



**CITY OF NEWPORT BEACH  
FINANCE COMMITTEE  
STAFF REPORT**

Agenda Item No. 5A  
November 10, 2022

**TO:** HONORABLE CHAIRMAN AND MEMBERS OF THE COMMITTEE

**FROM:** Finance Department  
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**SUBJECT: YEAR-END BUDGET RESULTS AND SURPLUS ALLOCATION**

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**SUMMARY:**

The Finance Department prepares quarterly financial reports to review in detail the status of revenues and expenditures for the City's General Fund and to identify any concerning budgetary trends in other City funds. This report contains information on revenues, expenditures, and estimated fund balance for the fourth quarter of Fiscal Year 2021-22. Because the City's financial records are undergoing the customary audit review, the financial information presented in this report is preliminary in nature and subject to adjustments as the year-end close process continues through December. Any such adjustments are not anticipated to have a material impact on the financial information presented in this report.

**RECOMMENDED ACTION:**

Review and discuss this report and provide any recommendations for consideration by the City Manager and City Council.

**DISCUSSION:**

This fourth financial report of Fiscal Year 2021-22 provides an analysis of the financial activity of the City from the months of July 2021 through June 2022. Based on information available at the end of the fourth quarter, staff has made positive adjustments to year-end projected revenues and preliminary expenditure savings have been identified that should result in a healthy year-end budget surplus. Year-to-date expenditure budget adjustments are fully offset by the additional projected revenues.

### Economic Overview

Key economic indicators such as unemployment, taxable sales, and assessed property values continue to improve, which is indicative of the recent robust improvement to the economy. While recent trends in inflation have caused concern in the broader economy and financial markets, the City is well-positioned to weather any short-term increase in inflation thanks to the related increase in many of the City's revenues such as sales tax and transient occupancy tax as prices increase. Additionally, long-term labor contracts with the City's employee associations have been negotiated that provide reasonable compensation increases that can be accommodated within projected revenue growth.

### General Fund Revenues

Overall General Fund revenue growth has outpaced projections generated by the City's consultants and staff that were incorporated into the adopted Fiscal Year 2021-22 budget. Growth in sales tax and transient occupancy tax has been the most pronounced, but growth in many other areas has contributed to a significant projected increase in General Fund revenues of \$27.4 million versus the adopted budget.

The following table summarizes the changes to projected General Fund revenues versus the adopted budget for Fiscal Year 2021-22.

**Fiscal Year 2021-22 Actual General Fund Revenues\***

Revenues by Category	PY Actual	A	B	C = B-A	D = C/A
		Adopted Budget	Unaudited Actual	Variance	% Variance
Property Taxes	119,157,540	122,229,980	124,335,984	2,106,004	2%
Sales Tax	38,956,275	40,275,670	46,164,860	5,889,190	15%
Transient Occupancy Tax	16,886,197	19,027,493	26,677,331	7,649,838	40%
Other Taxes	12,849,340	10,815,117	13,263,112	2,447,995	23%
Service Fees & Charges	18,264,952	19,046,329	22,870,701	3,824,372	20%
Parking Revenue	7,074,853	5,681,942	7,213,646	1,531,704	27%
Licenses and Permits	5,133,399	5,106,646	6,067,908	961,262	19%
Property Income	5,115,255	5,044,403	6,818,121	1,773,718	35%
Fines & Penalties	4,012,568	3,292,102	4,157,305	865,203	26%
Intergovernmental	5,175,738	1,760,934	4,578,283	2,817,349	160%
Investment Earnings	1,598,624	1,112,200	(2,615,502)	(3,727,702)	-335%
Misc Revenues	1,359,034	734,148	2,027,802	1,293,653	176%
<b>Total Revenues</b>	<b>235,583,776</b>	<b>234,126,964</b>	<b>261,559,549</b>	<b>27,432,585</b>	<b>12%</b>

\* Based on preliminary year-end close data available as of September 30, 2022

**Property Tax** - Property taxes are the City's single largest General Fund revenue and represent approximately 50% of all General Fund revenues. As these revenues are primarily dependent on the assessed valuation established in January of 2021, there is typically very little variance seen from the original budget as the year progresses. The growth rate for Fiscal Year 2021-22 was smaller than what has been seen in recent years,

primarily due to the lower 1.036% CPI factor. For Fiscal Year 2021-22, property taxes came in at \$124.3 million, or \$2.1 million over the adopted budget, which is an indication of timely property tax payments and higher valuations.

**Sales Tax** - The second largest funding source for the General Fund is sales tax revenue, making up more than 15% of General Fund revenues. The City's sales tax base is largely generated from three industry categories – autos and transportation, general consumer goods, and restaurants/hotels. Most of these industries are also heavily impacted by tourism.

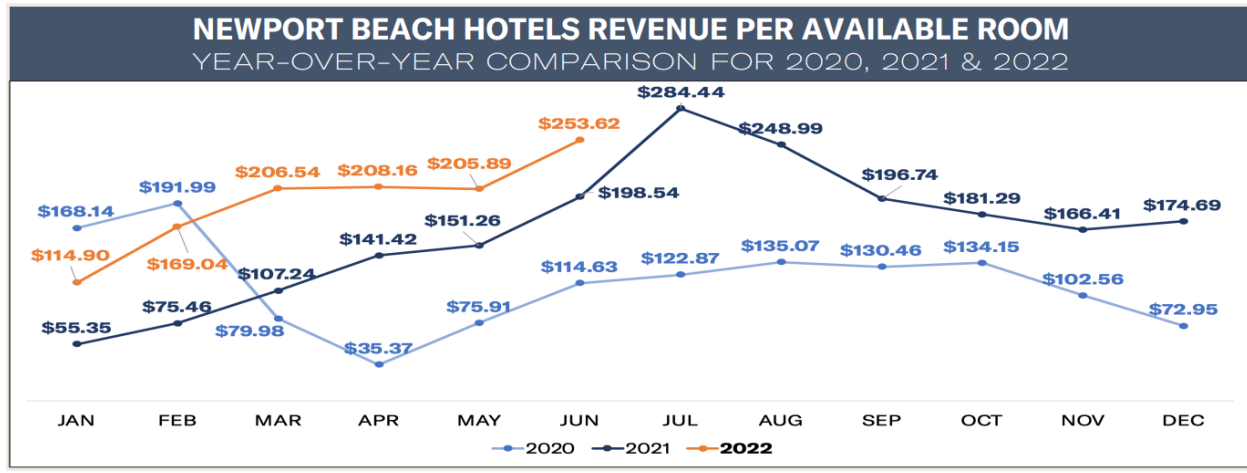
Based on the strong growth seen in the third quarter of Fiscal Year 2021-22 and the projections from the City's sales tax consultants, staff had increased the sales tax revenue estimate for Fiscal Year 2021-22 to \$45.4 million in the third quarter budget update. Actual sales tax receipts came in at \$46.2 million, or \$765,000 over staff's most recent estimate.

This increase results from two primary drivers. First, while auto sales have slowed due to inventory shortages, price increases have more than offset this decline and have resulted in strong growth in this category of sales tax revenues of 11% over Fiscal Year 2020-21. Second, revenues from brick-and-mortar retail establishments and restaurants & hotels have now surpassed the pre-pandemic high as consumer behavior has largely returned to normal. These revenues grew at rates of 30% and 37%, respectively, versus Fiscal Year 2020-21. Also factoring into the strong growth is revenue from fuel and service stations, with 46% growth versus the prior year due to higher fuel prices and higher demand. Overall revenue was up 18% over the prior year, leading to a year-end projection of 14.3% growth for the full fiscal year versus the prior fiscal year.

**Transient Occupancy Tax** – The City has seen a steady rebound and comeback for TOT revenues as the effects of the pandemic receded. Initially, the TOT budget for the current fiscal year was developed in anticipation of full recovery of TOT revenues not occurring until the end of Fiscal Year 2022-23. However, staff's revised projection in the second and third quarter budget updates estimated an increase in the budgeted revenues of \$6.5 million to \$25.6 million, an increase of 34.4%. Actual TOT revenues came in at \$26.7 million, or \$7.7 million over the Fiscal Year 2021-22 adopted budget.

Two factors caused this significant increase in TOT revenues. First, revenue from short-term lodging businesses, which grew throughout the pandemic, is at a record high level. Second, many hotel properties are reporting record high TOT receipts and have been doing so for multiple consecutive months. While occupancy levels have not returned to pre-pandemic levels, they are slowly increasing. This lag in occupancy levels has been largely offset by higher daily room rates, resulting in hotel TOT revenues that are projected to approach the pre-pandemic high in Fiscal Year 2022-23. When taken together, the strong growth in residential TOT makes up for the slightly lower hotel TOT revenue and the two in total have resulted in a record year for TOT revenues for the City.

Data provided by Visit Newport Beach illustrates these very positive trends:



**All Other Revenue** – This category includes all other revenue sources other than the top three (property tax, sales tax, and TOT). All Other Revenue is made up of the following:

- Other Taxes – real property transfer taxes, business license taxes, marine charter taxes, and franchise fees.
- Service Fees and Charges – plan check fees, recreation classes, emergency medical services fees, and numerous other cost-of-service fees.
- Parking Revenue – all General Fund related metered parking fees that are assessed throughout the various parking zones of the City.
- Licenses and Permits – fees charged to process building related permits, street closure permits, dog licenses, and police tow franchise fees.
- Property Income – City owned and managed income producing properties, long-term ground leases to concessions, restaurants, hotels and other businesses and organizations, and rental of City facilities to the public.
- Fines and Penalties – parking citation fines collected by the City, administrative citation fines, fines remitted to the City from the County for vehicle code violations, and false alarm penalties.
- Intergovernmental Revenues – federal, state, and local grant revenues, which includes, but is not limited to, the City's portion of the ½ cent sales tax revenue paid to the County for public safety, state mandate reimbursements, reimbursement for strike teams sent to assist with fires, and revenue sharing with the County of Orange under the Waste Disposal Agreement (WDA).
- Investment Earnings – revenue generated from the investment of City funds.
- Miscellaneous Revenues – restricted revenue, damage to City property, bad debt, donations and contributions, non-operating revenues such as proceeds from the

sale of materials and equipment, and other miscellaneous revenues.

Growth in other revenues as a whole is \$11.8 million above the adopted budget or 22%. Primary drivers of this growth include:

- Service fees and charges revenues exceeded the adopted budget by \$3.8 million primarily due to increased revenue received from recreation fee-based classes and the Junior Lifeguard program, as well as plan check fees and paramedic service fees.
- Property income revenues exceeded the adopted budget by \$1.7 million, primarily due to increased percentage-based rent revenues from the Lido House Hotel lease due to the hotel's increased revenues.
- Intergovernmental revenues are projected to exceed the adopted budget by \$2.8 million, primarily due to adjustments related to Fire Department mutual aid reimbursements and SB-2 Permanent Local Housing Allocation grant funds. The City received \$553,300 from the State of California for staff assigned to strike team deployments. Staff seek to align the FY 2021-22 budget with actual revenues received through the end of the fiscal year, which includes increasing revenue estimates & expenditure appropriations by \$553,300 and is reflected as an increase in intergovernmental revenues.
- Property transfer tax revenues, which are included in the Other Taxes category in the chart above, exceeded the adopted budget by \$1.7 million due to the strong sales activity discussed earlier in this report.

Governmental accounting standards require the City to adjust the value of the City's investments to market value. Because the City normally holds investments to maturity and receives the full value of securities regardless of market value fluctuations, these are paper-only gains and losses that net to \$0 over time. The impact of the gains and losses associated with the change in the value of the City's investments is recorded at year-end as an addition to or subtraction from investment income. Because of the current volatile and rising interest rate environment, staff anticipated a significant negative adjustment on June 30, 2022, to reflect the fair value of the City's investments, as was reported in the third quarter report. On June 30, 2022, the recorded entry was a negative adjustment of \$3.85 million to General Fund investment income to record the fair value adjustment. This material adjustment has reduced the projected surplus as reported later in this report. As the securities in the City's investment portfolio turnover in the next several years, the negative adjustment in the current year will be offset by positive adjustments that will cause future investment income to be reported as higher than the actual revenue received.

### **General Fund Expenditures**

The Fiscal Year 2021-22 General Fund revised expenditure budget totals \$238.9 million. Spending trends in Fiscal Year 2021-22 are generally consistent with prior years and do

not indicate any cause for concern. Total expenditure savings of \$10.9 million were realized, or 4.5% of the revised budget.

The table below summarizes the changes to the adopted expenditure budget for Fiscal Year 2021-22, as well as expenditure savings by budget category. Details follow highlighting the reasons for the material variances.

**FY 2021-22 Actual General Fund Expenditures \***

Expenditures by Category	Adopted Budget	A Revised Budget	B Projected Actual	C = A-B Savings (Overage)	D = C/A % Variance
Salary & Benefits	\$ 151,713,101	\$ 159,704,562	155,030,806	\$ 4,673,756	2.9%
Contract Services	24,702,901	27,262,619	23,849,856	3,412,762	12.5%
Grant Operating	600,000	926,490	851,954	74,536	8.0%
Utilities	3,011,315	3,219,168	3,909,494	(690,326)	-21.4%
Supplies & Materials	3,739,730	4,433,188	3,993,623	439,565	9.9%
Maintenance & Repair	12,640,923	13,160,524	11,103,973	2,056,551	15.6%
Travel & Training	814,868	832,259	664,486	167,773	20.2%
General Expenses	2,130,552	2,303,774	2,228,060	75,714	3.3%
Internal Svc Charge	25,078,890	25,093,732	25,093,732	-	0.0%
Risk Management	750,915	750,915	472,940	277,975	37.0%
Capital Expenditures	780,438	1,185,810	824,085	361,725	30.5%
<b>Total Expenditures</b>	<b>\$ 225,963,632</b>	<b>\$ 238,873,040</b>	<b>\$ 228,023,008</b>	<b>\$ 10,850,031</b>	<b>4.5%</b>

\* Based on preliminary year-end close data available as of September 30, 2022

Significant expenditure budget variances are as follows:

- The revised salary and benefits budget totals \$159.7 million, an increase of \$7.9 million over the adopted budget. The increase is primarily due to the appropriation of \$5.0 million from Fiscal Year 2020-21 year-end budget surplus as an additional discretionary payment to CalPERS to further reduce the City's unfunded pension liability. The remaining \$2.9 million relates to recently approved contracts with the City's employee associations. The City does not budget for unknown labor costs, which requires mid-year appropriations for negotiated salary and benefit increases in the year in which new labor contracts are negotiated. While the budget for FY 2021-22 did include a \$2.0 million vacancy factor, an additional \$4.7 million in salary and benefit savings beyond the vacancy factor have been realized. Reflected in the salary and benefit projected actuals is \$553,300 in overtime expenses related to staff assigned to strike team deployments. To align the FY 2021-22 budget with actual revenues and expenses through the end of the fiscal year, budget amendment No. 22-059 includes increasing revenue estimates & expenditure appropriations by \$553,300.

- Increases to the contract services budget relate to a variety of routine mid-year adjustments previously approved by the City Council, including \$0.6 million added to the contract instructors' budget for Recreation and Senior Services that is fully offset by higher revenues, \$0.4 million for the Be Well OC program, \$0.3 million for the Medical IGT Program that is fully offset by higher revenues, and appropriations offsetting several donations. Contract services savings of \$3.4 million were realized, however, \$2.3 million in encumbrances for contracts was carried over into Fiscal Year 2022-23. Staff has reserved a portion of the surplus to account for these rolled encumbrances as is done every year, which reduces the year-end surplus available to allocate.
- Staff identified and previously reported on an issue with the City's budgeting for utilities. A portion of this issue was addressed with a budget amendment approved by the City Council in the first quarter. Additional overages became apparent and were reported in the third quarter report. Staff has made adjustments in the Fiscal Year 2022-23 budget to address these overages. As budget savings in other expenditure categories fully offset the \$0.7 million overage, staff is not recommending a further adjustment to the utilities budget at this time.
- Savings of \$1.6 million from the residential refuse collection contract account for the majority of savings within the maintenance and repair category. Additional budget for this contract was built into the adopted budget; however, the contract was not executed until January 2022, resulting in unexpected budget savings that will not be ongoing in future years.

On October 26, 2021, the City Council approved \$31.0 million of recommended appropriations from prior year unrestricted General Fund resources as follows:

1. **CalPERS Unfunded Liability** – \$5.0 million to bring the City's annual unfunded liability contribution to CalPERS up from \$35 million to \$40 million, consistent with recent years and the recommendation of the Finance Committee.
2. **Facilities and Infrastructure Replacement Liabilities** – \$10.5 million toward additional contributions to long-term infrastructure liabilities within the Facilities Financial Plan and Harbor and Beaches CIP.
3. **CIP and Neighborhood Enhancements** – \$15.5 million toward the Fiscal Year 2022-23 capital improvement program, to include neighborhood enhancement projects.

Other than the previously discussed appropriation toward the City's CalPERS unfunded liability, the remainder of these appropriations are reflected in the budget as transfers out of the General Fund.

### General Fund Sources, Uses, and Projected Surplus

As a result of the strong revenue growth discussed earlier in this report, as well as the expenditure savings realized, the General Fund has a budget surplus of \$24.1 million for Fiscal Year 2021-22.

The table below illustrates the prior year sources and uses of funds as compared to the adopted budget and the projected year-end results:

### Fiscal Year 2021-22 Projected General Sources, Uses, and Budget Surplus

Category	FY 2020-21 Actual	A FY 2021-22 Adopted	B FY 2021-22 Projected	C=B-A Variance	D=C/A % Variance
<b>BEGINNING UNRESTRICTED FUND BALANCE</b>	<b>\$ 26,086,333</b>	<b>\$ 31,036,884</b>	<b>\$ 31,178,957</b>	<b>\$ 142,073</b>	<b>0.5%</b>
<b>SOURCES:</b>					
Operating Revenues	234,708,627	234,126,964	261,557,218	27,430,254	11.7%
Less: Restricted Revenues	(890,466)	(1,128,513)	(746,728)	381,785	-33.8%
Prior Year Resources Carried Forward	2,075,632	-	3,072,666	3,072,666	---
Release of Restricted Funds	1,557,463	1,220,000	6,476,034	5,256,034	430.8%
Transfers In from Other Funds	21,526,628	11,977,157	11,356,595	(620,562)	-5.2%
<b>TOTAL SOURCES</b>	<b>258,977,884</b>	<b>246,195,608</b>	<b>281,715,785</b>	<b>35,520,177</b>	<b>14.4%</b>
<b>USES:</b>					
Operating Expenditures	220,647,754	225,963,632	228,023,008	2,059,376	0.9%
Transfers Out	27,467,575	20,200,000	52,813,549	32,613,549	161.5%
Resources Carried Forward to Next Fiscal Year	3,072,666	-	4,429,573	4,429,573	---
Addition to 25% Contingency Reserve	2,697,265	-	3,535,171	3,535,171	---
<b>TOTAL USES</b>	<b>253,885,260</b>	<b>246,163,632</b>	<b>288,801,302</b>	<b>42,637,670</b>	<b>17.3%</b>
<b>ENDING UNRESTRICTED FUND BALANCE</b>	<b>\$ 31,178,957</b>	<b>\$ 31,068,860</b>	<b>\$ 24,093,441</b>	<b>\$ (6,975,419)</b>	<b>-22.5%</b>

As can be seen in the table above, even with the sizable appropriations earlier this year that allocated three prior years' budget surpluses, current projections now reflect a \$24.1 million budget surplus for the current fiscal year.

One item of note is that the transfers in from other funds has decreased by \$621,000. This is due to an updated projection of the activity in the Tidelands Operating Fund, which will require a higher subsidy from the General Fund than was anticipated when the budget was developed. A higher subsidy is necessary due to activity in the Tidelands fund such as capital expenditures brought forward mid-year.

Lastly, as discussed in the revenues section of this report, the impact from adjusting the value of the City's investments to fair value has negatively impact revenues by \$3.85 million.

### Recommended Allocation for Unrestricted General Fund Resources

Typically, year-end surplus funds are allocated based on the guidelines found in City Council Policy F-5, which recommends that roughly 50% of surplus funds be allocated to



long-term obligations such as pensions, debt, and other long-term needs and 50% be allocated to infrastructure or neighborhood capital improvements. As discussed, \$24.1 million of unrestricted General Fund resources are available for use at the Council's discretion at this time. Recognizing that City Council Policy F-5 was developed with smaller surpluses in mind and the Council already funded the Fiscal Year 2022-23 CalPERS unfunded liability contribution from the Fiscal Year 2022-23 structural surplus, staff is recommending that the Council waive policy elements C and D of City Council Policy F-5 as was done last year.

Staff's recommendation is to use the surplus funds of \$24.1 million to fund the majority of the proposed purchase of a parcel on Dove Street for a future relocation of the City's Police Facility, as discussed in detail in a separate staff report. Staff propose funding the remaining amount of \$6.7 million from available funds on hand in the Facilities Financial Planning (FFP) Fund.

### Other Funds

Staff have evaluated the fiscal condition of the City's other major operating funds (Tidelands, Water, and Wastewater). An analysis of the budget performance for the Water and Wastewater funds indicates that no budget adjustments are necessary and variances between budgeted and actual amounts are within reason.

An analysis of the Tidelands fund has demonstrated that a higher than budgeted subsidy will be necessary to fund the current activity in the fund. There is no budgetary impact due to the current presentation format of the Tidelands Fund, but this is reflected in the General Fund sources and uses as a reduced transfer in as previously discussed.

<b>Tidelands Operating Fund Activity</b>	<b>FY 2021-22 Projected</b>
Available Beginning Fund Balance	2,390,852
Projected Revenues	13,578,608
<b>Total Sources</b>	<b>15,969,460</b>
Operational Expenses	(1,130,636)
Capital Improvement Projects	(3,862,955)
Cost Allocation Plan	(17,490,906)
<b>Total Uses</b>	<b>(22,484,497)</b>
<b>Deficit (Subsidy)</b>	<b>(8,668,939)</b>
Projected Net Increase to GF (CAP less Subsidy)	8,821,967
Budgeted Net Increase to GF (CAP less Subsidy)	9,442,529
<b>Impact on General Fund</b>	<b>(620,562)</b>

### **Measure M Fund**

In Fiscal Year 2020-21, the City of Newport Beach received funding from the Orange County Transportation Authority (OCTA) for the Newport Bay Trash Mitigation project expensed in Fiscal Year 2019-20. The project cost was \$125,226, however only \$120,216.38 was received from OCTA. Staff is proposing transferring \$5,009.62 from the General Fund in order to balance the revenues and expenses for this prior year project.

### **American Rescue Plan Act Fund**

The City of Newport Beach received funding from the American Rescue Plan Act (ARPA), through the California State Water Resources Control Board to reimburse the City for delinquent water bills that were unpaid during the COVID-19 pandemic bill relief period. The City received approximately \$123,000 for this water arrearage program, and a budget amendment is needed to appropriate the revenues and expenses within the ARPA fund. There is also a wastewater arrearage program that will be brought forward in the Fiscal Year 2022-23 First Quarter Report.

### **Conclusion**

As a result of conservative budgeting and sound financial policies, the City remains well positioned to continue delivering a high level of service to the community while targeting surplus resources to key priorities at year-end as has been the case for a number of consecutive years. Staff recommends that the Finance Committee review and discuss this report and provide any recommendations for City Manager and City Council consideration prior to the November 15<sup>th</sup> City Council meeting, at which time this report will be presented.

Prepared and Submitted by:

/s/ Shelby Burguan

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