



# ***CITY COUNCIL AGENDA REPORT***

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**MEETING DATE: MAY 19, 2020**

**ITEM NUMBER: NB-5**

**SUBJECT: FISCAL YEAR 2020-21 PRELIMINARY GENERAL FUND REVENUE AND EXPENDITURE ESTIMATES AND OVERVIEW**

**DATE: MAY 14, 2020**

**FROM: CITY MANAGER'S OFFICE/FINANCE DEPARTMENT**

**PRESENTATION BY: CAROL MOLINA, ACTING FINANCE DIRECTOR**

**FOR FURTHER INFORMATION, CONTACT: CAROL MOLINA, ACTING FINANCE DIRECTOR, (714) 754-5036**

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## **RECOMMENDATIONS:**

Staff recommends that the City Council:

- 1) Discuss the Preliminary FY 2020-21 General Fund Revenue and Expenditure Estimates and projected COVID-19 fiscal impacts;
- 2) Provide direction on exercising the option to reduce the General Fund contribution to Capital Projects to be less than the combined 5.0% of the General Fund budgeted revenues required by the Capital Asset Needs (CAN) Ordinance;
- 3) Provide direction on exercising the option to defer the General Fund contribution to the Information Technology Fund of 1.5% of the General Fund budgeted revenues by six months to January 1, 2021;
- 4) Provide direction on the prepayment of the City's annual Unfunded Accrued Liability payment to CalPERS resulting in \$727,000 in savings to the FY 2020-21 Budget; and,
- 5) Provide direction on the use of a portion of the City's General Fund Economic and Declared Disaster Reserves in the development of the FY 2020-21 Proposed Budget to continue providing essential services during the COVID-19 pandemic.

## **BACKGROUND:**

In December 2019, staff began the process for preparing the FY 2020-21 Preliminary Operating and Capital Improvement Program (CIP) budget for delivery to the City Council. However, all of the work performed by the City's eight Departments for the past several months, and the proposals developed by City Management earlier this year for inclusion in the FY 2020-21 Proposed Budget, have unfortunately been shelved. On March 12, 2020, pursuant to Government Code Section 8558 (c) and Chapter 1 of Title 6 of the City of Costa Mesa Municipal Code, the City Manager and Director of Emergency Services issued an Emergency Declaration due to the unanticipated and deadly COVID-19 worldwide outbreak.

Prior to COVID-19, City management was working with all Departments to develop a structurally balanced FY 2020-21 Proposed General Fund Budget that while modest, still reflected minor increases in select revenue categories. Unfortunately, the City is now facing a significant and unprecedented workload and financial challenge due to the continuing global COVID-19 pandemic that has infected 4.2 million people worldwide and caused 287,525 deaths in 215 countries. As of this writing, the United States has 1.4 million confirmed COVID-19 positive cases and 82,246 deaths. In addition to the devastating impacts on public health and mortality, the impact of COVID-19 on the American economy has also been severe with 30 million Americans facing unemployment, wiping out all of the job gains made in the 11 years since the Great Recession in just four months. As a result, numerous General Fund revenue sources are declining significantly including tax revenues (e.g. sales tax, hotel tax, and business license tax, etc.), and fees, fines and charges.

## **ANALYSIS:**

On April 21, 2020, the Finance Department presented a Cost Containment Plan to address the projected funding shortfalls in this fiscal year, FY 2019-20, of \$10.0 million to \$18.5 million. At this meeting, the City Council received information regarding cuts to non-essential spending; the elimination of remaining appropriations for travel, conferences and training; the elimination of remaining funding for vacant positions; reductions in contracts and encumbrances; and, reductions in part-time staffing and hours. These expenditure reductions totaled \$4.0 million. In addition, the City Council approved staff's recommendation to reduce the FY 2019-20 Capital Improvement Projects Budget by deferring or suspending \$6.0 million in General Fund supported Capital Improvement Projects in Fund 401. In total, the City Council approved \$10.0 million in budget reductions to address the initial preliminary estimate of the current year FY 19-20 revenue shortfall (Attachment 1).

In conjunction with the current year's Cost Containment Plan, staff has been forced to shift its focus to reducing the FY 2020-21 Proposed Budget given the continued financial impacts of the COVID-19 pandemic. The impact of COVID-19 on the economy is unprecedented with the single month of April 2020 logging 20.5 million Americans out of work and an unemployment rate of 14.7 percent. The job losses in April 2020 of 20.5 million far exceeded the largest month of job losses during the Great Recession -- March 2009 -- with 800,000 jobs lost. The challenges of managing a global pandemic, a current year budget deficit, and a future year financial crisis, all within an eight-week timeframe, is a challenge that no State, County or City has ever faced before.

## ***Preliminary General Fund Budget Overview***

The preliminary FY 2020-21 General Fund expenditure base level budget, before any reductions, is \$150.4 million. This amount is \$8.2 million over the FY 2019-20 Adopted Budget which totaled \$142.2 million. The current preliminary FY 2020-21 General Fund revenue estimate, however, is \$120.5 million. Hence, the projected shortfall for next fiscal year is \$29.8 million before reductions and other budget balancing strategies are deployed. Table 1 is a summary of the preliminary estimated General Fund expenditures, revenues and projected deficit for FY 2020-21:

<b>TABLE 1- PRELIMINARY FY 2020-21 GENERAL FUND REVENUE AND EXPENDITURE ESTIMATES</b>				
	(in millions)			
	Adopted Budget	Preliminary	Increase/Decrease	
	<u>FY 2019-20</u>	<u>FY 2020-21</u>	<u>Amount</u>	<u>Percent</u>
Estimated Revenues	\$ 140.5	\$ 120.6	\$ (19.9)	-14.2%
Transfers In – Capital Fund	1.2	-	(1.2)	-100%
Use of Fund Balance	0.4	-	(0.4)	-100%
<b>Total Resources</b>	<b>\$142.2</b>	<b>\$ 120.6</b>	<b>\$ (21.5)</b>	<b>-15.2%</b>
Operating Budget	\$ 137.9	\$ 146.2	\$ 8.3	6.0%
Transfers Out	4.3	4.2	(0.1)	-1.2%
<b>Total Appropriations</b>	<b>\$ 142.2</b>	<b>\$ 150.4</b>	<b>\$ 8.2</b>	<b>5.8%</b>
<b>Estimated Shortfall</b>		<b>\$ (29.8)</b>		

### Expenditure Estimates

Currently, before any reductions in expenditures are made, the preliminary General Fund budget for FY 2020-21 reflects total expenditures of \$150.4 million. This amount represents an increase of \$8.2 million from the current year adopted budget of \$142.2 million. The FY 2020-21 preliminary expenditure estimate includes the following items, to name a few:

- A Table of Organization reflecting 498 full time employees (flat staffing levels);
- An additional \$1.7 million in capital spending required by Ordinance to fully comply with the Capital Assets Ordinance (CAN) for a total General Fund commitment of \$6.0 million, or five percent of estimated General Fund revenues;
- A \$1.8 million budget increase for the Council-approved Five Year Information Technology Strategic Plan reflecting 1.5 percent of estimated General Fund revenues;
- A \$3.6 million increase in the annual required CalPERS contributions;
- A \$265,000 increase for November 2020 elections costs;
- \$0.8 million in contractually required, fixed cost and other miscellaneous increases; and,
- The continuation of the \$4.1 million vacancy factor (negative appropriation) adopted in FY 2019-20 General Fund Budget.

It is important to note that the preliminary FY 2020-21 General Fund expenditure estimate of \$150.4 million does not include approximately \$6.7 million in requested budget increases from City departments that were submitted for consideration prior to COVID-19.

### Revenue Estimates

As reflected in Table 1, projected General Fund revenues of \$120.6 million for FY 2020-21 are not sufficient to cover the projected expenditures of \$150.4 million. Consequently, several budget balancing strategies are recommended for immediate City Council consideration, in order to help reduce the need for drastic cuts in FY 2020-21 resulting from a \$29.8 million projected deficit.

For FY 2020-21, sales tax is anticipated to decrease by at least \$8.9 million, which represents a 15 percent reduction from the Adopted FY 2019-20 sales tax revenue estimate, and a \$15.0 million reduction from the FY 2018-19 recurring sales tax revenue actuals. The City's hotel taxes are expected to decline from previous years' levels by 50 percent due to a decline in tourism, travel, conferences and conventions by \$4.8 million. The City's other revenue streams, including property tax, are expected to be somewhat more stable, with a slight increase of two percent for the annual CPI. Property Tax is a lagging economic indicator meaning that the result of a recession is not typically experienced in property taxes in the same year due to the one-year lag in setting the property tax assessments. This will be of great benefit to the City as many other revenue streams suffer declines.

Most other General Fund revenue categories are also anticipated to experience significant declines. Due to current stay-at-home orders, and the continuation of teleworking for residents, parking citations are anticipated to decline by 50%, by \$0.6 million. Summer park programs, youth and adult sports, as well as instructional classes, are expected to decline by 75%, estimated at \$0.4 million, representing revenue loss for three quarters of the fiscal year. Development-related fees, such as plan check fees are already showing signs of reductions, and special event billings are also anticipated to decline by 75% or almost \$1.0 million, as the order banning large group gatherings continues. Staff is also anticipating an approximately 40% reduction in the rental of fields and community centers resulting in a \$1.8 million revenue loss from the current year's adopted budget.

### **Budget Balancing**

To present a balanced budget for FY 2020-21, the City needs to reduce costs, defer non-essential spending, raise revenues and/or use General Fund reserves. At this time, the growth in revenue is not feasible as large industry sectors are struggling and certain household names, such as J. Crew, have been forced to file for bankruptcy. The strategic use of reserves, while valid and definitely appropriate in this case, is a partial solution, and cannot completely cover the projected revenue shortfall. Consequently, the City Manager has directed all departments to develop 5 percent, 10 percent and 15 percent reduction scenarios to help address a projected \$29.8 million General Fund deficit in FY 2020-21.

<b>Table 2 – 5%, 10%, and 15% Reduction Scenarios (in millions)</b>			
<b>Department</b>	<b>5%</b>	<b>10%</b>	<b>15%</b>
City Manager's Office	\$(0.48)	\$(0.97)	\$(1.45)
Development Services	(0.35)	(0.70)	(1.04)
Finance	(0.22)	(0.44)	(0.66)
Fire and Rescue	(1.41)	(2.82)	(4.24)
Information Technology	(0.18)	(0.36)	(0.53)
Parks and Community Services	(0.35)	(0.70)	(1.05)
Police	(2.47)	(4.95)	(7.42)
Public Services	(0.96)	(1.92)	(2.88)
<b>Total</b>	<b>\$(6.42)</b>	<b>\$(12.85)</b>	<b>\$(19.27)</b>

To address the \$29.8 million estimated budget shortfall, the City has to reduce departmental expenditures, postpone additional capital projects, and defer critical improvements to the City's software systems and technology until later next year, which is concerning given the antiquated status of the City's technology systems.

However, there are certain actions the City can take and/or explore to help mitigate the impact of this projected revenue shortfall as follows:

Waiver of the 5% CAN Requirement: Staff recommends transferring less than the combined 5.0% of the General Fund budgeted revenues required by the Capital Asset Needs (CAN) Ordinance to the Capital Improvement Fund, thereby providing additional funding towards operations. This action will require a City Council supermajority vote. While this means less funding is allocated to capital projects, for this fiscal year, the City is still able to meet the State and County Maintenance of Effort (MOE) requirements, at this time for the receipt of Measure M, SB 1 and Gas Tax/HUTA funds. Additionally, the CIP Budget contains the \$2.8 million for the required payment of principal and interest on the 2017 Lease Revenue Bonds.

Deferral of 1.5% IT Portion of the CAN: Staff also recommends that the newly approved 1.5% General Fund revenue contribution to the Information Technology Replacement Fund, currently estimated at \$1.8 million, be deferred by six months to January 1, 2021, to produce savings of \$900,000 in the 2020-21 fiscal year and further reduce the estimated deficit. A full year waiver is not requested as the City's technology systems are antiquated and must be replaced.

Employee Furloughs: In 2009, the City negotiated employee furloughs to reduce costs and avoid widespread layoffs. This is a practical approach given that labor costs comprise 70 percent of the City's overall budget. Employee furloughs also help the City maintain most essential functions to the greatest extent possible, a key consideration during a worldwide pandemic. However, an employee furlough often results in reduced work hours; hence, service levels to the public would still be likely impacted. The City Manager is currently in the process of negotiating a proposed 10 percent furlough with City employees.

## **Staffing Levels**

The preliminary budget includes a total of 498 FTEs. This amount is currently unchanged from current FY 2019-20 staffing levels in order to address essential services in the City, especially during the pandemic. However, the number of full-time employees is dependent on the ability of the City to address the estimated \$29.8 million shortfall without cutting services to the public which will be difficult. A combination of budget balancing strategies will be needed to avoid major cutbacks.

While the number of full-time staff at the City remains unchanged at this point, layoffs have been implemented in the City's part-time ranks due to the pandemic. Regrettably, in April 2020, the City was forced to lay off 54 part-time staff in the Parks and Community Services Department to help mitigate the looming current year deficit. An additional 38 part-time staff in the Department were furloughed to zero hours until they can be fully deployed in the Parks and Community Services Department, or reallocated to other departments requiring assistance due to the COVID-19 emergency.

## **Governor's May Revise**

On May 14, 2020, Governor Newsom revealed the May Revised budget, drastically adjusting the January proposed budget recommendations for the fiscal year starting July 1, 2020. Citing the unprecedented pandemic, rising unemployment, and significant revenue shortfalls in record time, Governor Newsom unveiled some details into the State's projected \$54.3 billion shortfall. The projected shortfall is significant and equates to three years' worth of funding for the California State University and University of California systems combined.

As a result, the Governor is recommending multiple solutions to balance the State's budget. Most of the recommended budget enhancements were rolled back, such as reducing funding for deferred maintenance projects in the state parks system by \$45 million. Additionally, there is a strategic multi-year approach to utilizing the State's different reserve accounts including a drawdown of \$16.2 billion from the Rainy Day Fund over three years, and the allocation of the Safety Net Reserve to offset increased costs in health programs over the next two years. Finally, reductions of \$14 billion that include a 10% pay reduction for State workers and a five-percent reduction to nearly all state department budgets are also included. Further detailed adjustments to the State's budget are outlined in Attachment 3.

## **Federal Stimulus Funding Proposals**

To date the City has not received any funding from the three rounds of stimulus funding adopted by the Federal government as there have been no direct allocations to cities with populations under 500,000. Federal economic stimulus funding can help to backfill revenue losses to cities caused by COVID-19 which are estimated at \$7 billion in Orange County alone. Currently, a \$3 trillion Federal stimulus package is under consideration in the U.S. House of Representatives, including a \$1 trillion "Heroes Act" apportionment, which would

provide much needed funding to state and local governments for revenue backfills. It is unclear if and when the proposed 4<sup>th</sup> round of stimulus funding will be adopted by both houses of Congress. The Mayors of all 34 cities in Orange County, plus the Orange County Board of Supervisors, is in support of Congress adopting the full allocation of Heroes Act funding for states and local governments.

### **LEGAL REVIEW:**

The City Attorney has reviewed and approved this report as to form.

### **CONCLUSION:**

This overview of the preliminary General Fund expenditure and revenue projections for FY 2020-21 presents the challenges of developing a balanced budget in the midst of a worldwide pandemic that has affected 4.2 million people worldwide, across 215 countries, caused 287,00 fatalities and crippled the global economy.

The impact to the American economy, as well as state and local governments is unprecedented in an eight-week timeframe, and has resulted in the significant loss of revenue that supports core essential services that are vital during a pandemic. The City will need to utilize multiple budget balancing strategies including expenditure reductions, negotiating with employees regarding compensation, use of designated emergency reserves, and lobbying efforts to obtain Federal relief, to help maintain essential services to the greatest extent possible.

To help develop a balanced FY 2020-21 Proposed General Fund Budget with the above stated goals in mind, Staff recommends that the City Council:

- 1) Discuss the Preliminary FY 2020-21 General Fund Revenue and Expenditure Estimates and projected COVID-19 induced deficit;
- 2) Provide direction on exercising the option to reduce the General Fund contribution to Capital Projects to be less than the combined 5.0% of the General Fund budgeted revenues required by the Capital Asset Needs (CAN) Ordinance;
- 3) Provide direction on exercising the option to defer the General Fund contribution to the Information Technology Fund of 1.5% of the General Fund budgeted revenues by six months to January 1, 2021;
- 4) Consider prepayment of the City's annual Unfunded Accrued Liability payment to CalPERS resulting in \$727,000 in savings to the FY 2020-21 Budget; and,
- 5) Direct staff regarding the potential use of the City's Economic and Declared Disaster Reserves in the development of the FY 2020-21 Proposed Budget in an effort to help maintain essential services during the COVID-19 pandemic.

The completed Proposed Budget for FY 2020-21 will be presented to the City Council for consideration and adoption in late May/early June and may require the use of Special Meetings in order to complete all deliberations and adopt the budget prior to July 1, 2020.

Staff asks for the City Council's continued support as we navigate the multitude of challenges and ever changing circumstances related to this pandemic in the weeks and months to come.

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**CAROL MOLINA**

Acting Finance Director

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**LORI ANN FARRELL HARRISON**

City Manager

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**KIMBERLY HALL BARLOW**

City Attorney

- Attachments:
1. [April 21, 2020 Agenda Report for FY 2019-20 Cost Containment Plan.](#)
  2. [FY 2020-21 Preliminary General Fund Expenditure and Revenue Estimates and Overview.](#)
  3. [Governor Newsom May 2020 Revised State Budget Recap Memo.](#)



