



## STAFF REPORT TO THE FINANCE COMMISSION

**DATE:** Regular Meeting of May 12, 2026

**TO:** Members of the Finance Commission

**SUBMITTED BY:** Edwin Gato, Director of Finance

**SUBJECT:** Budget Workshop: Fiscal Year (FY) 26-27 City of Hercules Proposed Annual Budget

### RECOMMENDED ACTION:

The staff recommends that the Finance Commission receive the budget presentation, review the preliminary budget documents, and the financial forecast for FY 26-27. This discussion should also cover the additional budget request outlined in Attachment 1, which details significant changes and the economic implications of each adjustment.

### EXECUTIVE SUMMARY:

The City operates within a structured fiscal framework, and this meeting marks the beginning of the FY 26-27 Annual Budget development process. This report outlines the proposed allocations for the FY 26-27 Annual Budget, including both one-time and ongoing investments, as well as strategies to enhance long-term financial stability. Our primary objective is to address the community's needs while remaining aligned with the City's current and projected financial resources. The proposed budget reflects the community's long-term vision, strategic priorities, and plans.

The first public hearing regarding the introduction of this budget will take place on June 9, 2026. Following this session, the City Council will deliberate on the adoption of the proposed FY 26-27 Annual Budget during a second public hearing, scheduled for June 23, 2026.

To improve public understanding of the budget development process, the City has created an informative video that explains the complexities of financial planning and management. This resource guides viewers through the essential steps of budget formulation, offering clear explanations and valuable insights. The video is available on the City's website at the following link: <https://www.ci.hercules.ca.us/government/finance/budgets>.

## **BACKGROUND:**

On May 28, 2024, the Hercules City Council officially adopted the Strategic Goals for 2024-2026. This important decision represents a significant step forward in shaping our community's future. The adoption establishes a clear framework that will guide the Council's priorities in the coming years. The multi-year objectives outlined in this plan are designed to address key needs and opportunities, ultimately enhancing the overall quality of life and social well-being for all Hercules residents.

The goals are as follows:

Goal #1: Advance the development of the Hercules Hub, creating a dynamic center for community engagement and economic activity.

Goal #2: Strengthen the city's fiscal sustainability through prudent financial management, ensuring long-term economic viability.

Goal #3: Enhance transparency and communication within the community, fostering a culture of openness and collaboration between residents and city officials.

Goal #4: Continue investing in a skilled and dedicated team at City Hall to ensure effective governance and service delivery.

Goal #5: Strategically plan and fund major infrastructure projects to improve connectivity and enhance the quality of life for all citizens.

Goal #6: Develop a comprehensive land-use strategy that promotes responsible development while preserving the unique character of our neighborhoods.

Goal #7: Formulate a detailed economic development strategy to attract new businesses and stimulate local employment opportunities.

The City Manager's proposed annual budget is a thoughtfully developed document that emphasizes a commitment to long-term financial stability. It includes detailed revenue forecasts and carefully allocated expenditures across various funding categories, such as the General Fund, designated restricted funds, sewer services, debt service, and internal service funds.

This budget comprehensively addresses all dimensions of City operations, ensuring the effective delivery of essential services. It encompasses routine operational functions, strategic capital investments intended to enhance infrastructure, and responsible management of existing debt obligations. By employing a holistic approach, this budget not only meets current operational requirements but also positions the City for sustainable growth and development.

This document offers comprehensive summaries of the various funds and detailed financial schedules that highlight the actual financial outcomes from the previous year. Additionally, it provides an in-depth comparative analysis of the proposed budget for FY 26-27 relative to the prior-year budget.

## **Overall Assumptions:**

The following sections break down the essential assumptions that shaped this budgeting process, offering a transparent and insightful roadmap for our strategic initiatives moving forward.

### I. Salaries and Benefits

Labor accounts for the largest share of our overall expenses, representing nearly 60% of total expenditures. This significant category includes not only direct compensation, such as wages and salaries, but also a variety of essential benefits, including comprehensive health insurance, robust retirement plans, and other associated labor costs. The following section details the key assumptions that have been meticulously considered in estimating the financial implications of salaries and benefits:

A. Base Salary: The costs related to personnel services include a 3% cost-of-living adjustment aimed at helping employees keep up with inflation. Additionally, a 2% equity adjustment has been implemented for members of the Police Officers Association (POA) bargaining group, in accordance with the terms outlined in the approved labor agreements. These adjustments demonstrate our commitment to offering fair and competitive compensation for our law enforcement professionals.

### B. Retirement Plans:

**Normal Cost:** The projected normal cost rates for the PERS Miscellaneous and Public Safety classifications have been determined through a comprehensive actuarial valuation based on data as of June 30, 2024. This analysis, conducted by CalPERS and specific to the City's retirement plans, is essential for establishing the minimum required contributions for FY 26-27.

The term "normal cost" refers to the annual amount, expressed as a percentage of payroll, required to fund the pension benefits earned by current employees during the current fiscal year. Additionally, the accompanying table provides an overview of changes in contribution rates, making a clear comparison with the previous year's budget. This information underscores the financial adjustments needed to ensure the sustainability and integrity of our retirement systems, which is crucial for policymakers and stakeholders involved in fiscal planning and management.

<b>Plan Type</b>	<b>Membership Type</b>	<b>FY 25-26 Prior Year Budget</b>	<b>FY 26-27 Proposed Budget</b>	<b>Change from Prior Year Budget</b>
Safety	Classic	27.38%	27.42%	0.04%
Safety	PEPRA	13.99%	13.91%	-0.08%
Non-Safety	Classic	11.94%	11.92%	-0.02%
Non-Safety	PEPRA	7.96%	7.93%	-0.03%

**Unfunded Actuarial Liability (UAL) Analysis:** The projected contribution amounts for the unfunded actuarial liability (UAL) for the PERS Miscellaneous and Public Safety classifications have been established through a thorough actuarial valuation conducted by CalPERS, using data as of June 30, 2023. This comprehensive analysis is vital for determining the minimum required contributions for the FY 26-27.

The Unfunded Actuarial Liability (UAL) represents the discrepancy between the total cost of promised pension benefits and the currently available assets to fund those obligations. This shortfall indicates that the existing assets are insufficient to fulfill all promised payments to both current and future retirees. A substantial UAL can create significant financial challenges for the pension system, potentially necessitating increased employer contributions to address the resulting deficit.

<b>Plan Type</b>	<b>Membership Type</b>	<b>FY 25-26 Prior Year Budget</b>	<b>FY 26-27 Proposed Budget</b>	<b>Change from Prior Year Budget</b>
Safety	Classic	\$ 1,049,426	\$ 1,170,121	\$ 120,695
Safety	PEPRA	\$ 20,455	\$ 20,455	\$ -
Non-Safety	Classic	\$ 862,624	\$ 961,249	\$ 98,625
Non-Safety	PEPRA	\$ 10,296	\$ 11,473	\$ 1,177
		<b>\$ 1,942,801</b>	<b>\$ 2,163,298</b>	<b>\$ 220,497</b>

The City's current funding ratio is approximately 70%. This figure is generally regarded as adequate by rating agencies, showing that the City's financial health is considered "fairly healthy." This evaluation indicates stable and responsible management of resources, which provides stakeholders and potential investors with a respectable level of confidence. However, it is essential to recognize that a funding ratio of 70% is not optimal. While it reduces the risk of immediate insolvency, it remains below the 80%–90% range that is typically classified as "resilient" or "strong". Consequently, this situation reflects moderate long-term risk and emphasizes the necessity for ongoing, consistent contributions to ultimately achieve a funding level of 100%.

Fortunately, the City has proactively established a section 115 trust, which allows for the prefunding of pension liabilities through an irrevocable, tax-exempt trust. This strategy not only aids in reducing long-term costs through investment returns but also safeguards assets from potential

budgetary reallocations. Furthermore, it enhances fiscal stability, improves credit ratings, and provides greater investment flexibility than conventional municipal funds, thereby supporting the effective management of high pension volatility.

- C. Employer-sponsored health insurance, which provides essential medical, dental, and vision coverage, is projected to experience a modest 3% increase in premiums relative to the prior year's FY 25-26 Kaiser rate. This anticipated adjustment reflects prevailing trends in healthcare expenses and underscores our commitment to delivering valuable health benefits to employees and their families. As we navigate the complexities of the healthcare landscape, we remain steadfast in our commitment to ensuring our workforce has access to comprehensive, vital health coverage.
- D. All other discretionary expenditures are projected to increase by an average of 2%. This average increase is based on prevailing economic trends, the Consumer Price Index (CPI) for the San Francisco area as of February 2026, and efforts to reduce or eliminate non-essential spending. This adjustment aims to manage payroll increases while maintaining overall financial stability effectively.

To ensure a balanced budget in FY 26-27, it is essential to reduce discretionary spending and optimize operational efficiency. By implementing these measures, we can streamline our resources and address the financial challenges posed by rising labor costs until we can generate additional revenue.

In addition to the previously outlined assumptions, Attachment 1 provides a thorough, detailed enumeration of significant budget increases. These additional budget requests are intended to enhance operational efficiency and to align compensation with the elevated responsibilities of various roles. Each proposed enhancement is carefully articulated, accompanied by a clear explanation of its projected impact on the overall budgetary framework. Below is a summary of these increases, underscoring their implications for our financial planning and resource allocation strategies. This approach will facilitate a more effective alignment of our resources with organizational objectives and ultimately promote overall success.

	Budget Impact		
	General Fund	Other Funds	Total
<b>Ongoing costs:</b>			
Reallocation of Full-Time Parking Enforcement Funding	\$11,000	\$0	\$11,000
Full-Time Recreation Technician - Child Care	\$21,000	\$0	\$21,000
Finance Director Salary Grade from 056 to 057.	\$10,000	\$10,000	\$20,000
Reclassifying an Accounting Technician to an Accountant position	\$300	\$0	\$300
<b>Total, Ongong</b>	<b>\$42,300</b>	<b>\$10,000</b>	<b>\$52,300</b>
<b>One-Time Costs:</b>			
Automated External Defibrillator (AED) Replacement	\$26,000	\$0	\$26,000
Community Center Oven Replacement	\$30,000	\$0	\$30,000
<b>Total, One-Time</b>	<b>\$56,000</b>	<b>\$0</b>	<b>\$56,000</b>
<b>Total</b>	<b>\$98,300</b>	<b>\$10,000</b>	<b>\$108,300</b>

The City's annual budget serves as an essential planning instrument that aligns community services with the resources needed to implement them. These critical services span multiple areas, including public safety through the police department, recreational opportunities in parks, community development initiatives, significant public works projects, and effective administrative operations. This comprehensive budget delineates a detailed financial strategy for the forthcoming fiscal year. It includes a five-year forecast for the General Fund, thereby facilitating informed planning for future needs and opportunities that will encourage growth and improve the quality of life for all residents.

As the City prepares to formulate the annual budget for FY 26-27, we encourage community members to share their valuable insights on the priorities that matter most to residents, businesses, and other stakeholders. Our objective is to develop a budget that not only ensures the City's financial sustainability but also supports the continuation of services deemed essential by our community. Your feedback is crucial to shaping a budget that accurately reflects the collective needs and expectations of our community.

## FUND ANALYSIS:

The City utilizes fund accounting to ensure compliance with financial regulations and to enhance transparency in its financial management. A fund is a collection of related accounts, specifically organized to manage resources designated for activities or objectives. In the Analysis section of this report, comprehensive and detailed information is presented on the various categories of funds, emphasizing their distinct purposes and financial implications.

This section provides an in-depth examination of the following fund categories:

- I. General Fund Revenue Estimates
- II. General Fund Expenditures Projections
- III. General Fund Projected Net Annual Results
- IV. General Fund Reserves
- V. General Fund Five-Year Forecast
- VI. Non-General Fund Programs

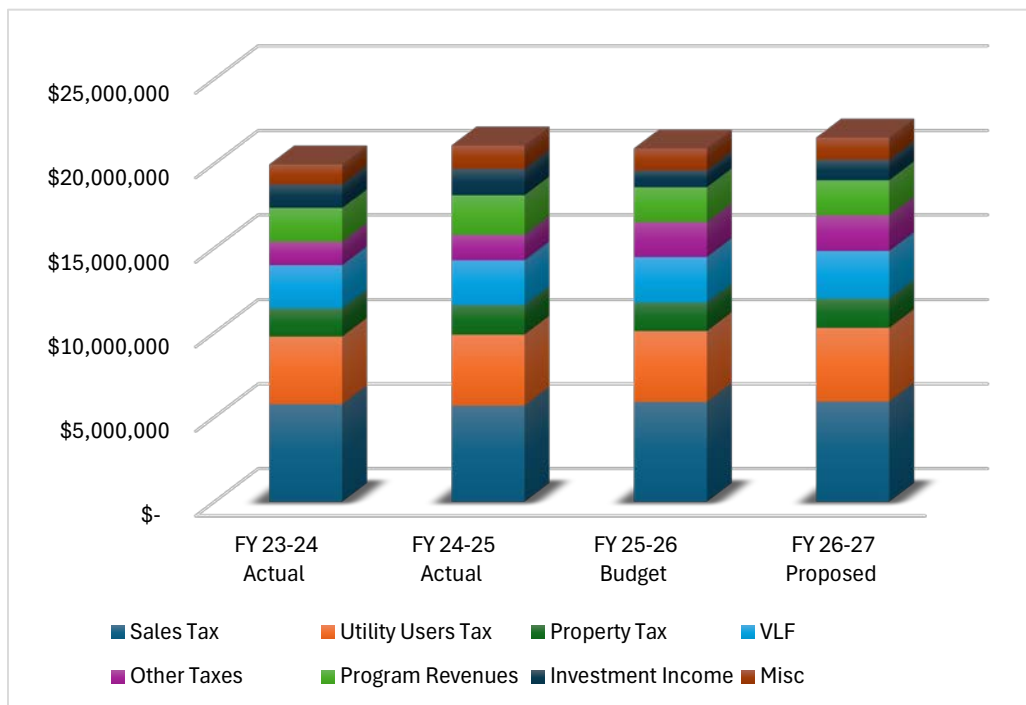
## General Fund

The General Fund serves as the City's primary operating fund, providing essential financial resources for a diverse array of services. It is financed through various revenue sources, including property taxes, sales taxes, utility users tax, business licenses, fines, forfeitures, fees, and intergovernmental revenue. This fund plays a vital role in delivering critical services such as law enforcement, parks and recreation, public works—encompassing street and facility maintenance—and fundamental governmental functions, including administration and finance.

Unlike other funds designated for specific purposes, such as water and sewer projects or capital improvements, the General Fund supports a broad spectrum of City operations. Its importance cannot be overstated, as it ensures consistent delivery of essential services and equips the City to respond effectively to unexpected circumstances or economic fluctuations.

A General Fund revenue budget is a comprehensive document that outlines the anticipated financial resources for a government's primary operating fund. This budget provides a detailed account of various funding sources, including taxes, fees, and other forms of revenue expected to be collected throughout the fiscal year. It serves as a strategic financial plan, crucial to supporting essential services such as public safety, infrastructure maintenance, and administrative functions. Moreover, the General Fund revenue budget serves as a benchmark for measuring actual revenue performance against projections, enabling staff to assess financial stability and make informed decisions on fiscal management.

### I. General Fund Revenue Estimates



As shown in the graph above and detailed in Attachment 2, the overall General Fund revenues for FY 26-27 are projected to increase modestly by about 2% compared to the audited actuals for FY 24-25. This expected growth is primarily attributed to the new Franchise Fee agreement with Republic Services and improvements in investment income, which is mainly influenced by rising interest rates and the reinvestment of maturing, lower-yielding securities into higher-yield instruments.

The General Fund revenues mainly come from several key tax sources, including the Utility User's Tax (UUT), Sales Tax, Property Tax, Real Property Transfer Tax (RPTT), and Transient Occupancy Tax (TOT), among others. The relationship among these crucial revenue streams is essential for maintaining financial stability. If there is a disruption in one or more of these significant contributors within the City of Hercules, it could lead to a substantial decline in overall revenues. Such a decline would not only jeopardize financial stability but also affect the availability of important programs and services for the community. This situation highlights the importance of maintaining a stable and diverse revenue base to effectively support the needs of our residents.

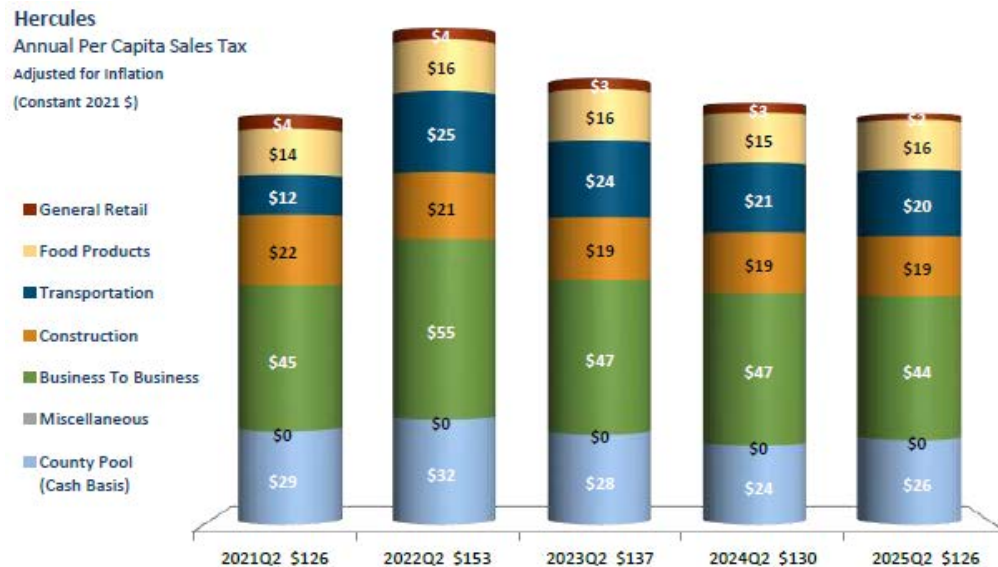
The following section presents an overview of the primary revenue sources supporting the General Fund:

- **Sales Tax**  
Sales tax revenue is the City's most significant funding source for the General Fund, with monthly remittances from the State. This consumption tax, applied to a broad range of goods and services, is essential to maintaining the City's financial stability and operational sustainability.

Recent analyses conducted in the second quarter, utilizing comprehensive data from the California Department of Tax and Fee Administration (CDTFA), indicate that sales tax revenues are likely to remain flat compared to the budget figures for FY 25-26. However, similar to other municipalities, a decline in estimated revenues may be expected for FY 26-27. This potential reduction could result from various economic factors, including significant increases in online shopping and notable decreases in discretionary spending, both of which may affect sales tax revenue. Staff will continue to monitor this revenue, and if any adjustments are necessary, they will return to the Council at midyear.

Additionally, it is critical to recognize that sales tax revenues are concentrated among a limited number of key operators. In fact, the top three sales tax producers account for over 50% of the City's total sales tax revenues. Consequently, fluctuations in revenue contributions from these vital stakeholders could significantly affect funding for future programs and services, underscoring the fragile nature of the City's fiscal landscape.

The chart below provides a breakdown of the City's sales tax revenues by industry group. This data has been adjusted for inflation and presented on a per capita basis for the second quarter ended in June 2025, offering a clearer understanding of the revenue contributions from various sectors to the City's sales tax:



- **Utility User's Tax**

The Utility User's Tax (UUT) is an 8% levy on the consumption of essential utilities used by both residents and businesses daily. This tax encompasses a diverse array of services, including electricity, gas, water, sewer, and various communication services, such as telephone (including both cell phone usage and long-distance calls) and cable television. The responsibility for establishing the tax rate lies with the City, which also determines how the revenues generated by this tax are allocated to support community needs and services effectively.

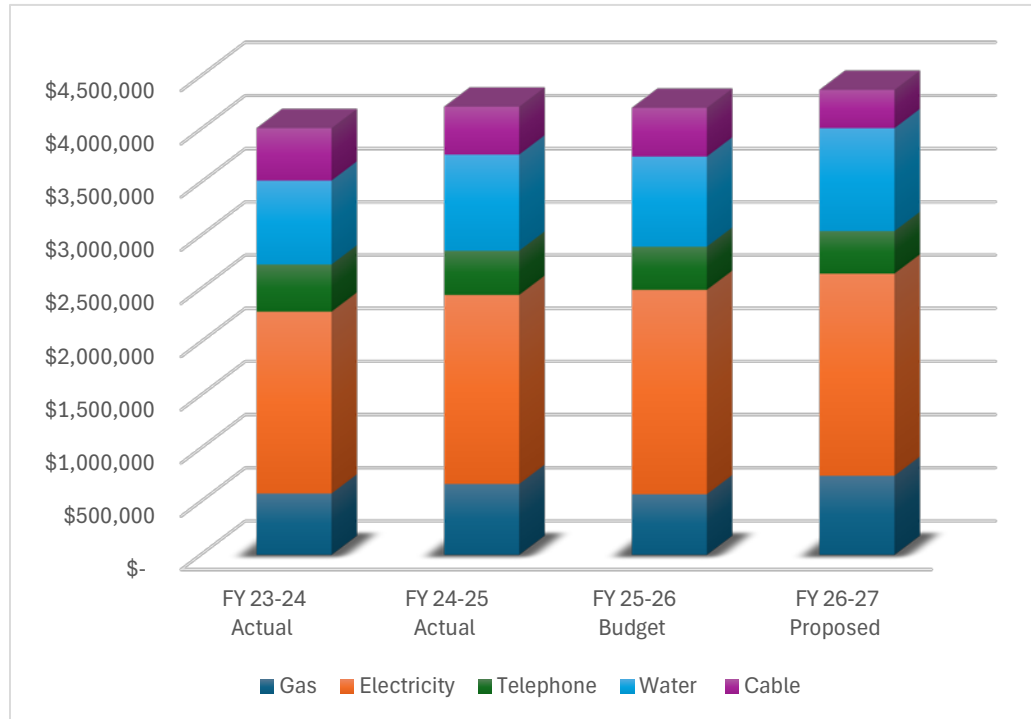
For the FY 26-27, the City expects to receive Utility User Tax (UUT) revenues amounting to \$4.3 million. However, there is a concerning trend regarding UUT revenues, particularly in the Wireless Telecommunications sector. This ongoing decline is mainly attributed to changes in the allocation structures of bundled service packages offered by telecom companies, which have shifted a larger share of costs to non-taxable data services.

In late 2025, the California Court of Appeals delivered a significant ruling in the case of Disney Platform Distribution, Inc. et al. v. City of Santa Barbara. This decision affirmed the city's authority to enforce its Utility User Tax (UUT) and Video Users' Tax (VUT) on digital streaming services, including platforms such as Hulu and Disney+. As a result, other municipalities in California, including Hercules, with similarly structured "technology-neutral" ordinances may now utilize this legal precedent to impose taxes on streaming providers without the need for new voter approval, in accordance with Proposition 218.

Despite the setback, there is a silver lining: the anticipated decline in Wireless Telecom revenues is expected to be balanced by an increase in Utility User Tax (UUT) revenues from other essential utilities, such as electricity, gas, and water. This rise in revenue is primarily due to recent rate hikes for these services, which aim to address growing infrastructure needs and ensure the continued availability of quality utilities to the community. Therefore, although challenges remain, the City's UUT revenue outlook appears stable due to these adjustments.

The chart below illustrates the sources of the City's Utility Users Tax (UUT) revenues, organized by category:

Utility User's Tax  
Summary by Fiscal Year



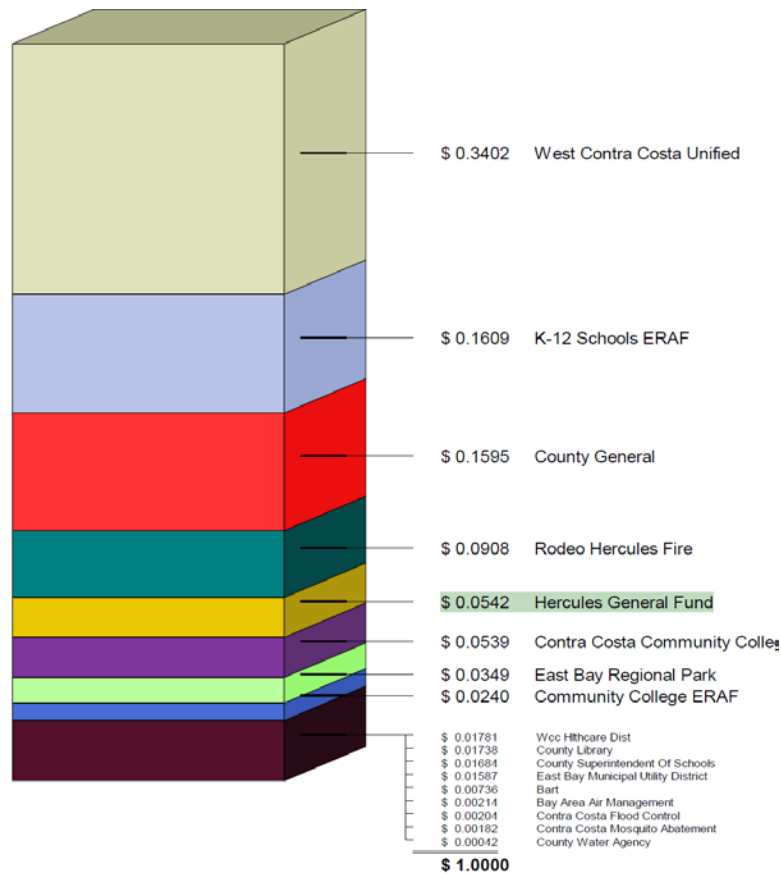
	<b>FY 23-24 Actual</b>	<b>FY 24-25 Actual</b>	<b>FY 25-26 Budget</b>	<b>FY 26-27 Proposed</b>
Gas	\$ 577,391	\$ 667,278	\$ 570,000	\$ 744,000
Electricity	\$ 1,708,846	\$ 1,776,185	\$ 1,921,000	\$ 1,900,000
Telephone	\$ 443,848	\$ 415,754	\$ 406,000	\$ 400,000
Water	\$ 788,337	\$ 903,390	\$ 847,000	\$ 967,000
Cable	\$ 492,744	\$ 449,836	\$ 458,000	\$ 360,000
<b>Total</b>	<b>\$ 4,011,166</b>	<b>\$ 4,212,443</b>	<b>\$ 4,202,000</b>	<b>\$ 4,371,000</b>

- Property Tax

The City receives a historically low percentage of property tax revenue compared to other municipalities, often deemed negligible because of its post-Proposition 13 property tax recapture rate. It currently receives only 5% of the base 1%. While residents of Hercules pay a high median effective property tax rate of 1.62%, the City's budget relies largely on alternative revenue sources, which necessitates the management of City services within a relatively limited financial framework.

In the current fiscal period, the Assessor's office has implemented a Consumer Price Index (CPI) factor of 2%, which reflects the projected assessed values of properties in the City. This adjustment is intended to ensure that property valuations remain consistent with prevailing economic conditions. Consequently, the City's allocation from the 1% property value tax will be approximately \$1.7 million for FY 26-27.

1% Weighted Tax Share



## Compared to other jurisdictions

City	GF Share	GF Related Share	Total GF Share
Richmond	27.51%	0.16%	27.67%
El Cerrito	22.28%		22.28%
Pinole	19.04%		19.04%
Pittsburg	17.51%		17.51%
Martinez	14.80%	0.13%	14.93%
Brentwood	12.07%	2.43%	14.50%
Antioch	10.98%	0.04%	11.02%
Concord	10.44%	0.05%	10.49%
San Pablo	9.59%		9.59%
Walnut Creek	9.18%	0.30%	9.48%
San Ramon	7.18%	1.63%	8.81%
Oakley	6.94%	1.20%	8.15%
Danville	7.83%		7.83%
Orinda	7.37%		7.37%
Clayton	6.75%	0.27%	7.02%
Pleasant Hill	5.55%	1.40%	6.95%
Lafayette	6.64%	0.03%	6.66%
Moraga	5.29%	0.40%	5.69%
Hercules	5.44%		5.44%

- **Franchise Fees**

A City franchise fee is an assessment enforced by local governments on utility companies that provide essential services such as electricity, natural gas, water, and cable. This fee authorizes these companies to use public rights-of-way—roads, streets, and sidewalks—to deliver essential services to residents and businesses. In essence, the franchise fee serves as compensation for the usage of public space.

The primary objective of the franchise fee is to mitigate the financial burden that cities and counties incur in maintaining the infrastructure essential for utility operations, including roads and public facilities. Revenue from these fees plays a critical role in funding community infrastructure maintenance and enhancing local government fiscal stability.

Franchise fees are typically outlined in a franchise agreement, which is a formal contract between the utility provider and the local government. This agreement specifies the terms and conditions governing the utility's use of public rights-of-way, fostering a collaborative partnership that benefits both parties.

On March 25, 2025, the City Council approved a resolution reaffirming the Solid Waste Franchise Agreement between the City of Hercules and Richmond Sanitary Service, Inc., operating under the name Republic Services. As part of this agreement, it is anticipated that Republic Services has increased its annual payment to the City by approximately \$195,000.

- **Transient Occupancy Tax (TOT)**

TOT, often called the "hotel tax," is a charge levied on individuals who temporarily occupy rental properties. Each guest who stays at these accommodations is mandated to pay 10% of the rental amount set by the property operator.

On October 22, 2019, the City entered into a Voluntary Collection Agreement with Airbnb to enhance the process of reporting, collecting, and remitting Transient Occupancy Tax (TOT) to the City.

Furthermore, pursuant to the Development Agreement for the Hercules Self-Storage facility, the City is entitled to receive 10% of Hercules Self-Storage Management LLC's rental income in place of TOT. The City began collecting this revenue in FY 24-25, estimating an annual revenue of approximately \$200,000.

- **Parks & Recreation Program Revenues**  
Hercules Parks & Recreation is dedicated to providing a diverse and comprehensive range of programs that enhance the well-being of our community. Our offerings include enriching summer camps, organized sports leagues that promote teamwork and physical fitness, educational classes that foster personal growth, and a variety of cultural events that celebrate our local heritage.

The Parks and Recreation Department faced a significant decline in revenue during the pandemic due to restrictions on program availability and the temporary closure of facilities. Since that period, the department has methodically reopened programs and achieved full recovery. The proposed budget for FY 26-27 forecasts ongoing growth in both program revenues and the diversity of offerings available to the community. This projection suggests a positive trend, reflecting a renewed interest and engagement in recreational activities that foster well-being and social connection within the community.

- **Fees for Services**  
The City establishes fees that reflect the costs associated with the services it provides to the community. These fees are detailed in the City's Master Fees Schedule, which is subject to periodic review and approval by the City Council. Individual fees may be adjusted at any time during the fiscal year, provided there is a clear and demonstrable connection to the costs incurred in delivering those services.

On October 10, 2023, the City conducted a comprehensive study of user fees to determine appropriate levels of cost recovery for services that primarily benefit specific individuals or groups, rather than the general public. Following this analysis, the newly established fees were officially adopted on October 24, 2023, thereby ensuring that the fee structure aligns with the value rendered to the community.

## II. General Fund Expenditure Projections

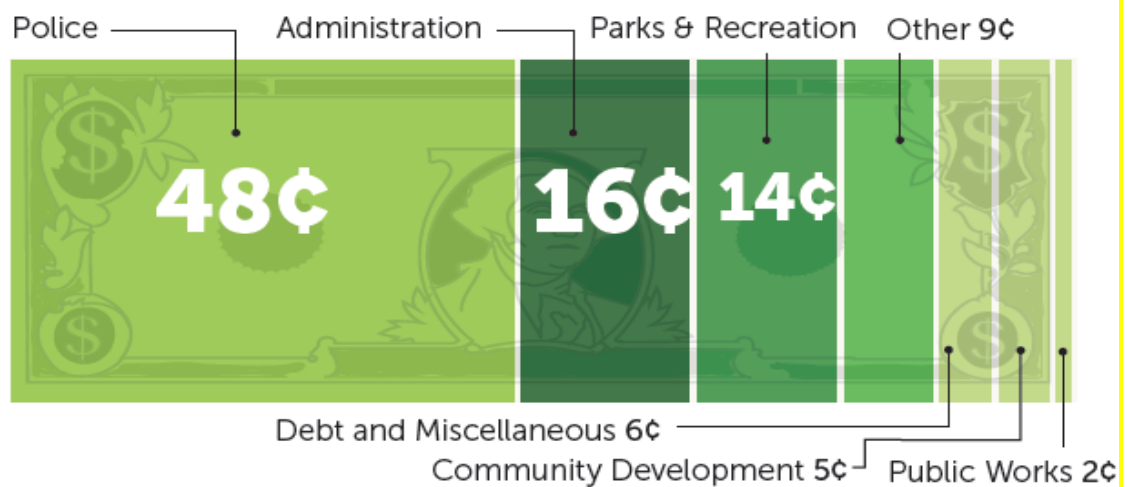
The General Fund serves as a fundamental financial resource that monitors the sources and uses of funds, which are largely managed at the City Council's discretion. This fund is dedicated to financing activities, programs, and services that the community considers essential and beneficial.

Expenditure allocations from the General Fund are meticulously planned and directed toward several key areas. Primarily, these resources are utilized to enhance public safety, thereby ensuring a secure environment for all residents. Additionally, funding is allocated to the maintenance and improvement of public infrastructure through public works projects, which are critical for the community's connectivity and overall functionality.

Moreover, the General Fund plays a significant role in supporting community development initiatives that contribute to economic growth and the vitality of the area. It also invests in enhancing parks and recreational opportunities, providing residents with valuable spaces for leisure activities and community interaction.

Beyond these initiatives, the General Fund is essential for supporting vital administrative functions, thus ensuring that the City operates efficiently and effectively meets the needs of its citizens.

The accompanying illustration provides a comprehensive overview of General Fund expenditures categorized by program:



According to the assumptions previously established, the ongoing expenditures for the General Fund are projected to increase by 5% in comparison to the budget of the preceding fiscal year. This estimation seeks to guarantee sufficient funding for essential services and responsibilities. A detailed summary of these financial projections can be found in Attachment 2.

Several significant changes have been observed compared to previous fiscal years. Notably, there has been a 6% reduction in General Liability insurance expenses, based on actual figures for FY 24-25. This decrease is attributed to improved loss history, particularly related to a single police incident. Additionally, there has been a sustained increase in funding for the County-administered animal control program, which has risen by \$100,000 to help offset the County's additional expenses from prior years.

### III. General Fund Projected Net Annual Results

The General Fund is projected to conclude FY 26-27 with a favorable net operating result of \$127,000. Additionally, it is expected to maintain an accumulated operating reserve of \$5.4 million. This reserve constitutes 25% of the overall General Fund budget, reflecting our commitment to effective financial management. Such a strong reserve not only demonstrates fiscal discipline but also provides a solid foundation for future planning and strategic initiatives.

### IV. General Fund Reserves

General fund reserves, commonly known as rainy-day funds, are a critical component of government financial management, enabling the allocation of resources to address unforeseen expenses or economic downturns. These reserves function as a fundamental financial buffer, enabling governments to respond effectively to unexpected financial demands that fall outside of the regular budgeting process.

Typically utilized for one-time, unanticipated expenditures—such as emergency response efforts or sudden revenue declines—general fund reserves play a significant role in mitigating financial risks. The primary objective of establishing these reserves is to enhance fiscal stability, thereby facilitating the management of unexpected costs while diminishing the potential negative effects of economic uncertainty. By implementing sound strategies for maintaining these reserves, governments can better navigate financial challenges and uphold their commitment to responsible fiscal governance.

The following is a comprehensive overview of the General Fund reserves. It outlines the various categories of reserves and provides the projected ending balance for FY 26-27, offering a clear understanding of the financial landscape and resources available:

#### **Restricted**

Section 115 Trust (Pension)	\$ 2,755,201
CalHFA Loan Repayments until Maturity (Former RDA)	\$ 3,021,000
Public Education and Government (PEG) Fees	\$ 310,000

#### **Designated**

Earthquake Insurance Deductible	\$ 500,000
Hercules HUB (Local Match Requirement)	\$ 3,000,000
Capital Improvement Projects (CIP)	\$ 1,000,000
Reusable Bags	\$ 13,930

#### **Unrestricted**

Economic Uncertainty or Operating Reserve	\$ 5,406,682
Set-Aside for Programs and Projects	\$ 1,350,467

Total	<b><u>\$ 17,357,280</u></b>
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Within the general fund, there are three distinct types of reserves:

1. Restricted: These funds are designated for specific purposes and cannot be utilized for general expenditures due to financial, accounting, or legal restrictions.
2. Designated: These funds are earmarked for purposes as determined by a governing body and can be deployed in accordance with their designated objectives.
3. Unrestricted: These funds are available for any purpose and are not subject to any restrictions.

#### V. General Fund Five-Year Forecast

The Five-Year Forecast offers both a current and long-term financial assessment of revenues, expenditures, fund balances, and operating reserves. Its primary goal is to provide the City Council and the community with an economic outlook while identifying significant issues that may need to be addressed during the annual budget development process.

It's important to note that a forecast is not a budget. Based on certain assumptions, the Five-Year Forecast serves as a tool that projects future financial conditions. If future deficits are anticipated, the forecast provides an opportunity to take corrective measures to maintain financial stability.

This analysis focuses on the City's General Fund, which is the main operating budget for tax-supported municipal services. Long-range financial forecasting helps the City make informed decisions that enable us to sustain the community's core services. Best practices recommend that the City update this plan annually.

As indicated in Attachment 5, the general fund forecast suggests a potential structural deficit beginning FY 28-29. This term indicates that, according to current projections, expenditure growth is beginning to outpace revenue growth. While the budget for FY 26-27 appears balanced, the anticipated gap underscores that various structural factors—such as rising pension costs, labor expenses, and contractual obligations—may lead to a small deficit, estimated at less than 1% of total expenditures, if appropriate measures are not taken. However, it is noteworthy that the City has successfully built a sufficient reserve to manage these projected deficits, offering a financial safeguard for the future. It is projected that the operating reserve will decrease from 25% to 23% by the end of FY 31-32. This anticipated decline may necessitate careful consideration of financial strategies and resource allocation moving forward.

#### VI. Non-General Fund Programs

##### **Special Revenue funds**

Special revenue funds are established to effectively monitor and manage revenues allocated for specific programs or projects. This structured approach

enhances transparency and accountability regarding the utilization of these funds. Typically, such revenues are obtained from grants or other designated funding sources that support particular initiatives, including transportation projects, assessment districts, and various specialized programs.

Given the restricted nature of these funding sources, it is essential to maintain a clear distinction in the tracking of revenues and expenditures, separate from the City's primary operating fund, known as the General Fund. Currently, sufficient funding exists to complete ongoing projects and programs, thereby ensuring the responsible use of resources. However, the initiation of new projects or programs will be contingent upon the availability of future funding sources, necessitating thorough planning and consideration of potential funding opportunities.

The following are funds under the Special Revenue category:

- a. **Asset Seizure (Fund #101):** The City has established a forfeited assets fund designed to manage the financial proceeds obtained from drug-related assets seized by the police. This fund is essential for accounting for the monetary amounts and property confiscated during law enforcement operations addressing illegal drug activities. The funds will remain in custody until a final court determination is made, ensuring compliance with legal standards. Moreover, these resources are strictly restricted for use in activities pertaining to law enforcement.
- b. **AB 3229 COPS Program (Fund #201):** The California State Legislature initiated the Citizens Options for Public Safety (COPS) program, a vital initiative designed to enhance front-line law enforcement services across the state. Each year, the City benefits from approximately \$150,000 in funding through this program. These essential funds are seamlessly integrated into the General Fund, providing crucial financial support that helps offset the costs associated with police services. This program plays a significant role in ensuring the safety and security of the community by bolstering the resources available to law enforcement agencies.
- c. **Landscaping and Lighting Assessment Districts (LLADs):** This funding is designated specifically for the maintenance of landscaping and lighting, as well as for capital improvements in city parks, along major roadways, and within each of the five Landscaping and Lighting Assessment Districts (LLADs). These districts collectively encompass approximately 8,500 parcels. An annual assessment must be submitted to the county and included on the county tax rolls. To facilitate this process, an engineer's report outlining the budget and assessment amount is required.

It is important to note that the Victoria by the Bay LLAD is expected to continue in deficit. However, the assessment increase approved by voters is projected to address this gap within the next ten years. In addition, the Hercules Village LLAD is currently indicating a structural deficit for the

fiscal year and is likely to maintain this deficit annually unless appropriate measures are implemented.

- d. **Stormwater (Fund #231):** Stormwater funds are established to address the costs associated with managing stormwater runoff. This encompasses activities such as regulatory compliance, planning, maintenance, capital improvements, and infrastructure repairs. Typically, these funds are financed through user fees, ensuring that those who benefit from stormwater management services contribute to their expenses. The activities supported by the Stormwater fund are currently exhibiting a favorable trend and are anticipated to continue improving as the years progress. Staff will persist in monitoring and analyzing the financial health of the fund to ensure adherence to the Clean Water Act and other regulatory requirements.
- e. **Development Impact Fees (DIF):** Under the California Mitigation Fee Act (AB 1600), municipalities and counties may implement Development Impact Fees (DIFs). This legislative framework enables local governments to impose fees on new development projects to support the financing of public infrastructure, facilities, improvements, and community amenities that are proportionate to the development's impacts. These fees play a crucial role in ensuring that the financial responsibilities associated with new developments are equitably distributed and that infrastructure improvements align with the community's needs.

It is important to emphasize that DIFs are not intended to cover operational and maintenance costs, nor can they be utilized to remedy existing capital or infrastructure deficiencies. Their primary aim is to mitigate the effects of new development projects on public facilities and services.

The City DIF funds are divided into specific categories, each of which has a projected available fund balance for FY 26-27:

- Public Facilities (Fund #241): \$202,753
- Community Development Tax Fund: \$79,564
- Other Development Fee (Fund #243): \$80,496
- Police Facilities (Fund #244): \$156,088
- Parks & Recreation (Fund #247): \$86,710
- Public Benefit Fee (Fund #249): \$1,091,960
- Traffic Facilities (Fund #261): \$748,541

- f. **State Gas Tax (Fund #262):** A gas tax fund, or Highway Users Tax Account (HUTA), is a dedicated fund that receives revenue from taxes on gasoline and diesel fuel, which is then used to finance transportation-related projects like road construction, maintenance, and public transit. The primary purpose of a gas tax fund is to ensure that the revenue generated from fuel consumption is used to maintain and improve the infrastructure that supports transportation, including roads, bridges, and public transportation systems. The revenue for these funds comes from excise taxes (a tax on the sale of a specific good, in this case, gasoline and diesel fuel) levied on the sale of these fuels. For the FY 26-27, projections indicate that the gas tax fund is expected to generate approximately \$770,000, providing vital support for the ongoing development and improvement of transportation.
- g. **Measure J Street Fund (Fund #263):** The Measure J Fund is a dedicated revenue fund established to monitor and manage the income generated from the County's ½-cent sales tax measure. This fund is specifically designated for critical initiatives focused on the maintenance and enhancement of local streets and transportation systems, operating in a manner similar to the Gas Tax. Funds collected through Measure J are reserved exclusively for projects that improve, repair, and preserve the City's transportation infrastructure, ensuring that it remains safe and efficient for all residents. For the FY 26-27, the Measure J Fund is anticipated to generate \$495,000 in revenue, underscoring its vital role in supporting the agency's commitment to maintaining and advancing transportation services.
- h. **SB1 Road Maintenance and Rehabilitation Account (Fund #268):** Senate Bill (SB) 1, Chapter 5, Statutes of 2017, represents a significant advancement in the effort to revitalize California's aging transportation infrastructure. This legislation established the Road Maintenance and Rehabilitation Program (RMRP), a strategic initiative designed to address the significant backlog of maintenance needs affecting the State Highway System and local street networks.

In addition, the bill created the Road Maintenance and Rehabilitation Account (RMRA), a dedicated funding source intended to support essential infrastructure improvements. The funds generated through the RMRA will be distributed to eligible cities and counties according to a specific formula outlined in Streets and Highways Code section 2032(h). This funding is vital for conducting necessary maintenance, undertaking comprehensive rehabilitation projects, and implementing crucial safety enhancements.

Through the implementation of this program, communities will be better positioned to manage and enhance their transportation infrastructure effectively. This initiative aims to ensure safer, more reliable transportation options for all residents. For FY26-27, the estimated revenue is \$736,000.

- i. **Solid Waste and Recycling (Fund #291):** The City of Hercules has entered into a Restated Solid Waste Franchise Agreement with Richmond Sanitary Service, Inc., operating as Republic Services, to oversee municipal waste and recycling services. This agreement is set to take effect in the years 2025 and 2026 and aims to improve the overall efficiency and effectiveness of waste management within the community.

A key aspect of this agreement is the introduction of updated rate structures, which will include a 3% increase for specific services. This increase is necessary to address the rising costs associated with post-collection operations, ensuring the continued delivery of high-quality services. Furthermore, the agreement aligns with compliance initiatives related to California's Senate Bill 1383, which focuses on reducing organic waste and enhancing recycling efforts throughout the state.

To facilitate a smooth transition to the new pricing structure, the remaining balance in the waste management fund will be designated as a rate stabilization fund. This allocation is intended to offset the initial rate increase of \$243,000 that will be incurred by the City Waste Program, thereby supporting residents during this adjustment period while ensuring the reliability of waste management services.

- j. **Water Quality Retention Basin (Fund #387):** This fund is established to collect revenues generated from the Property Tax Special Assessment associated with the creation of the City of Hercules Community Facilities District No. 2017-01, formed on April 11, 2017. The development projects at Bayfront and Muir Pointe necessitated the construction of a water quality detention basin to manage and mitigate runoff produced by the enhancements made to support these developments. The establishment of this Community Facilities District (CFD) provides a structured funding mechanism to address the ongoing maintenance costs linked to the water quality detention basin, thus ensuring both environmental protection and community health within the district. FY 26-27 projected ending available balance is \$440K.
- k. **Regional Water Quality (Fund #521):** This fund accounts for Regional Water Quality. Created by the State Legislature in 1967, the Board protects water quality by setting statewide policy, coordinating, and supporting the Regional Water Board efforts, and reviewing petitions that contest Regional Board actions. There are nine regional water quality control boards that exercise rulemaking and regulatory activities by basins. FY 26-27 estimated ending available balance is \$57K.
- l. **BART Park & Ride (Fund #266):** This fund is designated for the maintenance of BART's park-and-ride facility, ensuring its operational integrity and user satisfaction. BART will finance maintenance expenses through a revolving fund mechanism, thereby preventing the City from incurring any out-of-pocket costs. This approach facilitates consistent upkeep and fosters an efficient transit environment for all commuters.

- m. **General Plan Update Fee and Building Training Fee (Fund #267):** A general plan update fee is a fee established by local jurisdictions in California to recover costs associated with preparing, updating, and revising their general plans and related elements. These plans serve as fundamental frameworks for guiding a community's long-term vision. The fees are designed to cover the expenses incurred by local agencies in developing and maintaining these general plans, which are mandated by California law to address various dimensions of community development, including land use, circulation, housing, and more. In addition, the cash balance in the fund has been entirely allocated for the fiscal year 25-26 to facilitate the update of the City's general plan.
  
- n. **Successor Housing:** On February 27, 2024, the City Council adopted a resolution that designates the City as the Housing Successor to the Hercules Redevelopment Agency. This designation grants the City the authority to manage outstanding loans effectively and access resources within the Housing Funds. These financial assets will be used to cover administrative costs and to support the development of affordable housing, with particular focus on households categorized as extremely low-income to low-income.

Moreover, on January 28, 2025, the City Council approved a resolution to establish a policies and procedures manual for the administration of Hercules Successor Housing loans. This manual is designed to promote consistency and fairness in the management and oversight of approximately 41 collectible loans issued by the former Redevelopment Agency.

### **Sewer Enterprise Fund**

On January 23, 2001, the cities of Hercules and Pinole formalized a joint letter agreement concerning the operation and ownership of the Pinole/Hercules Wastewater Treatment Plant. The City of Hercules holds a fifty percent undivided ownership interest in the plant, while the City of Pinole is responsible for its management and operations. Hercules is responsible for the operation and maintenance of its own wastewater collection system. Furthermore, the City of Pinole is tasked with managing the records and accounts for all transactions related to the wastewater treatment plant.

The City of Hercules operates a collection system that consists of over 60 miles of underground piping and five lift stations. Wastewater collected through this system is treated at the Hercules-Pinole Wastewater Treatment Plant (WWTP), which is operated by the City of Pinole. Hercules maintains a 50% ownership stake in the WWTP.

The City generates approximately \$6 million annually in service charges from more than 8,400 connections, with billing processed through the County tax roll. Additionally, developers are required to pay impact fees to ensure that there is adequate capacity for the wastewater produced by their projects.

On July 22, 2025, the City Council adopted a resolution to increase sewer rates. This adjustment, essential to the ongoing improvement and maintenance of the city's sewer system, will take effect on July 1, 2025, and remain in place until 2029. The rates established by the resolution are as follows:

Description	Existing Rates	Projected for Fiscal Year Ending June 30,				
		2026	2027	2028	2029	2030
<b>Minimum Fixed Charge:</b>						
Single-Family Residence <sup>[1]</sup>	\$ 625.80	\$ 801.40	\$ 857.50	\$ 908.95	\$ 949.85	\$ 983.09
Multi-Family Residence (per Dwelling Unit) <sup>[1]</sup>	\$ 625.80	\$ 690.23	\$ 738.55	\$ 782.86	\$ 818.09	\$ 846.72
Senior Living (per Dwelling Unit) <sup>[1] [2]</sup>	\$ 427.16	\$ 562.37	\$ 601.74	\$ 637.84	\$ 666.54	\$ 689.87
Non-Residential Metered (per Business)	\$ 120.00	\$ 335.97	\$ 359.49	\$ 381.06	\$ 398.21	\$ 412.14
<b>Volumetric Rates Per 100 Cubic Feet - Non-Residential Metered:</b>						
All Flow	\$ 3.87	\$ 7.13	\$ 7.63	\$ 8.08	\$ 8.45	\$ 8.74
<b>Notes:</b>						
[1] All residential customers only pay a flat fee per dwelling unit, regardless of usage.						
[2] Apartments are currently charged the existing "Senior Living" flat fee per dwelling unit only, regardless of usage. Under the proposed rates, starting in FYE 2026, apartments will pay the "Multi-Family Residence" flat fee per dwelling unit only, regardless of usage.						

The Sewer Enterprise Fund is exclusively designated for the operations, maintenance, and capital improvements of the sewer system. Revenues generated from sewer fees are strictly allocated for sewer-related purposes and may not be diverted to non-sewer-related expenditures. For FY 26-27, the proposed operating budget is estimated at \$10.3 million, which includes planned capital improvements totaling \$3.2 and an annual debt obligation payment of \$2.1 million.

**Internal Service Funds (ISF)**

ISFs are established to account for activities that provide goods or services to other departments within a government, rather than to the general public. The City uses five Internal Service Funds (ISFs). Three of these funds are dedicated to the management of capital replacement and asset management for vehicles, facilities, and technology items. The remaining two ISFs focus on overseeing the City's Information Technology (IT) Operations and Facilities Maintenance.

- a. **Vehicle Replacement:** The City has developed a vehicle replacement cycle plan. This model outlines a schedule for replacing vehicles based on their age and mileage. Some vehicles need to be replaced before reaching their targeted age and mileage thresholds, while others may remain in service longer than planned. Each vehicle is evaluated using these criteria, along with an assessment of maintenance and fuel costs, to determine the optimal time for replacement. For FY 26-27, the police department plans to replace one patrol vehicle and one unmarked administrative vehicle at an estimated cost of \$132,000. The projected available balance for future vehicle replacements is noted to be \$476,000.
- b. **Information Technology Operations:** The Information Technology Fund is critical in providing the City with a comprehensive range of technology-related services. It encompasses components of essential networking and infrastructure technologies, including high-capacity servers and sophisticated switching systems that facilitate efficient data transmission.

The fund strongly emphasizes security and cyber protection, ensuring the safeguarding of digital assets against potential threats.

Additionally, it guarantees reliable internet connectivity, which is vital for departments to access essential online services and resources. The service desk operates as a key support mechanism, addressing and resolving technical issues as they arise.

Furthermore, well-defined disaster recovery plans are implemented to protect critical data and maintain operational continuity in the event of unforeseen circumstances. Collectively, these elements constitute a robust framework of data communication technologies designed to enhance the efficiency and resilience of the City's technological infrastructure.

For FY 26-27, the proposed IT operating Budget is estimated to be \$1.3 million. Resources are from administrative charges to departments based upon their proportional share of program costs.

- c. **Facilities Maintenance:** The fund accounts for Facility Maintenance and provides and manages maintenance and emergency structural repair services for all City facilities. The source of revenue is reimbursement from departments for the cost of providing facility maintenance services. This interservice fund pays for the maintenance and repair of the City's facilities which include:

- City Hall (including the Police Department)
- Senior Center
- Library
- Lupin & Hanna Kids Center
- Teen Center
- Community Center
- Ohlone & Foxboro Community Center

Activities include contract janitorial, HVAC, plumbing and other miscellaneous activities; various repairs and improvements performed by City staff, and utilities. FY 26-27 proposed Facilities Maintenance Budget is estimated to be \$1.2 million. Resources are from charges to departments based upon their proportional share of program costs using the square footage of the building they occupied.

- d. **Facility Replacement ISF:** This fund is designated to support the major replacement of City buildings and facilities. Currently, there is a considerable backlog of significant maintenance projects, particularly at City Hall and the Police Department.

- e. **IT Equipment Replacement ISF:** This fund will be utilized to replace the infrastructure and equipment necessary to support the city's technological requirements, including servers, switches, and data security systems. A model is currently being developed for the implementation of the IT Master Plan. Presently, expenditures are recorded under IT Operations using a "pay-as-you-go" approach.

The ISF plays a crucial role in financial management by receiving contributions from various operating funds, including the General Fund, Special Revenue Fund, and Sewer Enterprise Fund. These contributions not only support the ongoing operations of the organization but also facilitate future capital replacements.

The utilization of internal service funds allows for a more equitable distribution of costs over the asset's useful life. This budgeting approach is beneficial as it reduces the need for substantial financial allocations in one year followed by smaller ones in subsequent years. Instead, it involves calculating estimates for repairs or replacements in advance, with allocations made from the operating budget into the internal service funds. This proactive strategy ensures that resources are available when needed, promoting efficiency and financial stability.

**Debt Service Funds**

The Debt Service Fund is responsible for accumulating financial resources to cover the payment of principal, interest, and related costs for general long-term debt, primarily funded by taxes levied by the City. Debt is issued as necessary to support infrastructure improvements.

Below is a summary of the City's long-term debt and the debt service payment obligations for FY 26-27:

<b>Debt Description</b>	<b>Fund No.</b>	<b>Principal</b>	<b>Interest</b>	<b>Total</b>
2020 Lease Revenue Refunding Bond	672	477,396	85,766	563,162
Taxable Lease Revenue Bonds, Series 2009 (Bio-RAD Project)	673	325,000	580,796	905,796
Engie Energy Construction Loan	388	158,064	97,545	255,609
Wastewater Revenue Bonds, Series 2021A	Sewer Fund	395,000	161,186	556,186
Public Owned Treatment Works Construction Loan	Sewer Fund	1,213,515	297,322	1,510,837
<b>Total, Annual Debt Service</b>		<b>2,568,975</b>	<b>1,222,615</b>	<b>3,791,590</b>

**CalHFA Loans:** The City received loans from CalHFA through the Residential Development Loan Program (RDLP) and the Housing Enabled by Local Partnerships (HELP) to build the Sycamore North project, also known as the Aventine development. The City expected income from leasing the residential units to be enough to repay these loans. However, the actual cost of finishing the project was much higher than the budget set by the City and the Redevelopment Agency. As a result, the project failed and was put up for sale to find a qualified developer who could offer the best deal. Now, the City is responsible for repaying the loans.

In 2012, City staff talked to CalHFA and negotiated new loan terms after several meetings. They extended the payment deadline and lowered the interest rate from 3% to 1.5%. The updated loan agreements for CalHFA Loan No. HELP-080604-03 and RDLP-060506-01 were signed on April 11, 2005, and February 15, 2007. These agreements will end on April 11, 2027, and August 15, 2026. The remaining loan balance must be paid in full by the contract expiration dates.

On January 10, 2023, the City Council adopted a resolution to allocate funds from the State Local Assistance Funds associated with Senate Bill 154 (Skinner) from the Budget Act of 2022. The Council has designated \$2.5 million for a partial repayment of the California Housing Finance Agency (CalHFA) loans. The City is currently engaged in discussions with CalHFA to establish a repayment plan for the outstanding loan balance, with a term anticipated to range from 5 to 10 years. At this time, staff has submitted a formal proposal to CalHFA and is awaiting approval from their Board.

**Capital Improvement Projects (CIP)**

Each year, the staff prepares and presents a Capital Improvement Program (CIP) budget to the City Council for adoption, alongside the operating budget for the upcoming fiscal year. The CIP budget is established for a single year, while also encompassing projected programming over a ten-year period.

The formulation of the CIP is informed by a variety of sources, including assessments of ongoing projects, active grant applications, requests from the community and the City Council, regulatory mandates, as well as numerous condition reports, studies, and evaluations conducted by work groups. This comprehensive process entails the identification and prioritization of infrastructure needs. The staff diligently balances these requirements with available funding to develop the CIP, prioritizing projects for funding consideration as early as possible within the five-year framework, subject to available financial resources. It is important to note that the demand for projects significantly exceeds the available funding over the ten-year horizon. Therefore, the staff maintains a list of projects that are not recommended for funding, referred to as "unfunded projects," which may be considered in subsequent years. Attachment 7 contains the project list and its corresponding funding sources for FY 26-27, as summarized below.

<b>Funding Sources</b>	<b>Fund No.</b>	<b>Amount</b>
General Fund	100	2,650,495
SB1 RMRA	268	260,000
Gas Tax	262	455,000
Measure J	263	225,000
Sewer	420	444,700
MTC/TDA 3	296	150,000
TIRCP	354	1,000,000
		<b>5,185,195</b>

**FISCAL IMPACT:**

This report has no direct fiscal impact. Direction provided by the City Council will be incorporated into the FY 26-27 Annual Budget.

**ATTACHMENTS:**

1. FY 26-27 List of Additional Budget Request
2. FY 26-27 Proposed General Fund - Fund Summaries
3. FY 26-27 Proposed Special Revenue Budget - Fund Summaries
4. FY 26-27 Proposed Sewer Enterprise Budget - Fund Summaries
5. FY 26-27 Proposed Internal Service Budget - Fund Summaries
6. FY 26-27 Proposed Debt Service Budget - Fund Summaries
7. FY 26-27 Proposed Capital Improvement Projects (CIP) Budget and Funding Sources
8. Presentation