



CITY COUNCIL AGENDA REPORT

MEETING DATE: JUNE 9, 2020

ITEM NUMBER: PH-1

SUBJECT: FISCAL YEAR 2020-21 PROPOSED OPERATING AND CAPITAL IMPROVEMENT PROGRAM BUDGET

DATE: JUNE 4, 2020

FROM: FINANCE DEPARTMENT

PRESENTATION BY: CAROL MOLINA, ACTING FINANCE DIRECTOR

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

RECOMMENDATIONS:

Staff recommends that the City Council:

1. Discuss and consider approval of Resolution No. 20-XX (Attachment 1) adopting the City of Costa Mesa FY 2020-21 Operating and Capital Improvement Program Budget including exercising the emergency exception to the Capital Assets Needs Ordinance (CAN) by waiving the 5% CAN requirement; and,
2. Discuss and consider approval of the use of the City's General Fund Declared Disaster/Emergency Reserves in the FY 2020-21 Proposed Budget to continue providing essential services.

BACKGROUND:

In December 2019, the Finance Department held the official FY 2020/21 Budget Kick-Off meeting with citywide department staff. In March 2020, mid-way through the budget development process, the City was faced with the impacts of the worldwide coronavirus pandemic (COVID-19). The multiple emergency proclamations of the United States President, State of California Governor Newsom, and the City Manager for the City of Costa Mesa propelled the City into full emergency protective mode. 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. As a result, the work performed by the City's eight Departments up to the date of the emergency proclamations had to be essentially shelved.

Prior to COVID-19, City management was working with departments to develop a structurally balanced FY 2020-21 Proposed 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 6.75 million people worldwide and caused 394,969 deaths in 215 countries. As of this writing, the United States has 1.9 million confirmed COVID-19 positive cases and 108,334 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 21.5 million Americans facing unemployment, essentially 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.), fees, fines and charges.

ANALYSIS:

The City's Municipal Code requires the City Manager to prepare and submit the FY 2020-21 Proposed Budget to the City Council and administer it after adoption. The City Manager submitted a preliminary overview of the FY 2020-21 Proposed Budget to the City Council at the May 19, 2020 City Council Meeting. The FY 2020-21 Capital Improvement Program (CIP) Budget and Five Year CIP (FY 2020-21 to FY 2024/23) was presented to the City Council on May 26, 2020. Additionally, Finance staff presented the FY 2020/21 Preliminary General Fund Revenue and Expenditures Budget, and the FY 2020/21 Capital Improvement Program to the FiPAC (Finance and Pension Advisory Committee) on May 21, 2020. The next regularly scheduled FiPAC meeting on June 10, 2020 will continue the FY 2020/21 Proposed Budget discussions.

Reductions to the Current Year FY 2019/2020 General Fund Budget

Due to the speed and severity of the fiscal impact of COVID-19 on various City revenue sources, the City immediately presented to the City Council the estimated budget impacts to the current fiscal year, FY 2019/20. Finance staff reported to the City Council on April 21, 2020 two potential deficit scenarios facing the City's coffers in the current fiscal year. The first scenario estimates an approximate \$10 million deficit by June 30, 2020. In an effort to immediately manage this projection, City staff presented a Cost Containment Plan distributed to departments eliminating and reducing non-essential costs for the duration of the fiscal year. Training and Conferences budgets were reduced to actual amounts spent to date, with the exception of mandatory safety training. An essential work documentation process was implemented requesting detailed justifications for upcoming expenses, thereby reducing potential expenditures to year-end. Vacant positions savings were captured, and a soft hiring freeze was implemented. Moreover, General Fund capital projects were reduced by \$6.0 million. These measures are expected to realize an approximate \$10.0 million in General Fund cost savings by June 30, 2020.

Under Scenario 2, an \$18.5 million deficit is projected by June 30, 2020. The cost savings measures utilized in Scenario 1 are fully implemented, and the remaining potential shortfall of \$8.5 million would be addressed by \$1.0 million in additional General Fund capital project savings, and the utilization of General Fund Declared Disaster Reserves. Final fiscal impacts to the FY 2019/20 budget will not be fully known until the City's Comprehensive Financial Annual Report (CAFR) is finalized by independent auditors in December 2020.

Addressing the Fiscal Year 2020/2021 Budget Shortfall

In mid-March, staff immediately pivoted into addressing the financial impacts of revenue reductions as a result of the COVID-19 pandemic to the FY 2020-21 Proposed Budget. 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 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 in such a short timeframe, is a challenge that no State, County or City has ever faced.

Proposed Budget - All Funds

The Proposed Fiscal Year 2020-21 All Funds Budget solves a projected \$29.8 million deficit due primarily to the effects of COVID-19. The FY 2020-21 Budget maintains the headcount flat at 499 full-time positions, but contains an attrition factor of \$3.9 million, similar to previous years, and defunds several other positions due to reduced funding. The All Funds Budget reflects revenue reductions of \$11.2 million or seven percent resulting from the COVID-19 pandemic. Multiple funds are showing signs of revenue loss, such as the Gas Tax, Park Development Fees, and both Measure M Funds. Stay at home orders, Great Depression era unemployment rates, and business closures are impacting revenue streams that are related to these types of activities. Below is the Proposed Fiscal Year 2020-21 Budget for all funds compared to the Adopted Fiscal Year 2019-20 Budget:

Table 1

Expenditure Category	Adopted FY 2019-20	Proposed FY 2020-21	Increase/(Decrease)		FY 2020-21 % of Total
			Amount	Percent	
Operating Budget	\$ 149,016,164	\$ 142,804,662	\$ (6,211,502)	-4%	89%
Transfers Out	5,430,141	4,099,924	(1,330,217)	-24%	3%
Capital Budget	17,597,366	13,855,245	(3,742,121)	-21%	9%
Total	\$ 172,043,671	\$ 160,759,831	\$ (11,283,840)	-7%	100%

Balancing the General Fund

The Proposed General Fund Budget reflects a multi-faceted approach to addressing the estimated deficit presented at the May 12, 2020 City Council of \$29.8 million. The proposed budget defunds 13.75 full time and 3.68 part time vacant positions citywide for all or a portion of next fiscal year, reduces certain non-essential services, assumes the establishment of a 10 percent employee furlough, and the use of emergency reserves.

The following provides an overview of citywide and department-specific items reduced or eliminated in the budget. Below is a summary of the FY 2020-21 General Fund resources and appropriations:

Table 2

PROPOSED BUDGET – GENERAL FUND (in millions)				
Appropriations General Fund	Adopted	Proposed	Increase/Decrease	
	FY 2019-20	FY 2020-21	Amount	Percent
Estimated Revenues	\$ 140.5	\$ 126.1	\$ (14.1)	-10.0%
Transfers In	1.2	-	(1.2)	-100%
Use of Fund Balance	0.4	7.5	6.8	1700%
Total Resources	\$ 142.2	\$ 133.6	\$ (8.5)	-6.0%
Operating Budget	\$ 137.9	\$ 129.5	\$ (8.4)	-6.1%
Transfers Out	4.3	4.1	(0.2)	-4.7%
Total Appropriations	\$ 142.2	\$ 133.6	\$ (8.6)	-6.0%

Revenue Estimates

As reflected in Table 2, projected General Fund revenues of \$126.1 million for FY 2020-21 are not sufficient to cover the projected expenditures of \$133.6 million. Consequently, several budget balancing strategies were approved by City Council at the May 19, 2020 meeting, in order to help reduce the need for drastic cuts in FY 2020-21 related to the shortfall in revenue resulting from the COVID-19 pandemic, including the use of reserves.

In addition, subsequent to the May 19, 2020 City Council meeting, on May 23, 2020, the Governor approved Orange County’s request to reopen its economy further into Stage 2 of the Roadmap to Resiliency, thereby legally allowing restaurants and retailers to allow in person dining and shopping. This action represented a major development in moving the local economy forward. Later, on May 26, 2020, barber shops and hair salons were also allowed to reopen creating a pathway to Stage 3 of the State’s Roadmap to Resiliency and reopening the economy. As such, the FY 2020-21 Proposed Operating and Capital Improvement Program Budget presented to the City Council today includes slightly increased revenue estimates of \$4.3 million in the General Fund as dining, retail and other amenities reopen to the public. An additional \$0.7 million increase in General Fund revenue is also included based on the expiration of the street sweeping citations waiver. Effective July 1, 2020, staff recommends parking fines be reinstated for violations of street sweeping parking rules.

For FY 2020-21, sales tax is anticipated to decrease by at least \$4.4 million, which represents a 7.5 percent reduction from the Adopted FY 2019-20 sales tax revenue estimate, and a \$10.6 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, or \$4.8 million due to a decline in tourism, travel, conferences and conventions. 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 property tax CPI. Property Tax is a lagging economic indicator meaning that the result of a recession is not typically experienced in the same year due to the one-year lag in setting the property tax roll and 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. 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.

Due to current stay-at-home orders, and the continuation of teleworking for residents, fines and forfeitures are anticipated to decline by 8.4%, by \$0.1 million. Summer park programs, youth and adult sports, as well as instructional classes, are expected to decline by 26%, estimated at \$0.2 million, representing returning normal revenues slowly into the fiscal year.

Table 3

BALANCING THE BUDGET - GENERAL FUND		
(in millions)		
REVENUES	FY 2020/21	FY 2020/21
DESCRIPTION	Preliminary	Proposed
May 19, 2020 Prelimin.	120.6	120.6
Adjusted Sales Tax: Opening OC		4.3
Government Reimbursement		0.5
Street Sweeping/Parks		0.7
Use of Reserves: Declared Disasters		7.5
TOTAL	120.6	133.6
EXPENDITURES	FY 2020/21	FY 2020/21
DESCRIPTION	Preliminary	Proposed
May 19, 2020 Prelimin.	150.4	150.4
Dept Reductions		(10.8)
Staff Furloughs		(6.0)
TOTAL	150.4	133.6
Surplus/(Deficit)	(29.8)	0.0

Expenditure Estimates

The General Fund provides 89% of the total operating budget for all governmental funds. The Proposed General Fund Budget for FY 2020-21 reflects total expenditures of \$133.6 million. This amount represents a decrease of \$8.6 million from the current year adopted budget of \$142.2 million.

To address the \$29.8 million estimated budget shortfall, the City is proposing to reduce departmental expenditures, postpone additional capital projects, include slightly updated revenue projections, and temporarily defund vacant positions for all or a portion of the fiscal year. It is important to note that staff's previous recommendation that the City delay the implementation of the adopted 5 Year Information Technology Strategic Plan by six months has been rescinded. The City's technology systems are antiquated, including the City's financial software system, and are in immediate need of replacement.

Department Targets: City departments reduced operating budgets, overtime, defunded certain positions, transferred eligible expenses to other funds, and reduced capital improvement projects totaling \$10.8 million in solutions.

Table 4

Department	Prior Year Vacancy Attrition	Total Reduction
City Manager		361,698
City Council		38,661
City Attorney		50,000
Development Services		744,653
Finance		218,482
Fire and Rescue		472,732
Information Technology	108,870	358,507
Parks & Comm Svcs	99,455	476,462
Police	3,671,868	3,985,819
Public Services		1,715,322
Non-Departmental		2,328,014
TOTAL	3,880,193	10,750,350

Non-Departmental includes staff's recommendation of transferring less than the 5.0% of the General Fund budgeted revenues required by the Capital Asset Needs (CAN) Ordinance to the Capital Improvement Fund, thereby preserving General Fund revenue towards operations. This action will require a City Council supermajority vote. While this temporary measure 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 Proposed Budget contains the \$2.8 million for the required principal and interest payments on the 2017 Lease Revenue Bonds. The City's PCI of 85.8 is Very Good and will remain so next year.

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 impacted. The City is currently in the process of negotiating a proposed 10 percent furlough with City employees. If the furlough is not achieved, further reductions, potentially including cuts to the City's workforce, will need to be brought to the City Council to balance next year's budget.

Use of General Fund Declared Disaster and Economic Reserves: The COVID-19 pandemic is unprecedented in its scale and scope of damage to the economy and the human death toll worldwide. As such, it's unclear how much of its impact is temporary. The City has two fund balance designations that were specifically created for situations of an unprecedented and temporary nature. The Declared Disasters Reserve of \$14.125 million was established in 2011 as a set-aside of funds to assist the City during a declared disaster. A total of \$7.5 million in Declared Disaster and Economic Reserves will be used to offset a portion of the projected revenue losses in FY 2020-21 to ensure the provision of critical public safety services. As a reminder, as part of the Fiscal 2019-2020 year-end balancing, a portion of these funds (\$7.0 million) is also recommended to offset the losses experienced in the current fiscal year. If the estimated revenue shortfalls for both the current year and next year are correct, the Declared Disaster/Economic Reserves of \$14.5 million will have been fully utilized to help offset the impact of this pandemic and preserve essential services when needed the most.

Staffing Levels

The preliminary budget includes a total of 499 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. While the table of organization still contains 499 FTEs, the budget temporarily removes funding for 13.75 full time and 3.68 part time positions for all or a portion of the year to help balance the budget. This is a one-time recommendation due to COVID-19, and will be re-examined during the course of the year and for the FY 2020-21 budget. The ability of the City to address the estimated \$29.8 million shortfall without cutting services to the public will be difficult. A combination of budget balancing strategies is needed to avoid major cutbacks.

In the current year, layoffs were implemented in the City's part-time ranks due to the pandemic. 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. Moreover, the proposed budget continues the \$3.9 million vacancy factor in the FY 2019-20 budget until the economy is restored and additional funding is identified.

Next Steps

Following today's public hearing on the budget, next steps in the budget cycle include:

- Second public hearing to be held on June 16, 2020
- An additional public hearing, if needed, on June 23, 2020. Fiscal year end closing in the months following June 30, 2020 for the FY 2019-20 Budget.
- Publish the Adopted FY 2020-21 Operating and Capital Improvement Budget Book.
- First Quarter Budget Report in October or November 2020.
- Mid-year Budget Report in February 2021.

ALTERNATIVES CONSIDERED:

The City Council can discuss the item and continue discussions to the public hearing on June 16, 2020, or later, if needed.

LEGAL REVIEW:

The City Attorney's Office reviewed this report and reviewed and approved the proposed resolutions as to form.

CONCLUSION:

The Proposed FY 2020-21 Operating and Capital Improvement Program Budget presents the challenges of developing a balanced budget in the midst of a worldwide pandemic that has infected 6.75 million people worldwide, across 215 countries, caused 394,969 fatalities, and crippled the global economy.

The impact to the American economy, as well as state and local governments is unprecedented, 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 additional Federal and State relief, to maintain essential services to the greatest extent possible.

The Proposed FY 2020-21 Budget represents a balanced budget with the above stated goals in mind. Staff recommends that the City Council:

1. Approve Resolution No. 20-XX (Attachment 1) adopting the City of Costa Mesa FY 2020-21 Operating and Capital Improvement Budget including exercising the emergency exception to the CAN resulting in the waiver of the 5% CAN requirement; and,
2. Approve the use of a portion of the City's General Fund Economic and Declared Disaster Reserves to balance the FY 2020-21 Proposed Budget to continue providing essential services during the COVID-19 pandemic.

CAROL MOLINA

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LORI ANN FARRELL HARRISON

City Manager

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Attachments:

1. [Resolution No. 20-XX Adopting Operating and Capital Budget](#)
2. [May 19, 2020 Agenda Report for FY 2020-21 Preliminary General Fund Revenue and Expenditure Estimates and Overview](#)
3. [April 21, 2020 Agenda Report for FY 2019-20 Cost Containment Plan](#)
4. [FY 2020-21 Proposed Reductions by Department](#)
5. [City Budget and Financial Actions and Presentations since July 1, 2019](#)
6. [Proposed Fiscal Year 2020-2021 Operating & Capital Improvement Budget](#)