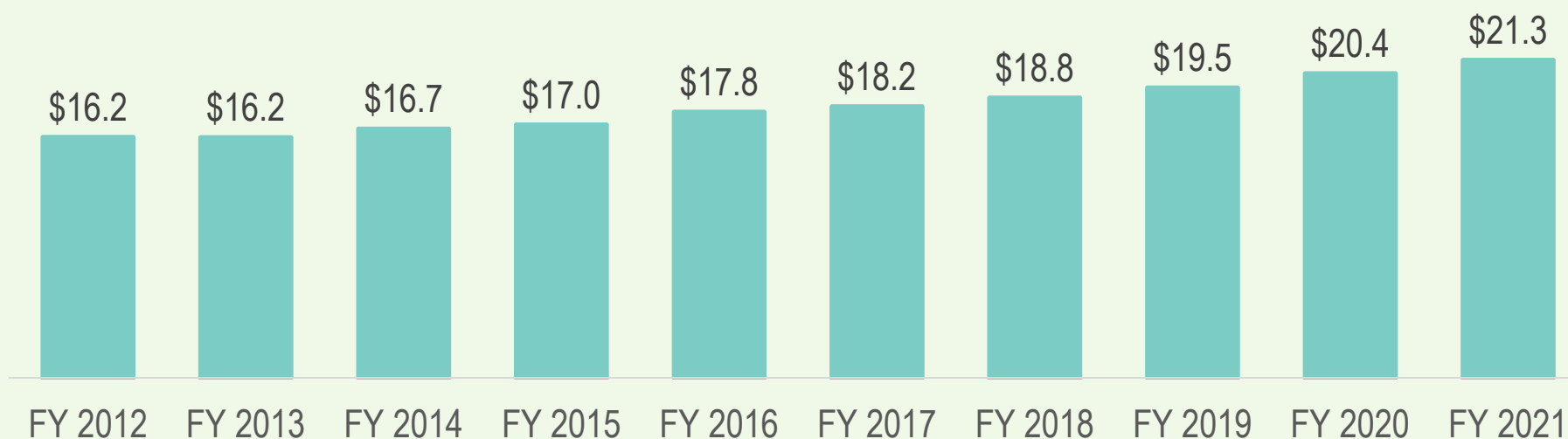| City	Income
Davis	$41,828
Long Beach	$42,079
Pasadena	$44,181
Oakland	$46,407
Santa Clara	$47,868
Berkeley	$48,229
Santa Monica	$66,684

- Average personal income of Berkeley residents increased 11% between FY 2012 and FY 2021.

Source: Cities' FY 2020 or FY 2021 ACFRs, Figure 12 in report

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

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

FY 2012	FY 2013	FY 2014	FY 2015	FY 2016	FY 2017	FY 2018	FY 2019	FY 2020	FY 2021
$16.2	$16.2	$16.7	$17.0	$17.8	$18.2	$18.8	$19.5	$20.4	$21.3

- Berkeley's taxable assessed property values grew during the COVID-19 pandemic.

Source: Berkeley ACFRs, Figure 13 in report

What we found:
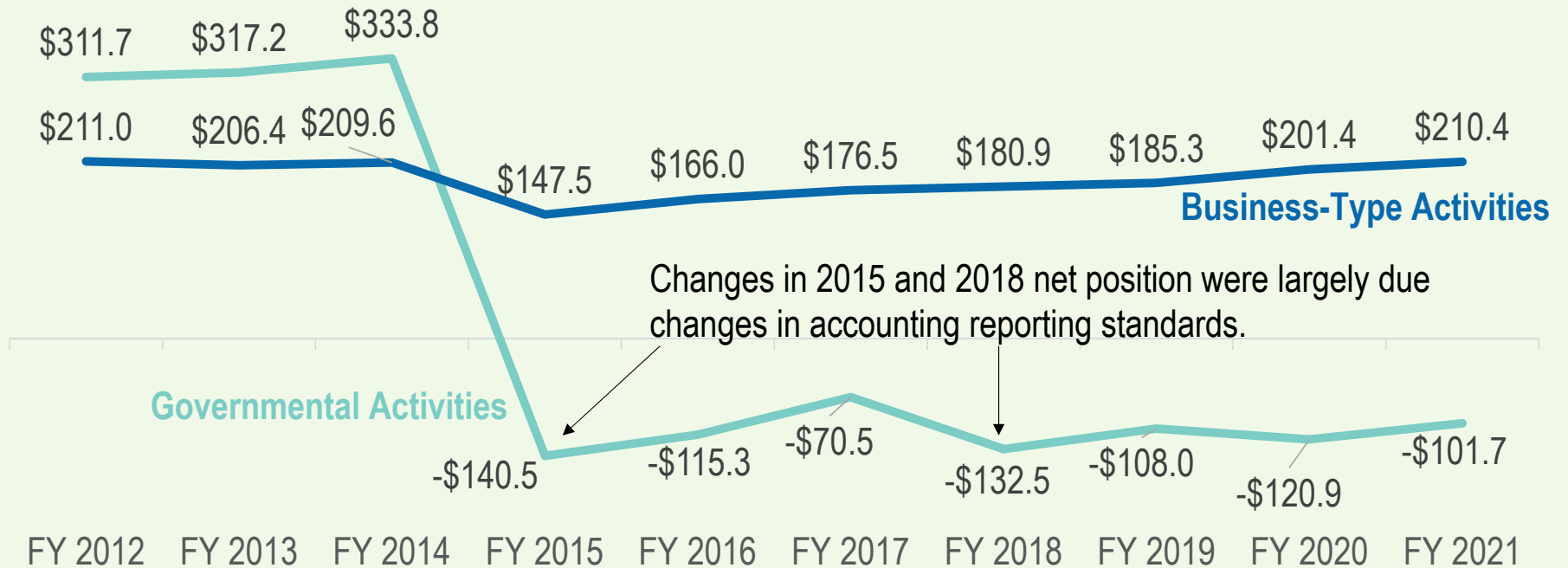
Near-term indicators are generally positive:

- Revenues and Expenses

- Demographic and Economic Indicators

- **Net Position, Liquidity, and Reserves**

Long-term indicators reveal some challenges:

- Long-Term Debt and Liabilities

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

- Capital Assets

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

Net Position (in millions, adjusted for inflation)

$311.7 $317.2 $333.8

$211.0 $206.4 $209.6 $147.5 $166.0 $176.5 $180.9 $185.3 $201.4 $210.4

Business-Type Activities

Changes in 2015 and 2018 net position were largely due changes in accounting reporting standards.

Governmental Activities

-$140.5   -$115.3   -$70.5   -$132.5   -$108.0   -$120.9   -$101.7

FY 2012   FY 2013   FY 2014   FY 2015   FY 2016   FY 2017   FY 2018   FY 2019   FY 2020   FY 2021

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

Liquidity Ratio of Current Assets to Current Liabilities

- Ratio of >1 is a positive indicator.

FY 2012	FY 2013	FY 2014	FY 2015	FY 2016	FY 2017	FY 2018	FY 2019	FY 2020	FY 2021
2.6	3.5	3.6	4.0	4.5	5.6	5.9	4.8	3.0	1.7
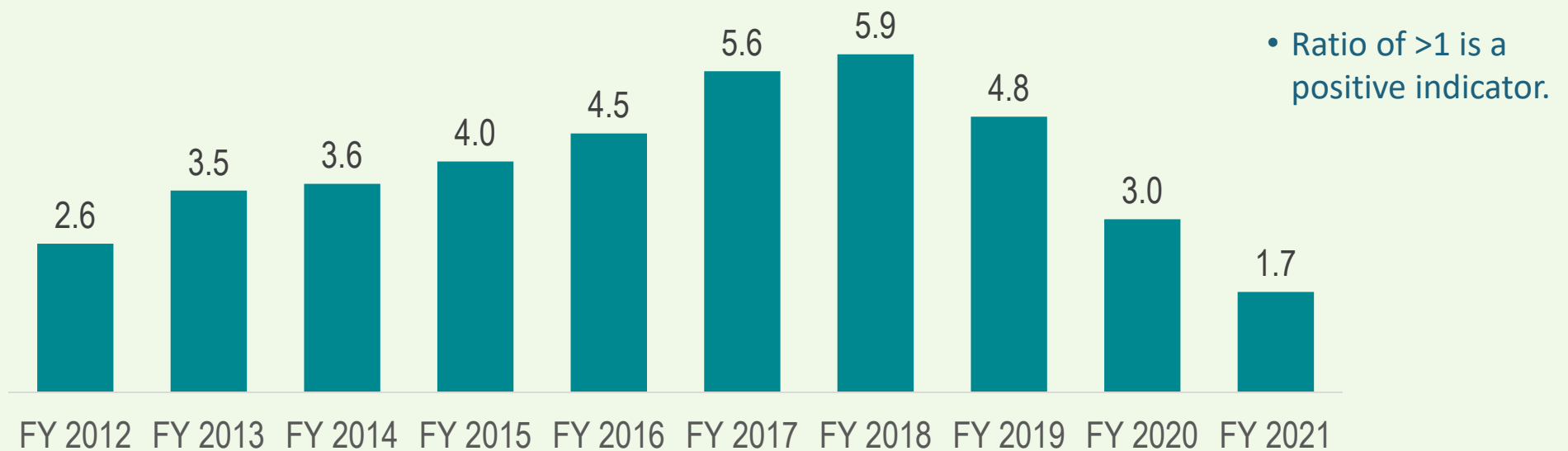
Source: Berkeley ACFRs, Figure 15 in report

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

Actual Reserves Compared to Reserve Goal

Reserve Policy Goal: 30% in FY 2027

30%

20%

10%

0%

Actual reserves as percentage of General Fund revenues

FY 2017 FY 2018 FY 2019 FY 2020 FY 2021 FY 2022 FY 2023 FY 2024 FY 2025 FY 2026 FY 2027
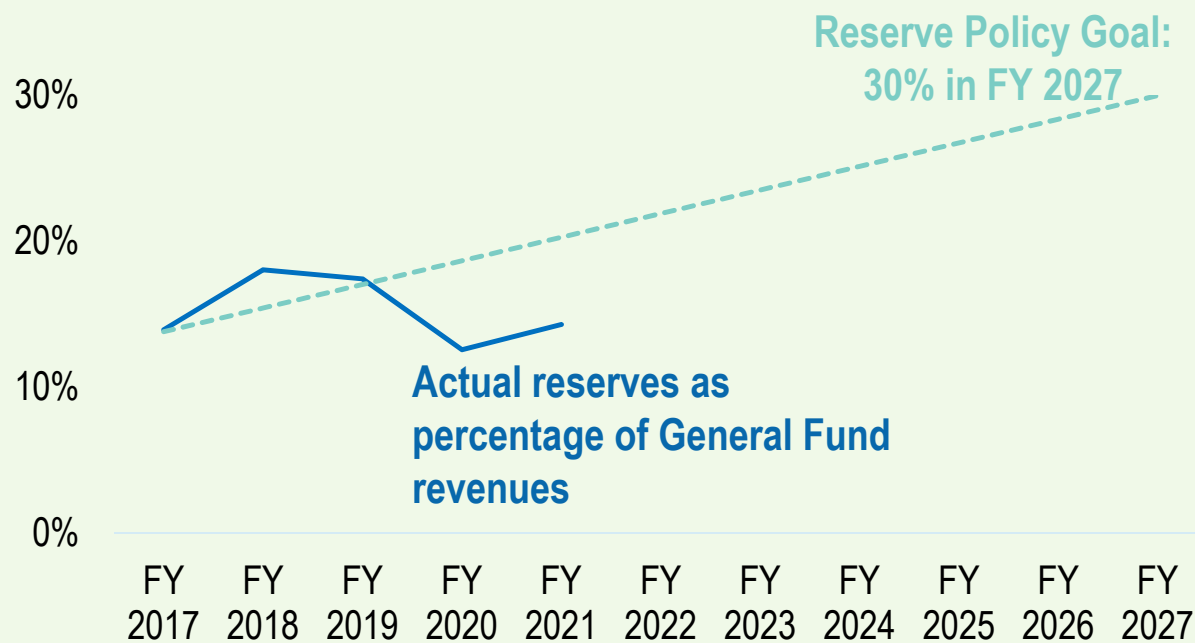
- The City is currently off track to meet goal.
- The City used reserves to address shortfalls due to the COVID-19 pandemic.
- The City doesn't have a plan for how to meet its FY 2027 reserve goal.

Source: Year-End Results and First Quarter Budget Update Reports, Figure 16 in report

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

Enterprise Fund Annual Shortfalls

	FY 2016	FY 2017	FY 2018	FY 2019	FY 2020	FY 2021
Permit Service Center	✕			✕		✕
Sanitary Sewer	✕				✕	
Zero Waste						✕
Parking Meter			✕		✕	
Marina			✕		✕	✕
Off-Street Parking	--	--	--	✕	✕	

- Recurring shortfalls may compromise a fund's ability to meet balance requirement.
- Difficult to assess fund health without balance targets.

Source: Berkeley's budgets, Tables 1-6 in report

What we found:

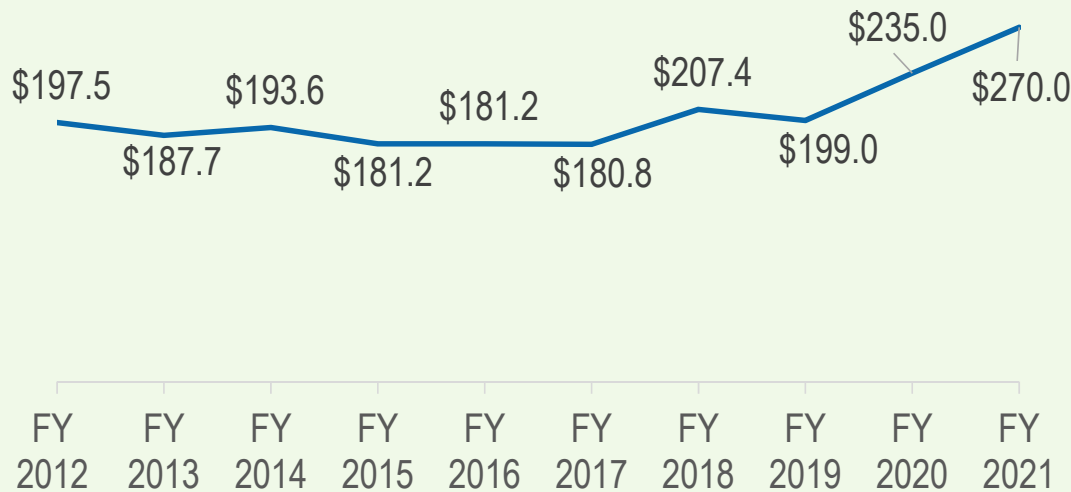Near-term indicators are generally positive:

- Revenues and Expenses

- Demographic and Economic Indicators

- Net Position, Liquidity, and Reserves
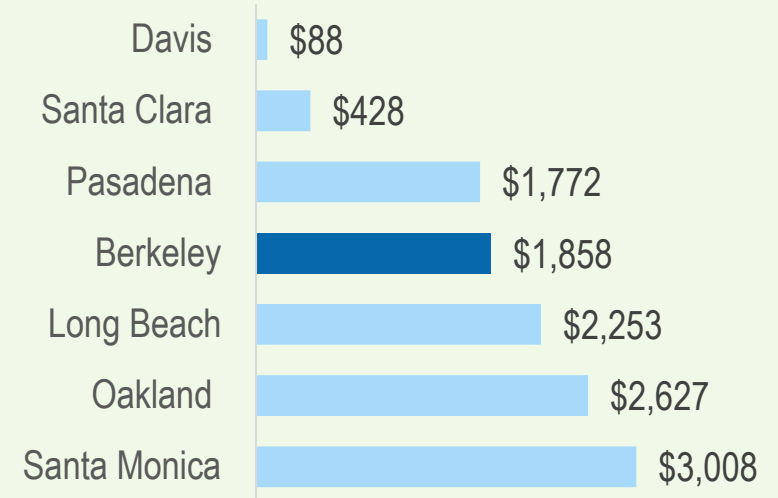
Long-term indicators reveal some challenges:

- **Long-Term Debt and Liabilities**

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

- Capital Assets

Long-term liabilities increased between FY 2012 and FY 2021.

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

$197.5
$187.7
$193.6
$181.2
$181.2
$180.8
$207.4
$199.0
$235.0
$270.0

FY 2012　FY 2013　FY 2014　FY 2015　FY 2016　FY 2017　FY 2018　FY 2019　FY 2020　FY 2021

Governmental Activities Long-Term Liabilities per Resident, FY 2020

City	Amount
Davis	$88
Santa Clara	$428
Pasadena	$1,772
Berkeley	$1,858
Long Beach	$2,253
Oakland	$2,627
Santa Monica	$3,008

Source: Berkeley ACFRs, Figure 17 in report; Cities' FY 2020 ACFRs, Figure 18 in report

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

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

- 91% of Berkeley's debt is general obligation (GO) bonds.

Source: Berkeley ACFRs, Table 7 in report

General obligation bond debt per resident has grown.

Outstanding General Obligation Debt per Resident (adjusted for inflation)

Fiscal Year	General Obligation Bond 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

Total debt issued:
$148,000,000

- Since FY 2012, Berkeley has passed three general obligation bond measures totaling $265 million.
- $117 million in unissued debt remains for Measures T1 and O.

Source: Berkeley ACFRs, Table 8 in report

Payments for existing debt will peak in FY 2024.

Scheduled Debt Service on Outstanding General Obligation Debt (in millions)

Fiscal Year	Scheduled Debt Service
2022	$10.8
2023	$12.5
2024	$12.7
2025	$11.8
2026	$11.8
2027	$11.8
2028	$11.8
2029	$10.9
2030	$9.7
2031	$9.2
2032	$9.2
2033	$9.2
2034	$9.2
2035	$9.2
2036	$9.2
2037	$9.2

Fiscal Year	Scheduled Debt Service
2038	$9.2
2039	$8.8
2040	$8.8
2041	$7.4
2042	$7.4
2043	$7.5
2044	$7.5
2045	$6.6
2046	$6.6
2047	$6.6
2048	$5.7
2049	$4.0
2050	$4.0
2051	$4.0
2052	$2.0

- Debt service is scheduled to peak in FY 2024.
- Existing debt does not include debt that has not yet been issued.

Source: Berkeley ACFRs, Table 9 in report

The City's general obligation bond debt remained under 1 percent of taxable assessed property value.

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

FY 2012	FY 2013	FY 2014	FY 2015	FY 2016	FY 2017	FY 2018	FY 2019	FY 2020	FY 2021	Debt Limit in Policy
0.63%	0.59%	0.65%	0.59%	0.56%	0.56%	0.68%	0.60%	0.72%	0.85%	15%

- 15% debt limit may overlook important considerations in determining what a manageable amount of debt looks like for Berkeley.
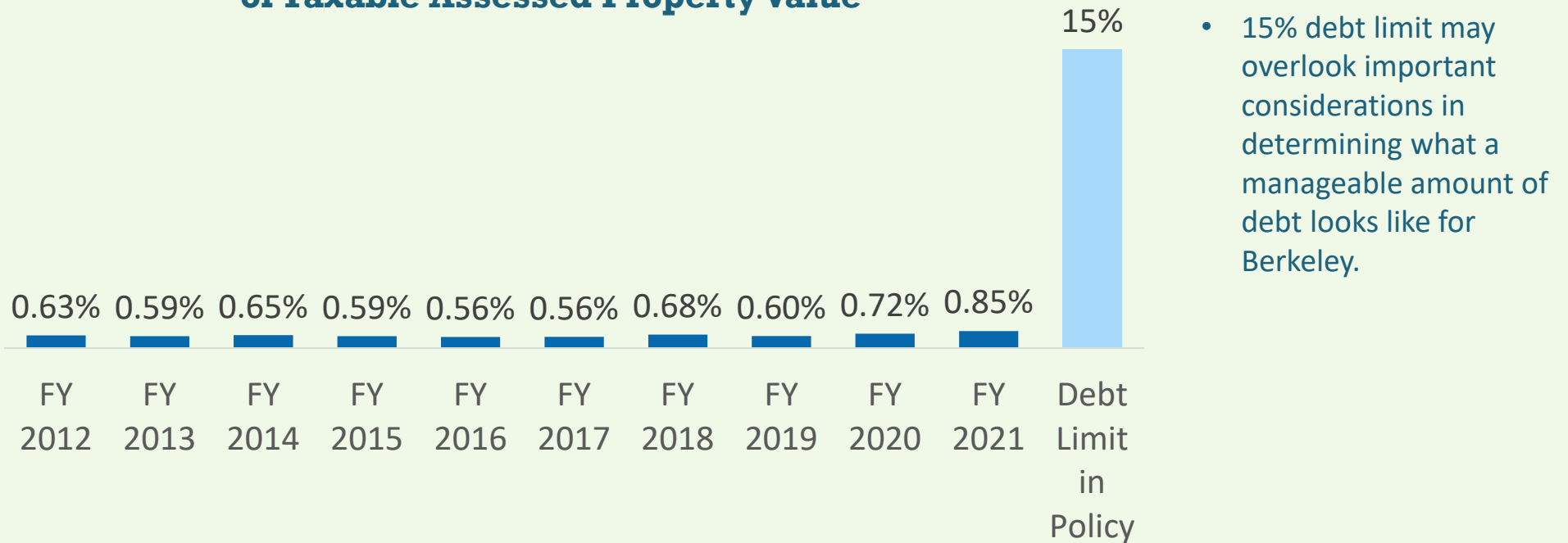
Source: Berkeley ACFRs, Figure 20 in report

What we found:

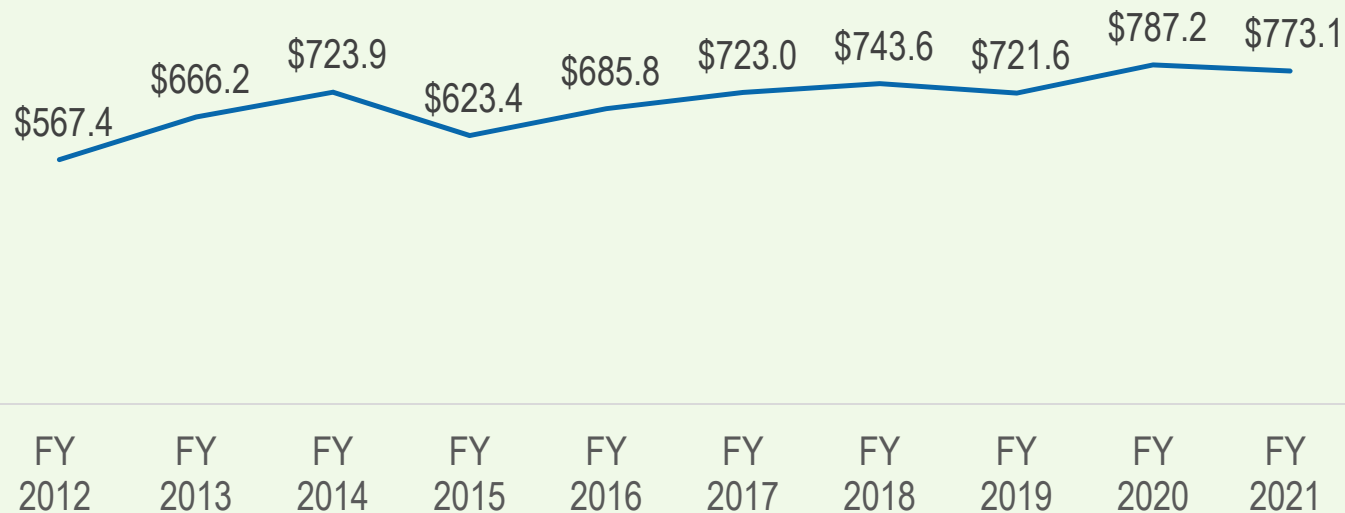Near-term indicators are generally positive:

- Revenues and Expenses

- Demographic and Economic Indicators

- Net Position, Liquidity, and Reserves

Long-term indicators reveal some challenges:

- Long-Term Debt and Liabilities

- **Unfunded Pension and Other Post-Employment Benefit (OPEB) Liabilities**

- Capital Assets

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

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

$567.4 $666.2 $723.9 $623.4 $685.8 $723.0 $743.6 $721.6 $787.2 $773.1

FY 2012   FY 2013   FY 2014   FY 2015   FY 2016   FY 2017   FY 2018   FY 2019   FY 2020   FY 2021

Net pension liability increased by:
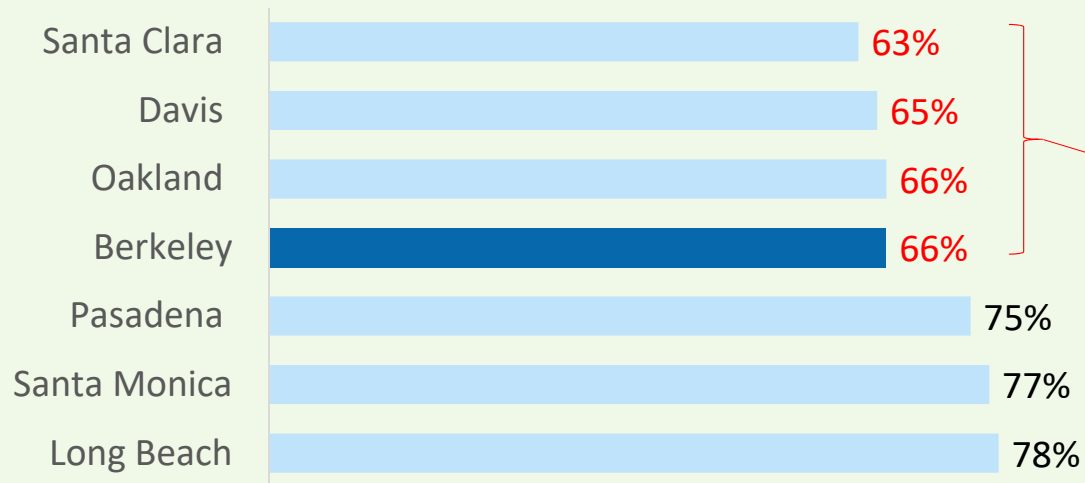
$151.0 million

Net OPEB liability increased by:

$54.7 million

Source: Department of Finance data, Figure 21 in report

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

Funded Ratio of Pension Plans, FY 2020

City	Funded Ratio
Santa Clara	63%
Davis	65%
Oakland	66%
Berkeley	66%
Pasadena	75%
Santa Monica	77%
Long Beach	78%

State Auditor's Funded Ratio Risk Levels

Risk	Value of Pension Assets Compared to Accrued Pension Liabilities
High	0-70%
Moderate	71-80%
Low	81-100%

- If the pension funded ratio is too low, the City may face higher required contributions which could impact future spending priorities.

Source: California State Auditor's Financial Health Dashboard, Table 10 in report; Figure 24 in report

The City has taken steps to increase pension funding.

Contributions to the Section 115 Trust, FY 2018 to 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)

- The City hasn't met its annual target contributions into the Trust.

Source: Office of Budget and Fiscal Management data, Department of Finance data, Table 11 in report

What we found:

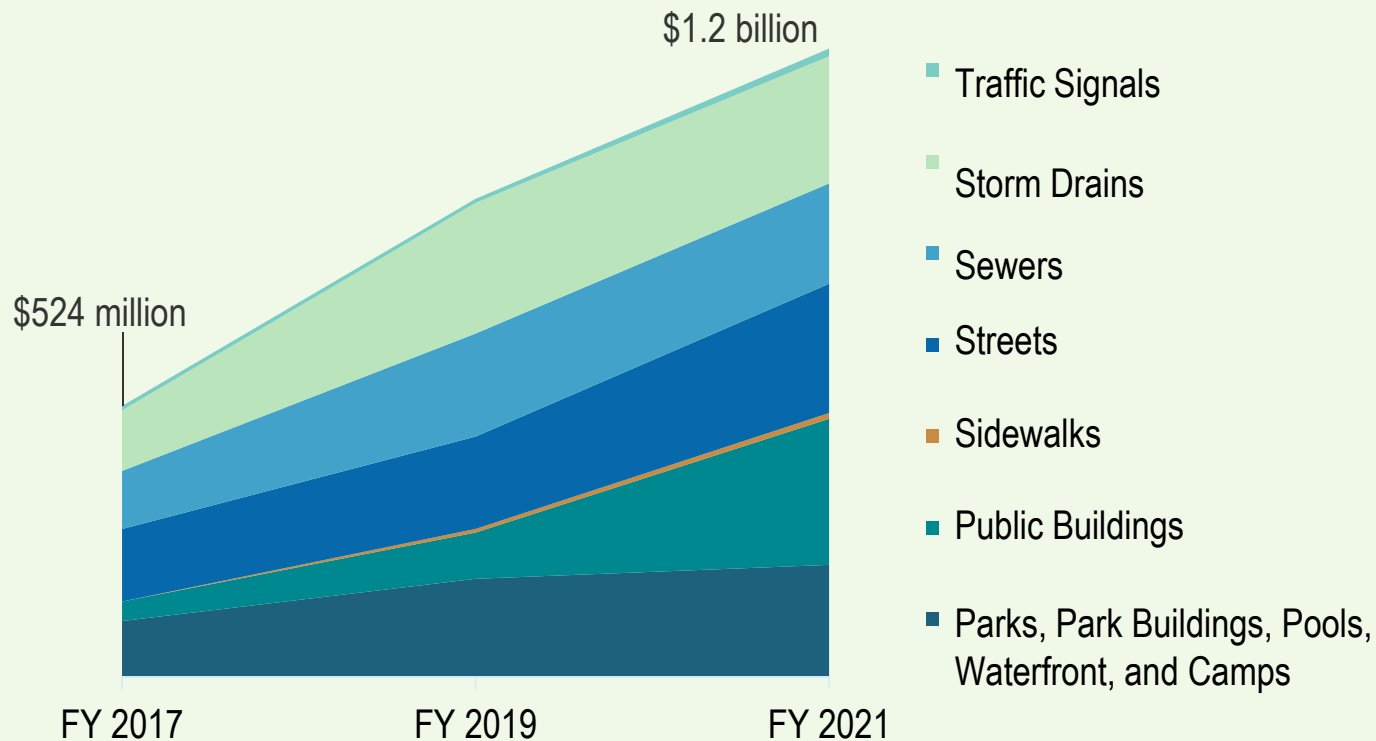### Near-term indicators are generally positive:

- Revenues and Expenses

- Demographic and Economic Indicators

- Net Position, Liquidity, and Reserves

Long-term indicators reveal some challenges:

- Long-Term Debt and Liabilities

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

- **Capital Assets**

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

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

- Traffic Signals
- Storm Drains
- Sewers
- Streets
- Sidewalks
- Public Buildings
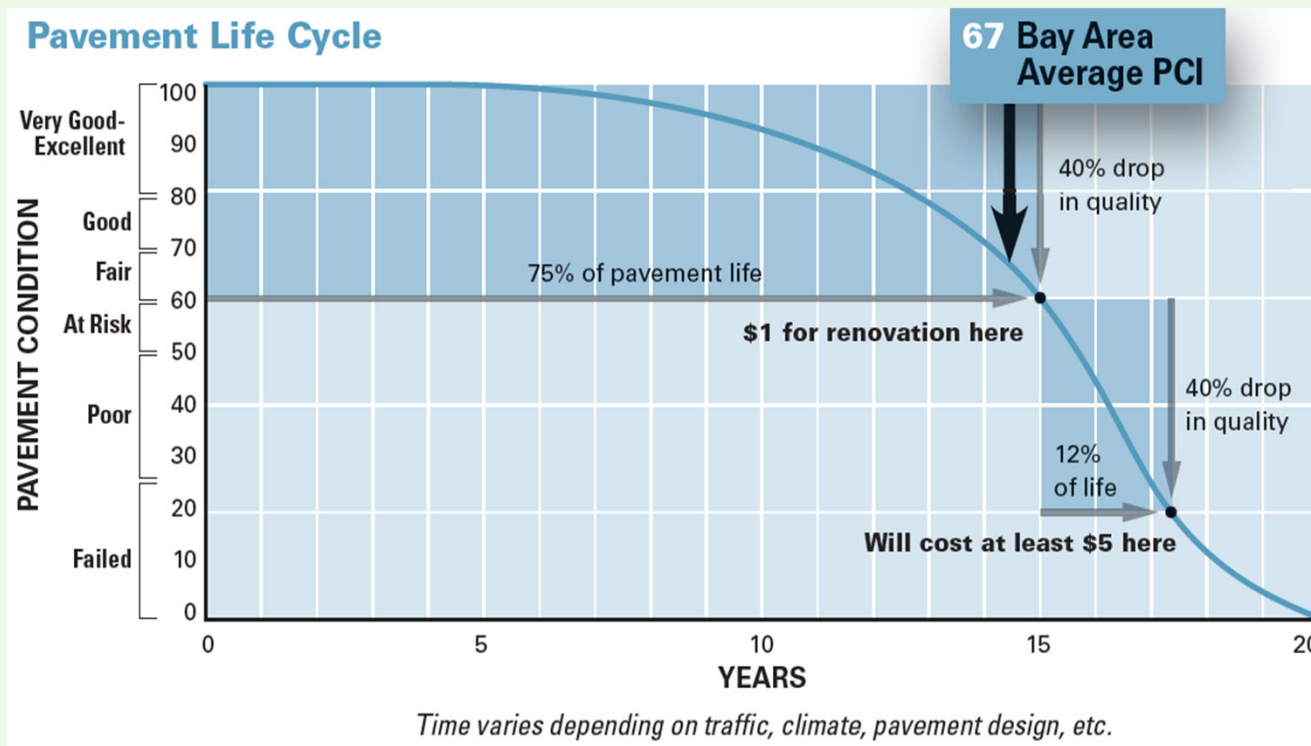- Parks, Park Buildings, Pools, Waterfront, and Camps

- Various factors drove the increase
- Measures M, T1, and O were steps in the right direction but didn't cover all needs

Source: Berkeley's unfunded liability reports, Figure 26 in report

Without regular investment, the City will face deferred maintenance costs down the line.

Pavement Maintenance Costs

Pavement Life Cycle

67 Bay Area Average PCI

40% drop in quality

75% of pavement life

$1 for renovation here

40% drop in quality

12% of life

Will cost at least $5 here

PAVEMENT CONDITION

Very Good-Excellent — 100, 90
Good — 80, 70
Fair — 60
At Risk — 50
Poor — 40, 30, 20
Failed — 10, 0

YEARS — 0, 5, 10, 15, 20

Time varies depending on traffic, climate, pavement design, etc.

- Underinvestment now can lead to higher rehabilitation costs later.

Source: Metropolitan Transportation Commission Pothole Report III, Figure 25 in report

Recommendations

We recommend that the City:

1. Complete a risk assessment and propose a plan to City Council to replenish the **reserves**.

2. Assess the appropriate fund balance for **enterprise funds**, report findings to City Council, and explore financial policy options.

3. Update the **Debt Management Policy**.

4. Present a plan for adoption by the City Council to assure sufficient contributions to the **Section 115 Trust**.

5. Implement a funding plan to reduce unfunded **capital and deferred maintenance needs** and prevent excessive deferred maintenance costs in the future.

Management Response

The City Manager, Director of Finance, Budget Director and Director of Public Works agreed with our audit findings, conclusions and recommendations, and provided an action plan to address our recommendations.

BERKELEY CITY AUDITOR

We would like to thank the City Manager, Director of Finance, Budget Director and Director of Public for their cooperation with this audit.

BERKELEY CITY AUDITOR