

TRANSMITTAL LETTER

July 1, 2026

To the Honorable Mayor and City Council

2027 Fiscal Year Adopted Operating & Capital Budget Transmittal

Honorable Mayor and Council Members:

In accordance with the City Charter, I am presenting the City of Palo Alto's Fiscal Year 2027 Adopted Operating Budget and Fiscal Year 2027 Adopted Capital Budget along with the 2027-2031 Capital Improvement Plan (CIP). This budget represents a continuation of the investments made by the Council last year in providing high quality services, while reflecting comprehensive budget strategies including revenue enhancement, careful spending reductions, government efficiencies and management of contracts, liabilities and reserves. The City's total budget is \$1.04 billion, including a FY 2027 Capital Budget of \$316.8 million, and a Capital Plan of \$1.2 billion over the five-year CIP. The City's General Fund Budget of \$311.96 million continues to prioritize high-quality services for the community and advances City Council priorities.

Reflecting on Key Milestones

Over the past year, Palo Alto celebrated reaching landmark community goals. We officially opened the seismically resilient Public Safety Building in November 2025, centralizing emergency operations for a modernized, agile response and broke ground on Fire Station 4 – two key projects of the City Council 2014 Infrastructure Plan. We reached a definitive housing milestone with Palo Alto Homekey set to be completed this spring which will provide 88 units of interim housing and support services for our unhoused community. We opened 429 Bryant as a teen center, community center, and senior nutrition program through partnership with La Comida. The Palo Alto Junior Museum & Zoo achieved prestigious national accreditation (AZA), a mark of excellence in wildlife education. We also executed the agreement with the school district to purchase seven acres of the Cubberley Community Center, reigniting work on a concept plan with environmental review, establishing partnerships for key improvements with non-profits, and exploring funding needs and sources for a renovated community center. Our community infrastructure commitment remains visible in continued improvement in California Avenue and Ramona Street streetscape and the December 2025 selection of a south Palo Alto pedestrian/bicycle rail crossing alternative. We advanced the Sustainability and Climate Action Plan (S/CAP) programs, grid modernization and residential electrification programs. At the Regional Water Quality Control Plant, the flagship project of the City's generational reinvestment, the Secondary Treatment Upgrade project to modernize the facility's biological treatment process and protect San Francisco Bay reached its halfway

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point with completion of two of the four aeration basin tanks. These milestones demonstrate an organization determined to deliver high-value results while maintaining our AAA credit rating. Balancing a wide range of priorities, we have also responded to emergency community needs such as oversized vehicle parking impacts and supporting youth mental health.

Managing Fiscal Realities through Comprehensive Budget Strategies and Government Efficiencies

The City's fiscal health is impacted by persistent economic uncertainty, tariffs, inflation, supply chain interruptions, state/federal administration policy agendas and potential new legislative updates or challenges. These external pressures require the City to prepare and adapt as needed. Historically, through challenges ranging from the pandemic to extreme weather events, the City and community have adjusted and focused on advancing priorities while addressing changing community needs. This budget continues that stewardship by preserving the most valued city services—including public safety, community services, libraries, parks and utilities—while advancing efficiencies and recognizing that generational investments in electrification and critical infrastructure require a stable, long-term financial footing.

We are currently navigating a period of adjustment in our major tax revenues, which contributes to the projected General Fund budget deficit of \$17.1 million (or 5.5%) for the fiscal year, FY 2027. The two primary drivers are reduced sales tax baseline due to state administration changes and reduced growth projections for property tax. This budget also includes previously unanticipated expenditures such as contracted train crossing monitors, oversized vehicle program and the additional appropriation as determined by the latest Other Post Employment Benefit (OPEB) actuarial analysis. Continuing the efforts from long-range financial forecast (LRFF) with Council, this budget addresses the financial challenge through multi-year comprehensive budget balancing strategies and makes permanent the FY 2026 budget reductions incorporated herein. With greater effort on government efficiencies, these strategies yield better outcomes, minimizing community impacts.

- Spending Reductions (\$5.9 million solution): Thoughtful spending reductions are proposed that are focused on upholding high quality services through greater government efficiencies and alternative service delivery models where possible. These reductions are in addition to the FY 2026 budget reductions. To streamline administration throughout the organization, this budget reflects updated staffing, policies, procedures and systems, such as new/updated digital service platforms, right-sizing procurement thresholds and inter-departmental collaboration on administrative functions. Facility optimization will increase use of city facilities and reduce third-party rents long term. Cost allocations are realigned to the appropriate funds to reduce reliance on the General Fund; this is prudent, appropriate and creates General Fund capacity. This budget incorporates updated costs to utilities and internal service funds, reduces the Parking Fund dependence and leverages various special revenues for eligible costs previously borne by the General Fund. Our review of contracts relinquishes one-time encumbrance funding, reduces contract appropriations; increases City inter-departmental support and improves City-contractor partnerships for enhanced outcomes. Major contracts and appropriations were thoroughly reviewed including comparison of in-house and outsourced performance efficacy. This budget incorporates more inter-departmental services between utilities, public works and community service operations that enabled a modest reduction of general service contracts. Select on-call

professional services are retained providing resource augmentation when specialized skills are needed and/or demand surge, especially important given staffing reductions and the need to reduce cycle time in critical city operations. Lastly, any debt financing is strategically aligned with project demand to reduce financing costs.

- Revenue Enhancements (\$1.7 million solution): To maximize revenues, we thoroughly analyzed fees and rates to align with costs and demand, audit revenues and collections, diversify revenue sources and payee categories, advocate intergovernmental funding, and update associated policies, administration, and foster economic development. Noteworthy, this budget reflects the higher investment earning yield from the recently updated investment policy and portfolio management change.
- One-time Resources (\$2.6 million solution): To maintain service continuity, this budget utilizes one-time funding to sustain essential community and senior programming—including Measure B, Stanford University Medical Center (SUMC) development agreement final proceeds (\$2.4 million) and the Hamilton Avenue Benefit Fund (\$0.20 million).
- CIP Reduction (\$1.5 million solution): This budget reduces the capital funding by another \$1.5 million from projected FY 2027 to appropriated FY 2027. With the relinquished budget encumbrance balances and General Fund transfers (from base, transient occupancy tax, Measure K, and other sources), the total FY 2027 General Fund transfer and available CIP funding exceeds prior year.
- Pension Cost & Liability (\$4.5 million solution): We proactively manage to reduce costs and liabilities for retiree pension and medical, general liabilities and workers compensation. This budget and long-range forecast incorporate the Section 115 Pension Trust to reduce pension costs while effectively managing pension liability. The Council's leadership with the help of labor contract terms proactively planned for long-term pension liability beginning in 2017 through contributions to a 115 trust is enabling ongoing expense reductions modeled and sustained throughout the long-term forecast to ensure the City remains proactive and resilient given pension volatility.

Ultimately, this budget reflects a steadfast commitment to service while proactively managing financial constraints. We are safeguarding the programs our residents value most, ensuring Palo Alto remains a vibrant and fiscally sound community.

Reserves

Staff remains cautious, recommending a budget that sustains core City services while navigating current economic headwinds. To safeguard the City's fiscal resilience, this budget maintains a Budget Stabilization Reserve (BSR) of \$53.7 million, representing 17.2% of General Fund expenditures. This remains within the Council-approved range of 15 to 20%, however, is below our long-term policy target of 18.5%, reflecting the disciplined trade-offs required to balance the upcoming fiscal year. We anticipate a sales tax prior year one-time adjustment will be more favorable than assumed in this financial plan, which may improve the BSR by \$2.0 million bringing it to \$55.7 million or 17.9% of General Fund expenditures.

In accordance with Council direction to conduct a review of reserve policies, the City Auditor completed a City Utility Reserve Advisory Report to review the reserve policies and peer agency benchmarks in the various enterprise funds in the Utilities and Public Works Departments. Staff will be exploring approaches

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that align with existing structures and resources and that can be implemented with gradual impacts to utility rates that are paid for by residents and businesses in Palo Alto. Any financial decision will consider risk profile, impact to customers, and regulatory requirements, and go to Council for review.

FY 2027 Budget Highlights

The FY 2027 Budget of \$1.04 billion reflects an increase of 1.7% (\$17.5 million) compared to the FY 2026 Adopted Budget of \$1.03 billion. This change is primarily driven by operating expenses—linked largely to essential commodity adjustments and infrastructure investments within our Electric and Wastewater Utilities. In contrast, the budget reflects a 0.4% decrease in General Fund operating expenses and a 1.2% increase in the City's Capital Improvement Program. Funding for the Capital Budget of \$316.8 million includes \$142.1 million in estimated reappropriations from FY 2026 to FY 2027 for multi-year infrastructure projects. Consistent with our focus on realizing governmental efficiencies, this budget recommends a net decrease of 21.25 FTE (or 1.9%) for a total authorized staffing of 1,089.10 FTE in FY 2027 and 6.00 FTE frozen positions, 3.00 FTE in the General Fund and 3.00 FTE frozen one-year within Utilities Funds.

City Council Priority Objectives Investments

The budget is a direct reflection of the City Council's annual priorities, investing in actionable efforts that deliver essential services today while securing a resilient fiscal future. In January, the Council selected four core pillars to guide our work: Achieving Near-Term Priority Housing Milestones, Cubberley Acquisition and Renovation Funding, Enhancing Business Vibrancy, and Government Efficiency. Despite a constrained fiscal environment, this budget successfully resources the Council's most mission-critical objectives. This budget provides the necessary funding to meet our mandated Housing Element milestones and completion of the Homekey transitional housing complex—vital steps toward our community's housing goals. Furthermore, we are investing in the City's digital future by resourcing the first phase of our new SAP/HANA system, an essential move to modernize.

Operating Budget Recommendations by City Service Area

Through ongoing vacancy management and the identification of potential reassignment of staff in impacted positions, we have been largely able to avoid layoffs while achieving the net decrease of 21.25 (or 1.9%) FTE, and we thank all departments and work groups for the effort involved. As a result, the recommended position eliminations predominantly reflect vacant roles while funding customer-facing positions, largely preserving the core city services our community expects, and realizing department efficiencies. Moreover, for long-term budget balancing, we are formalizing the \$3.4 million reduction in FY 2026 as ongoing savings and incorporated into FY 2027 budget. Some positions are also re-allocated to other funds for better alignment of costs and operations.

- **Internal Support & Administration:** Within this service area, we propose elimination of 5.25 FTE and reallocation of 0.95 FTE. This includes eliminations within Administrative Services Department

elimination of 3.00 FTE, Human Resources Department elimination of 1.25 FTE, Information Technology Department of 1.00 FTE. This may lead to longer transaction cycle time and delay responsiveness in the near term, but short of increasing risk exposures. Further streamlining administration will enable us to reduce costs, be more efficient while minimizing service impacts. We are also allocating more costs to appropriate funds for support services. Adhering to our Retiree Benefit Funding Policy, the Section 115 Pension Trust will disburse \$20 million Additional Discretionary Payment (ADP) and \$6 million Actuarially Determined Contribution (ADC) to CalPERS, resulting in \$1.3 million pension cost reduction (with \$0.85 million in General Fund) and \$6.0 million pension cost offset (with \$3.6 million in General Fund). This budget includes enhanced policies for cyber and seismic risks.

- **Community & Library Services:** Within this service area, we propose elimination of 6.00 FTE, re-allocation of 1.00 FTE and addition of 1.00 FTE. This includes eliminations within the Community Services Department of 2.00 FTE and Library of 4.00 FTE. These reductions may lead to slightly reduced customer service experience but short of eliminating programs. Seven-day-a-week library services are maintained at Mitchell Park and Rinconada; however, a reduction from six to five days is necessary at the Children's Library. We will further add programs to 429 Bryant. To maintain our public spaces with greater efficiency, we are eliminating 1.00 FTE as a cost savings, and as it relates to the dissolved PAUSD field maintenance agreement which had 4.50 FTEs and we are re-allocating 1.00 FTE to CIP and 3.50 FTE to other priority maintenance which reduces contracted costs. The Nonprofit Partnership Workplan Phase I process for discretionary awards is proceeding concurrently with the budget development cycle. The adopted FY 2027 budget includes appropriations for allcove totaling \$200,000 and appropriations for direct allocations for Youth Connectedness Initiative (YCI) (\$50,000), Environmental Volunteers (\$10,780) and Neighbors Abroad (\$17,500).
- **Planning & Transportation:** Within this service area, we propose elimination of 3.00 FTE, and the addition of 1.00 FTE Assistant Engineer in the Office of Transportation. This includes eliminations within Planning of 3.00 FTE and re-allocations of Transportation costs amongst alternative funding sources. These reductions will enable delivery of core service but may lead to longer transaction cycle time as we adapt and delay Council priorities. We are transitioning our parking funds toward self-sufficiency, reducing the General Fund parking subsidy and transitioning from Palo Alto Link to a voucher program of \$100,000. Additionally, we are leveraging Measure B funding for the Safe Routes to School Program, which reduces the financial burden on the General Fund while advancing our commitment to a safe and connected community.
- **Infrastructure & Environment:** Within this service area, we propose elimination of 10.00 FTE and re-allocation of 1.95 FTE, frozen of 3.00 FTE and addition of 3.00 FTE. This includes eliminations within Public Works of 5.00 FTE and Utilities of 5.00 FTE, with 3.00 FTE positions frozen in Utilities. These reductions will enable delivery of core services and short of service reductions and/or greater risk exposure but may delay Council priorities. Public Works is reducing general services for maintenance, true-up of fuel appropriation and providing more internal support to Utilities, which reduces overall contract services for Utilities. We propose to continue next cycle of fire engine replacements with diesel engines given financial constraints. Consistent with Wastewater Treatment study, 3.00 FTE additions are proposed given existing gap in operations, maintenance and infrastructure projects. Utilities gaining more internal services from Public Works will build greater resiliency and reduce

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contract costs. Completion of Advanced Metering Infrastructure (AMI) advances our S/CAP priorities and improves customer experience. We also propose to change the approach, cost and timeline of grid modernization to align with anticipated service demand while reducing financing costs. With the proposed enterprise fund rate/fee increases (i.e. utilities, storm drain, refuse, airport, etc.), we balance principles of affordability, innovation, reliability, new capital investments, and operational efficiencies. Further work to evaluate reserves is underway as referenced above.

- **Public Safety:** Within this service area, we propose elimination of 3.00 FTE and 3.00 FTE to be frozen. This includes 1.00 FTE elimination, 1.00 FTE frozen and 1.00 FTE added in Police. In Fire, there will be 2.00 FTE eliminations and 2.00 FTE frozen. These reductions will enable delivery of core service as we civilianize for efficiency without compromising public safety. We are maintaining our fundamental commitment to emergency response by sustaining the Single-Role EMS Division to ensure peak-hour ambulance coverage. To address fiscal constraints, we are freezing the dedicated EMS Manager position, prioritizing both customer-facing delivery and the implementation of 12-hour peak medic unit. This Single Role unit is non-sworn which is more efficient with onboarding and activation. We are civilianizing the police special events coordination with an Administrative Assistant, with other duties to be reassigned to other sergeants. We continue to emphasize transparency and modernization by funding \$289,000 for Police Field Contact Recording technology to enhance data integrity and field safety. Furthermore, we are protecting our long-term response capability by fully funding the scheduled replacement cycles for fire apparatus and police vehicles to ensure our first responders have the tools necessary to maintain a safe and resilient community. This budget continues to fund existing school crossing guard services and the new track watch rail crossing monitors through the end of the fiscal year with anticipated cost sharing from the Palo Alto Unified School District (PAUSD).

Capital Budget Recommendations

The capital plan continues progress on the City Council 2014 Infrastructure Plan and additional projects that help advance continued infrastructure replacement, improvements and repairs. The FY 2027 capital budget advances critical projects that further innovative city services and addresses critical infrastructure, with limited financial resources. As part of the effort to proactively plan for economic uncertainty, the General Fund base transfer to the Capital Improvement Fund reflects the disciplined 1.2% increase in the City's Capital Improvement Program mentioned in earlier sections. Moreover, a meticulous clean-up of budget re-appropriations relinquished one-time funds coupled with reprioritizing less urgent, non-emergency projects. This ensures that our capital investments remain aligned with our available resources:

- 2014 Council Infrastructure Plan projects: complete the Fire Station 4 replacement project and transition the New Downtown Parking Garage from design to the procurement and construction phase
- Regional Water Quality Control Plant (RWQCP) facility upgrades and infrastructure upgrades for stormwater systems drain pipes, wastewater collection main and treatment systems, gas and water main maintenance, and the water cross-bore safety program
- Generational investment of \$57.0 million in Electric Grid Modernization projects to support citywide electrification, grid resilience and safety.

- Advancing vital stewardship for the Cubberley Community Center with \$0.9 million programmed for redevelopment planning, roof replacements, and infrastructure repairs. Ultimately spending and projects will be dependent upon approval of the ballot measure.
- Park improvements at Rinconada, Mitchell, Eleanor Pardee, Boulware, and Foothills Nature Preserve, including the modernization of park restrooms and dog park amenities
- Recognizing investments in grade separation projects (partially funded by Measure K Business Tax proceeds) including Meadow Drive, Charleston Road, and Churchill Avenue
- Improving traffic intersection accessibility and safety through the implementation of Automated Traffic Signal Performance Measures (ATSPM) and bike/pedestrian safety enhancements
- Planning for the Phase 1 pilot of Fiber to the Premises/Dark Fiber rebuild to modernize citywide connectivity
- Maintenance and repair of Electric Vehicle (EV) charging stations to support the City's climate action goals
- Equipment and furniture replacements at City libraries to maintain high-quality community learning spaces
- Replacement equipment and fleet investments for public safety, public works and utilities.

Stakeholder Engagement

In May and June, several days of Finance Committee budget hearings, Council discussions, and a Community Budget Informational Session were held to review, discuss, and consider revisions to the Proposed Budget documents before they were adopted by the Council. Community members were encouraged to join these discussions to help inform the decisions that the City Council considered for adoption. A calendar of these meetings and discussions can be found in the Budget Process and Document section of this budget document.

Changes from the Proposed Budget document to the Adopted Budget document are summarized by department and by fund in the memorandum that recommends approval of the FY 2027 budget adoption ordinance (Staff Report # 2512-5698). This report can be found on the City's website: www.paloalto.gov/City-Hall/City-Council/Council-Agendas-Minutes under the June 15, 2026 meeting agenda.

In Closing

The FY 2027 Budget reflects a disciplined approach to our current fiscal reality. By prioritizing sustainable financial frameworks, we ensure that our structural obligations do not displace the high-quality city services that define our community's character. This budget bridges fiscal challenges by realizing efficiencies and streamlining administration to ensure the highest value for every taxpayer dollar. Ultimately, we remain committed to preserving critical public safety and customer-facing services while also incrementally advancing Council priorities. We have built a balanced and sustainable path forward, and I appreciate the collaborative work of the City Council, staff, and the community.

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Acknowledgments

The formulation of this budget is a shared endeavor that reflects the values and aspirations of the Palo Alto community. I would like to express my sincere appreciation to the City Council for their leadership in establishing the 2026 Priorities and for providing the guidance necessary to navigate this period of organizational modernization. I also want to thank our residents and businesses for their active participation and continued investment in our city, which remains the bedrock of our collective success.

Special recognition is due to the Administrative Services Department and specifically to the professional staff within the Office of Management and Budget: Charles Benham, Alyssa Ching, Rene Escobar-Mena, Naomi Hsu, Chaitali Paliwal, Jonathan Rwers, Kayla Shapiro, and Robert Valentukonis. Their technical expertise and tireless commitment to fiscal stewardship have been instrumental in realizing the department efficiencies outlined in this document. I am also grateful to our Executive Leadership Team and all Department Directors for their partnership in refining our operations to protect the core city services our community relies upon. Together, we have built a balanced and sustainable framework that ensures Palo Alto's long-term fiscal resilience.

Respectfully Submitted,

A handwritten signature in blue ink, appearing to read 'Ed Shikada'.

Ed Shikada
City Manager

Online Resource to Learn More About the City Budget

Learn about City Council Priorities and Objectives at
www.paloalto.gov/councilpriorities

Join the Budget Conversation at www.paloalto.gov/budget