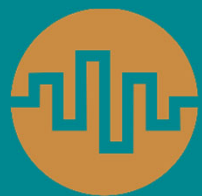


Berkeley's Financial Condition (FY 2012 - FY 2021): Pension Liabilities and Infrastructure Need Attention

City Council Meeting
May 24, 2022



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.



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.

**Audit Scope:
FY 2012 – FY 2021**

Findings:

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

Findings:

Near-term indicators are generally positive:

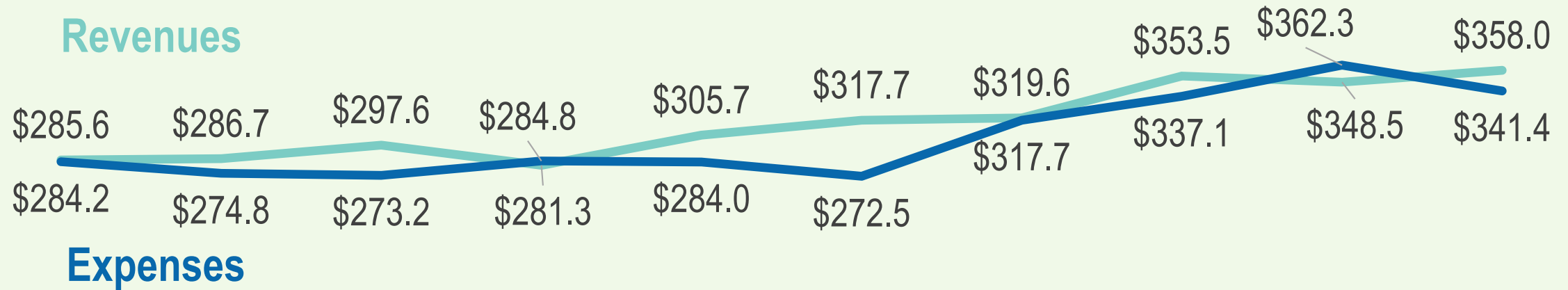
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The City's governmental activities revenues generally outpaced expenses.

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

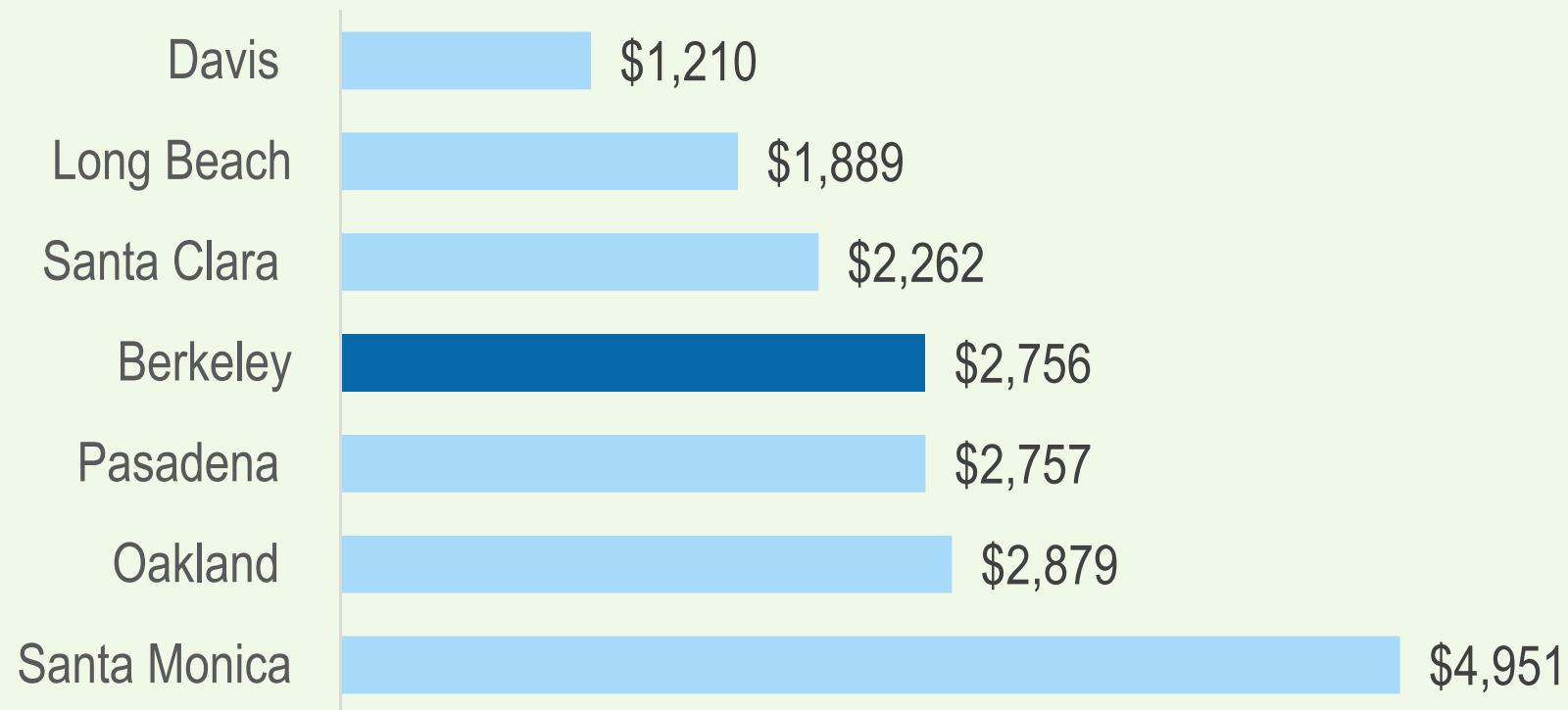


Governmental revenues exceeded **governmental expenses** for all years surveyed except for FY 2015 and FY 2020.

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

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



Source: Cities' FY 2020 ACFRs, Figure 5 in report

Findings:

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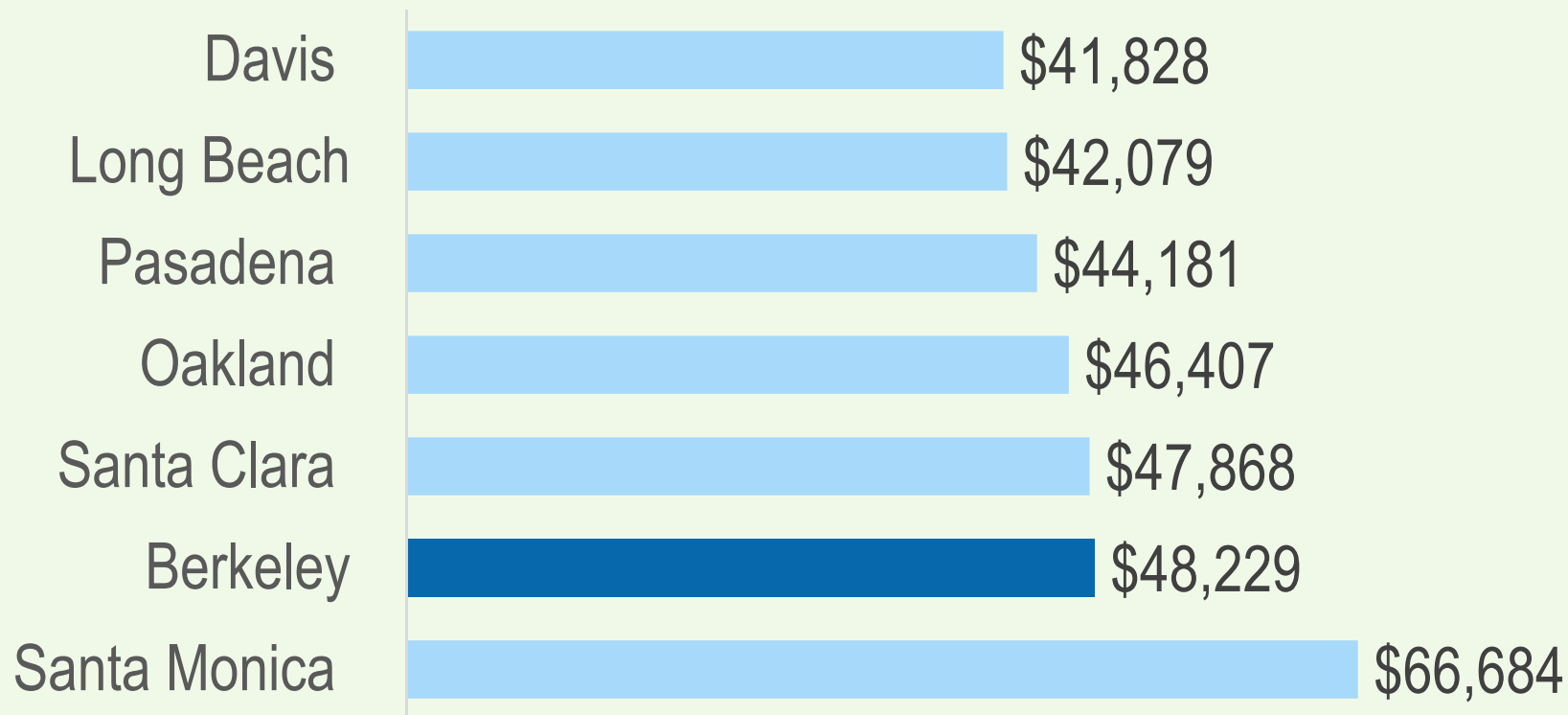
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Berkeley's personal income per resident was high compared to benchmark cities in FY 2020.

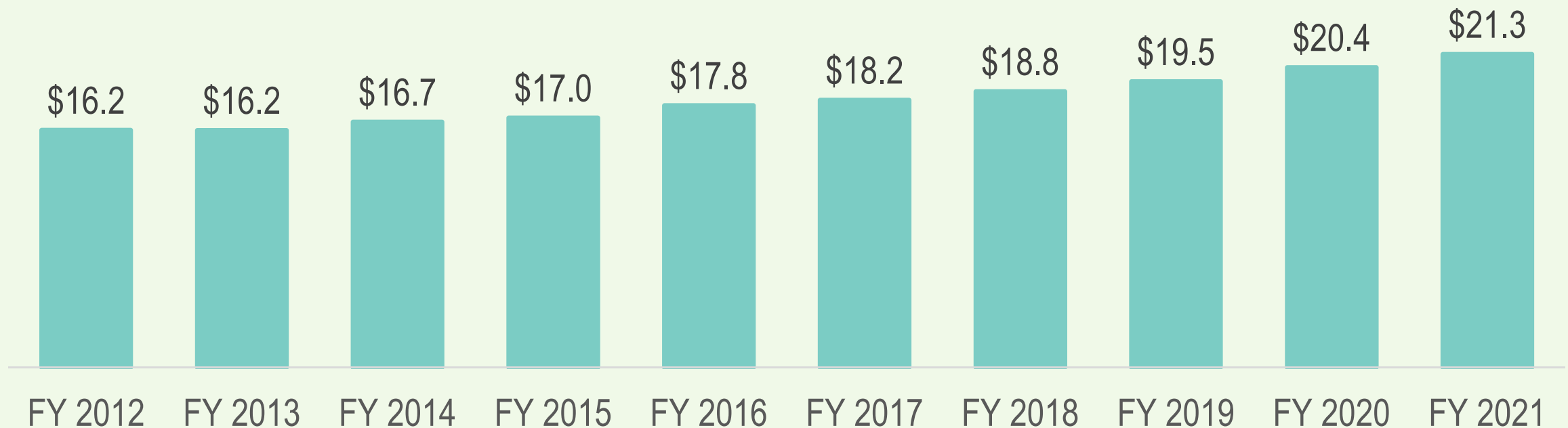
Personal Income per Resident, FY 2020



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

Property values have been a growing source of city revenues.

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



Findings:

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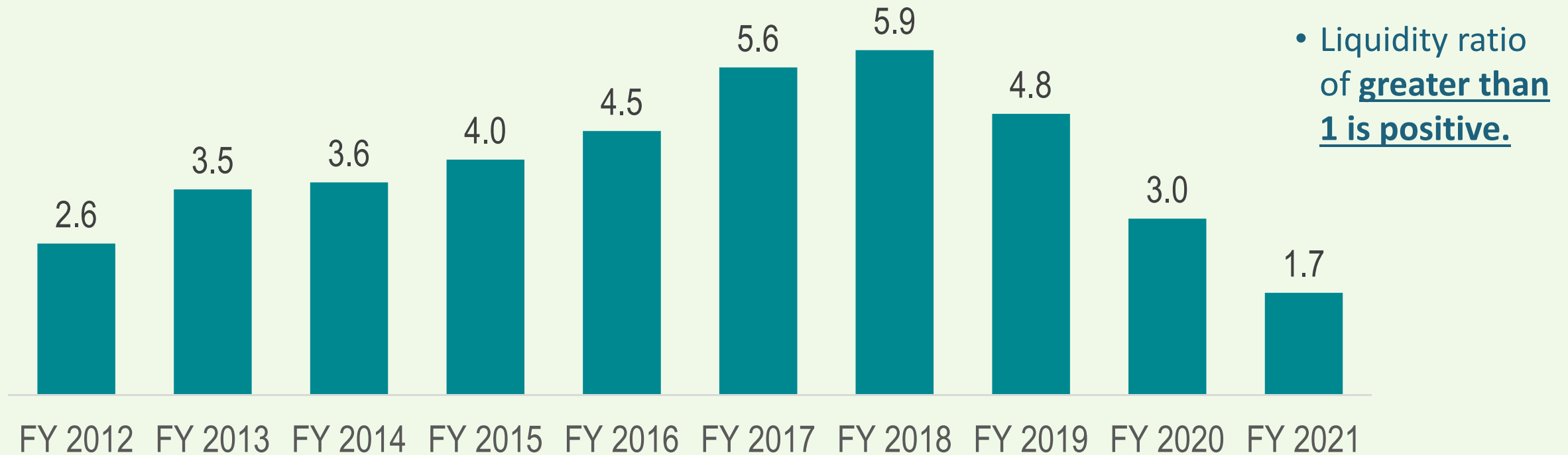
- Revenues and Expenses
- Demographic and Economic Indicators
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Berkeley's liquidity ratio is strong, but has declined since FY 2018.

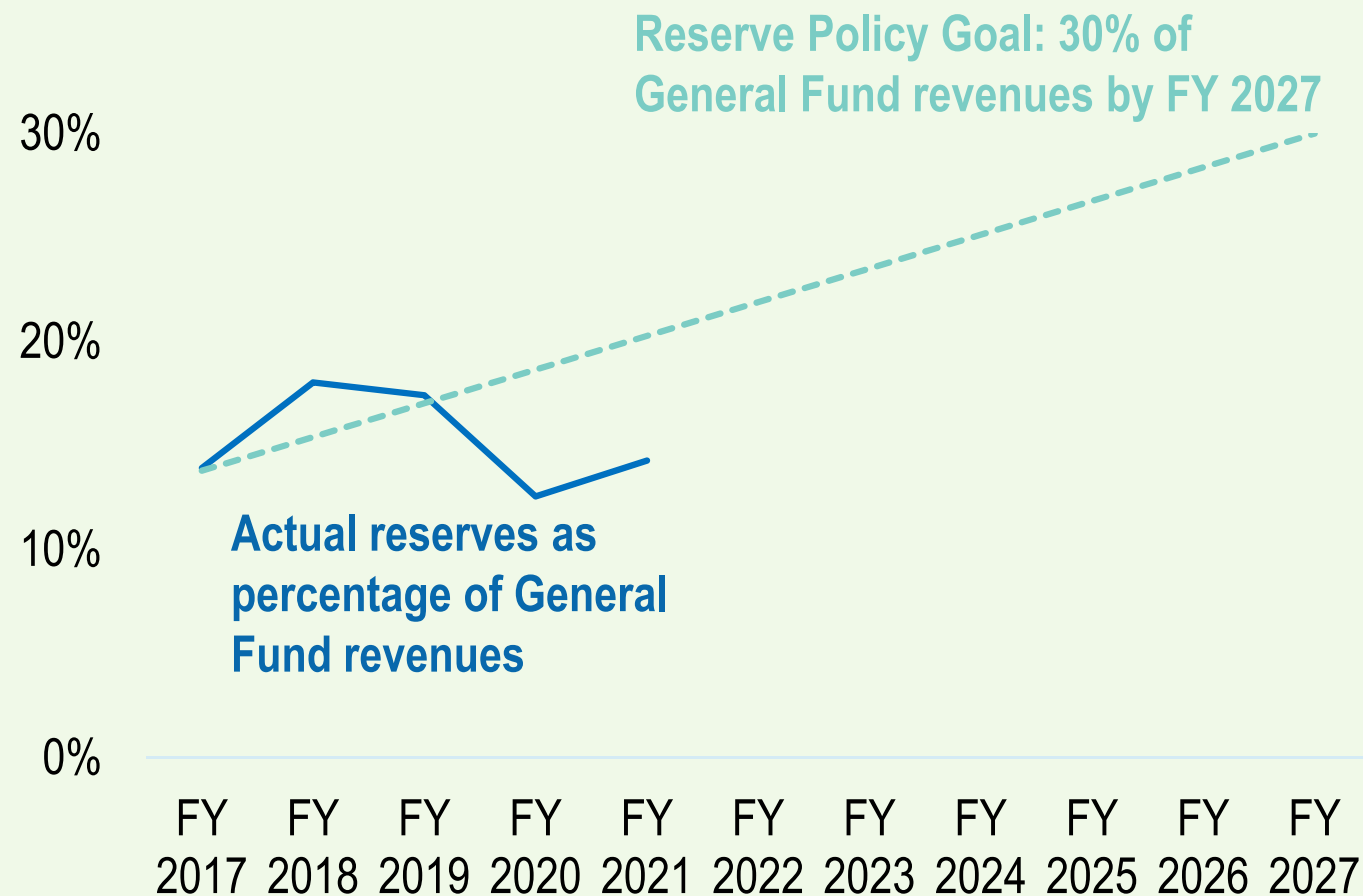
Liquidity Ratio of Current Assets to Current Liabilities



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



- 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	X			X		X
Sanitary Sewer	X				X	
Zero Waste						X
Parking Meter			X		X	
Marina			X		X	X
Off-Street Parking	--	--	--	X	X	

- 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

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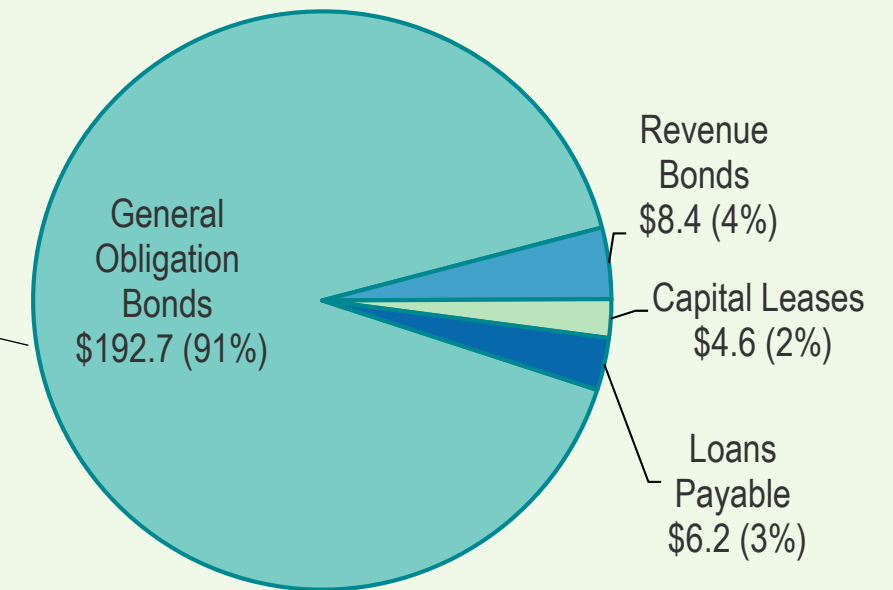
- **Long-Term Debt and Liabilities**
- Unfunded Pension and Other Post-Employment Benefit (OPEB) Liabilities
- Capital Assets

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

**Governmental Activities
Debt by Type, FY 2021**

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	AA+	AA+	AA+	AA+	AA+	AA+	AA+	AA+	AA+	AA+
Moody's	Aa2	Aa2	Aa2	Aa2	Aa2	Aa2	Aa2	Aa1	Aa1	Aa1



Source: Berkeley ACFRs, Table 7 in report; Figure 19 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

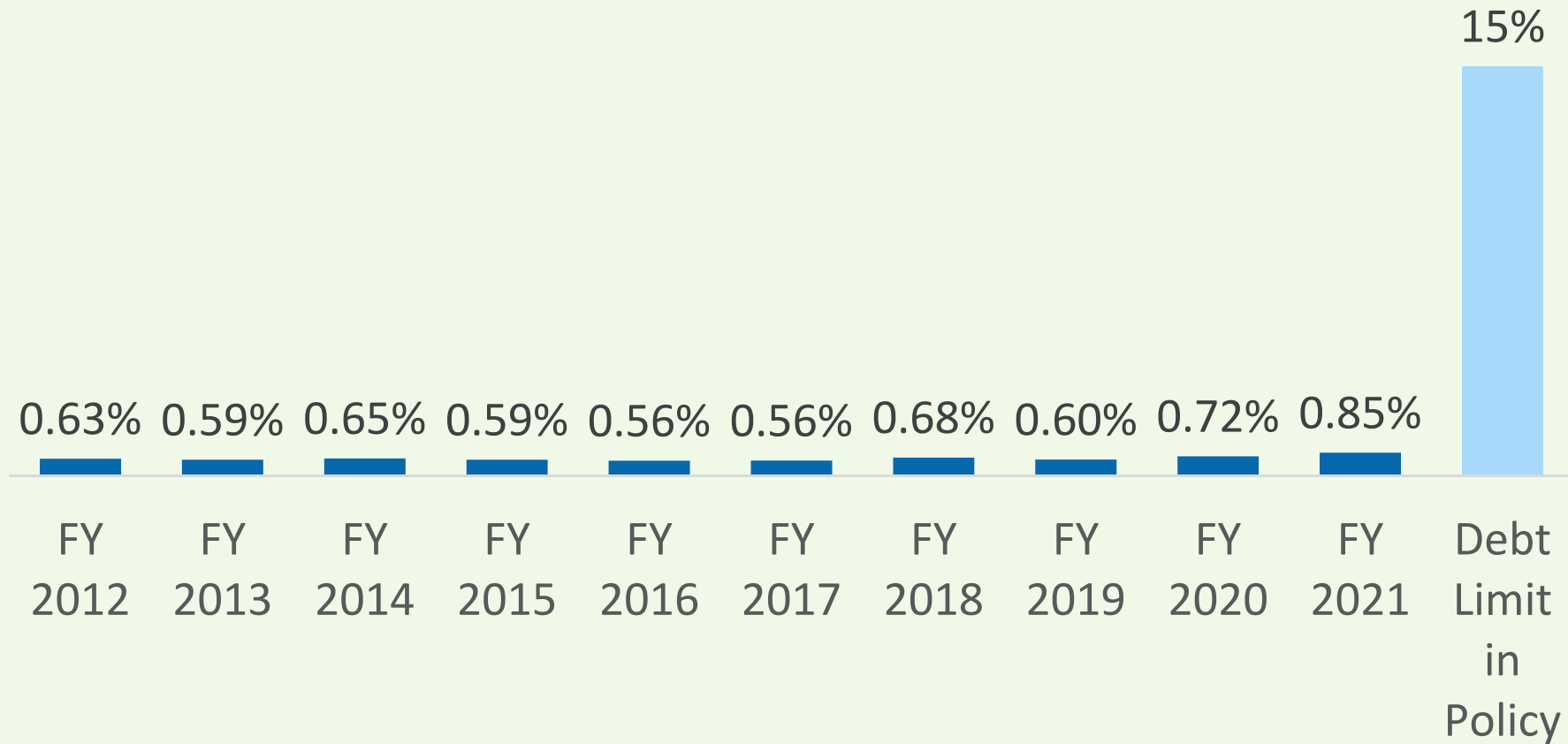
- Since FY 2012, Berkeley has passed three general obligation bond measures totaling \$265 million.
- \$117 million in unissued debt remains for Measures T1 and O.

**Total debt issued:
\$148,000,000**

Source: Berkeley ACFRs, Table 8 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



Source: Berkeley ACFRs, Figure 20 in report

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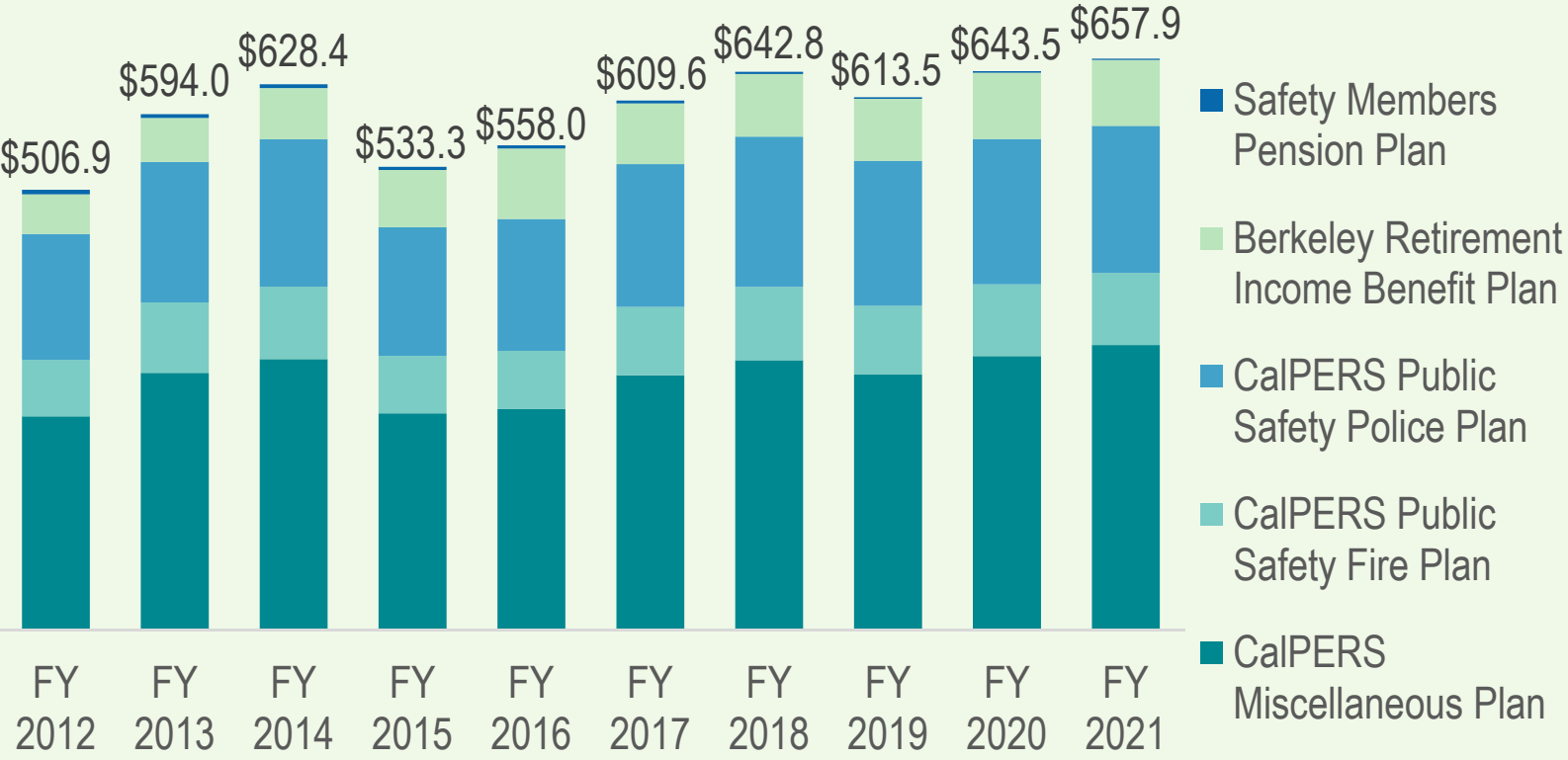
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- Capital Assets

The City's net pension liability grew by 30 percent.

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

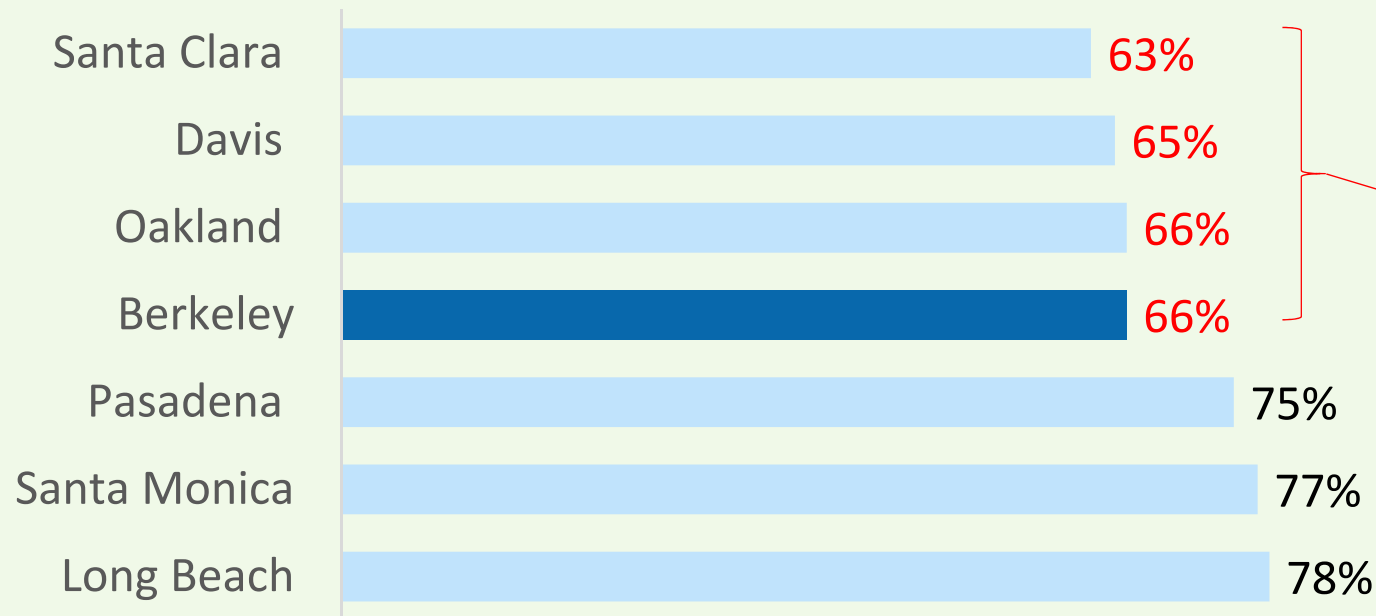


Net pension liability increased by:
\$151.0 million

Source: Department of Finance data, Figure 22 in report

The California State Auditor considers the pension funded ratio of Berkeley and other cities to be high risk.

Funded Ratio of Pension Plans, FY 2020



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%

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 by establishing the Section 115 Trust.

Contributions to the Section 115 Trust, FY 2019 to 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: Department of Finance data; May 14, 2019 staff report to City Council

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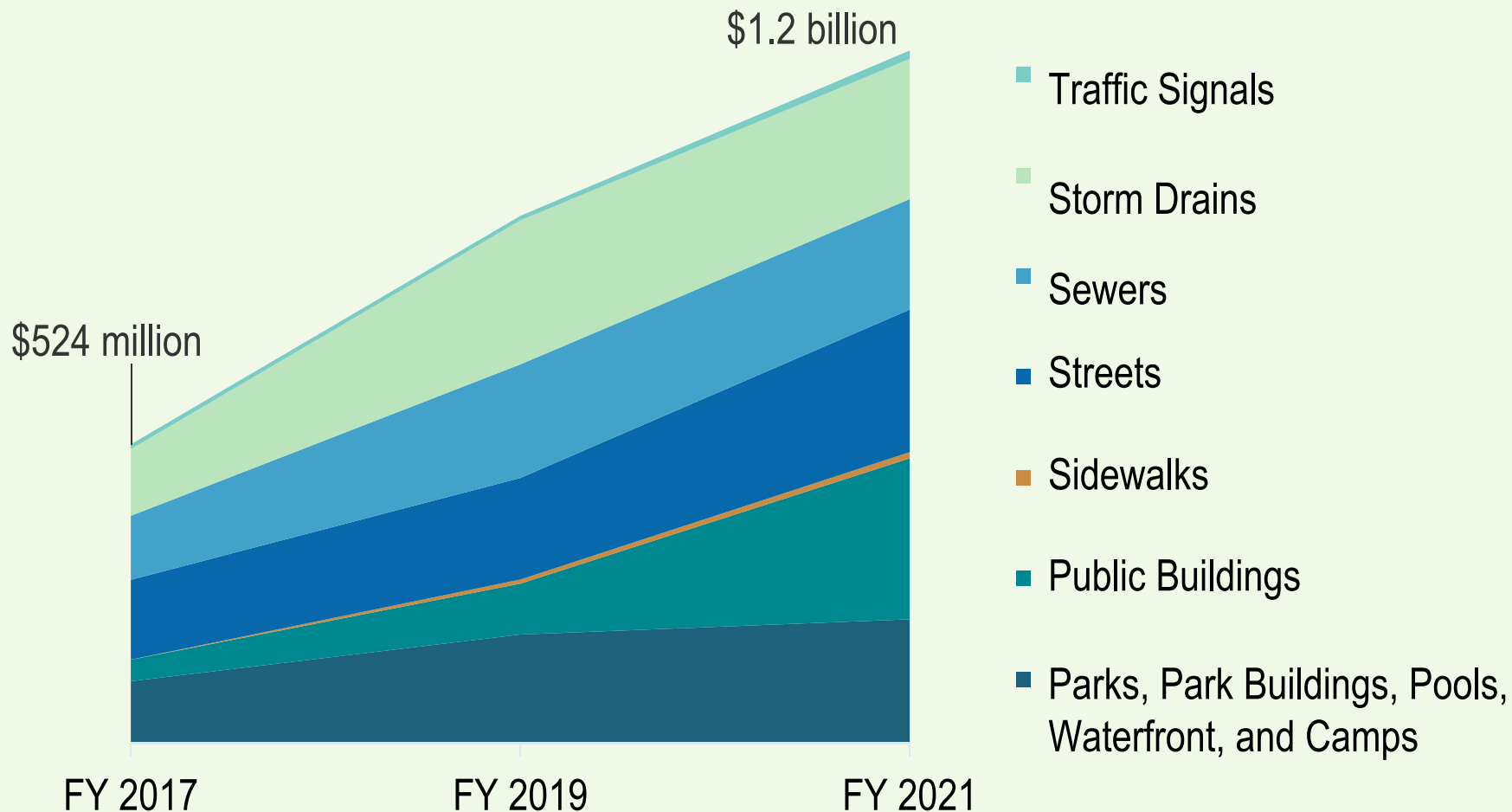
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- **Capital Assets**

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)

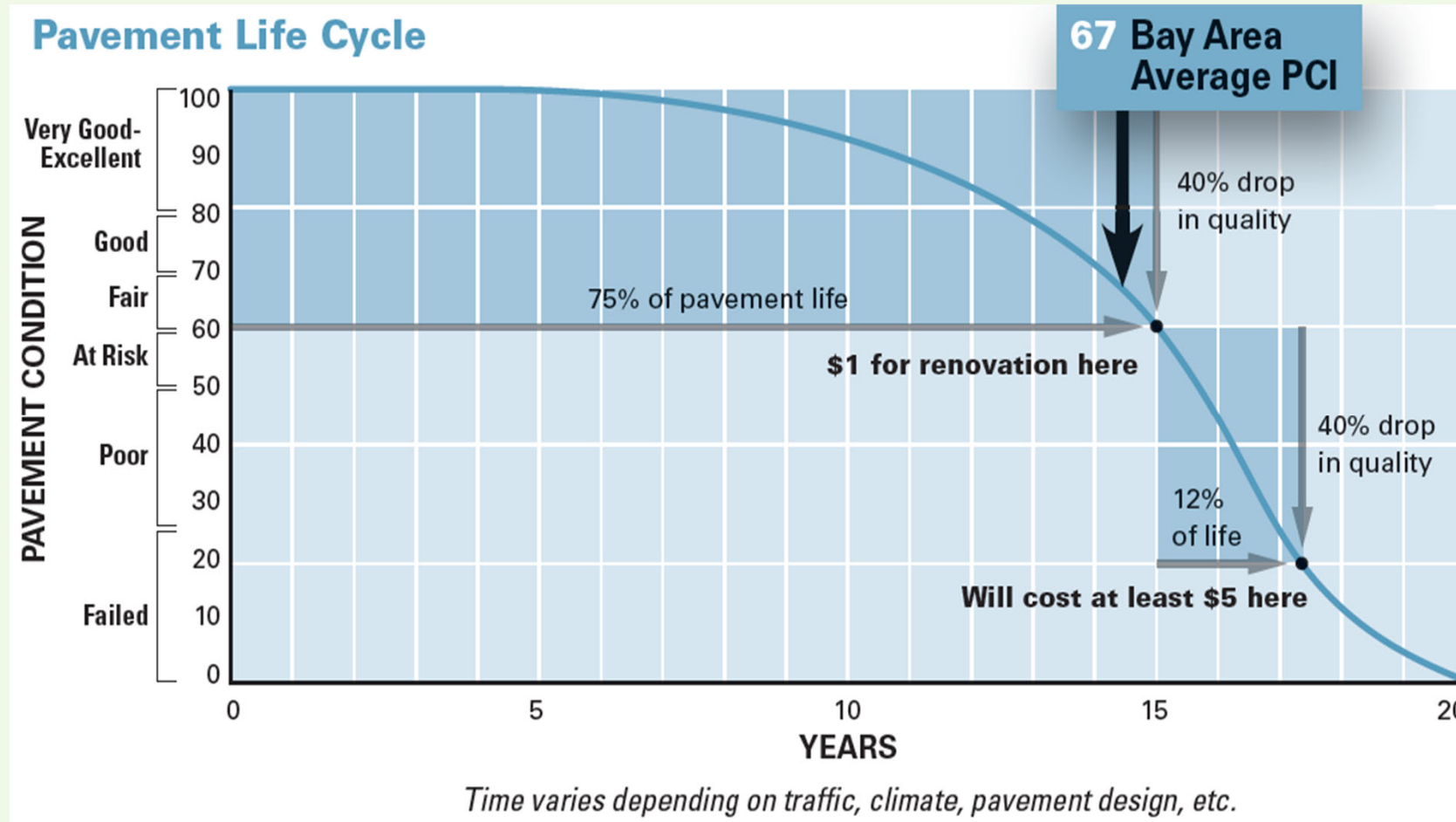


- Measures M, T1, and O were steps in the right direction but didn't cover all needs

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



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.



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



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