



CITY OF NEWPORT BEACH FINANCE COMMITTEE STAFF REPORT

Agenda Item No. 5B
November 10, 2022

TO: HONORABLE CHAIRMAN AND MEMBERS OF THE COMMITTEE

FROM: Finance Department
Michael Gomez, Acting Finance Director / Treasurer
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SUBJECT: FIRST QUARTER BUDGET UPDATE **(UPDATED)**

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 first quarter of Fiscal Year 2022-23.

The first financial report of Fiscal Year 2022-23 provides an analysis of the financial activity of the City from the months of July through September 2022. Based on information available at the end of the first quarter, positive revenue adjustments are expected and will be reflected in the proposed first quarter budget amendment. Several expenditure budget adjustments are also recommended, all of which are fully offset by the additional revenues.

RECOMMENDED ACTION:

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

DISCUSSION:

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

Most revenue categories performed at or higher than their budgeted levels last year due to more favorable economic conditions than anticipated when the budget was originally adopted. Overall General Fund revenue growth has outpaced projections generated by the City's consultants and staff that were incorporated into the adopted Fiscal Year 2022-23 budget. Growth in 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 \$3.2 million versus the adopted budget. Of note, sales tax in the categories hardest hit by the pandemic (brick-and-mortar businesses and restaurants & hotels) has now surpassed the record high levels seen just prior to the pandemic's onset, and transient occupancy tax has now exceeded the pre-pandemic high.

The following table summarizes the changes to projected General Fund revenues versus the adopted budget for Fiscal Year 2022-23. Details follow highlighting the reasons for the material variances.

Fiscal Year 2022-23 Projected General Fund Revenues*

Revenues by Category	PY Actual	A	B	C = B-A	D = C/A
		Adopted Budget	Projected Actual	Variance	% Variance
Property Taxes	124,335,985	131,403,081	132,290,053	886,972	1%
Sales Tax	46,164,860	46,526,493	46,526,493	-	0%
Transient Occupancy Tax	26,677,331	27,788,728	28,908,841	1,120,113	4%
Other Taxes	13,263,112	12,174,567	12,174,567	-	0%
Service Fees & Charges	22,870,701	22,005,339	22,654,447	649,108	3%
Parking Revenue	7,213,646	5,681,942	5,681,942	-	0%
Licenses and Permits	6,067,908	5,870,375	5,870,375	-	0%
Property Income	6,818,121	6,416,226	6,416,226	-	0%
Fines & Penalties	4,157,305	3,870,567	3,870,567	-	0%
Intergovernmental	4,578,283	1,823,903	2,372,999	549,096	30%
Investment Earnings	(2,615,502)	1,300,000	1,300,000	-	0%
Misc Revenues	2,027,802	169,280	169,280	-	0%
Total Revenues	261,559,550	265,030,502	268,235,791	3,205,289	1%

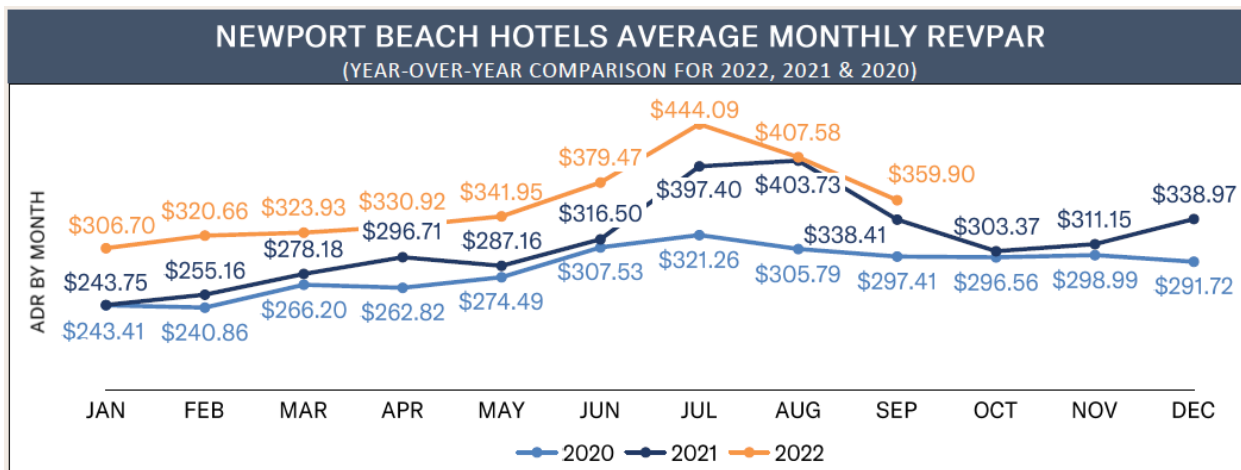
** Based on preliminary year-end close data available as of September 30, 2022*

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 2022, there is typically very little variance seen from the original budget as the year progresses. Projections for Fiscal Year 2022-23 property tax revenues from the City's property tax

consultant reflect a 7.6% increase in assessed values in the year ahead. This strong growth is a result of the CPI factor returning to the maximum 2.0% allowed and adding \$1.2 billion to the assessed valuation, as well as continued strong property sales activity and price appreciation adding \$5.0 billion to the assessed valuation. The City's total assessed valuation for Fiscal Year 2022-23 is now projected to grow from \$66.2 billion to \$71.2 billion.

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 heavily impacted by tourism and were impacted by the effects of the COVID-19 pandemic. The adopted budget for this revenue source was developed in conjunction with the City's sales tax consultant and remains the current projection at this time.

Transient Occupancy Tax – The City has seen a steady rebound and comeback for TOT revenues as the effects of the pandemic receded. The TOT budget for the current fiscal year was developed in anticipation of full recovery of TOT revenues. Revenue from short-term lodging businesses, which grew throughout the pandemic, is at a record high level. Additionally, 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 room rates as shown in the chart provided by Visit Newport Beach:



VEA Newport Beach is now operational, with expanded meeting space, higher room rates, and a full complement of rooms available that have not been usable during the renovation process this past year. Staff has conservatively not included an impact in the TOT revenue projection from the changes to the hotel, which should result in a positive variance beyond the Fiscal Year 2022-23 projection. The Fashion Island Hotel remains closed but is expected to reopen in the Summer of 2023 following a sale and renovation

as the Pendry Newport Beach. Similarly, because the timing of the Pendry's opening is uncertain, staff has not included any revenue from the hotel in the projection for next fiscal year. These reopening's, combined with the expected return of more business travelers, are anticipated to have additional positive impact on the City's TOT revenues in the years ahead.

An updated analysis of the City's TOT revenues shows an expected increase of \$1.1 million, due largely to strong short term lodging businesses, which increases the current year projection to \$28.9 million. Staff will continue to monitor TOT trends and will provide additional updates to projections as necessary in future quarterly financial reports.

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.

Service fees and charges revenues are projected to exceed the adopted budget by \$600,000. This is primarily due to increased revenue received from recreation fee-based

classes. An amendment is proposed to increase both revenues and expenditures associated with fee-based classes.

Intergovernmental revenues are projected to exceed the adopted budget by \$550,000, primarily due to adjustments related to Fire Department mutual aid reimbursements and SB-2 Permanent Local Housing Allocation grant funds.

General Fund Expenditures

The Fiscal Year 2022-23 General Fund revised expenditure budget totals \$255.7 million. Spending trends in fiscal year 2022-23 are generally consistent with prior years and do not indicate any cause for concern. Total expenditure savings of \$330,000 are projected at this time due to year-to-date savings from vacancies, offset by expense overages that are addressed in Budget Amendment No. 23-027 (Attachment A), and are explained in detail below.

The table below summarizes the changes to the adopted expenditure budget for Fiscal Year 2022-23, as well as expenditure savings by budget category. Details follow highlighting the reasons for the material variances.

Fiscal Year 2022-23 Projected 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	\$ 163,463,320	\$169,670,545	\$ 168,664,236	\$ 1,006,308	0.6%
Contract Services	26,873,734	29,498,100	30,092,600	(594,500)	-2.0%
Grant Operating	548,485	552,485	552,485	-	0.0%
Utilities	3,837,745	3,837,745	3,837,745	-	0.0%
Supplies & Materials	3,902,350	4,676,788	4,676,788	-	0.0%
Maintenance & Repair	13,282,330	14,445,304	14,445,304	-	0.0%
Travel & Training	833,758	843,049	843,049	-	0.0%
General Expenses	2,178,896	2,279,465	2,279,465	-	0.0%
Internal Svc Charge	28,190,206	28,190,206	28,190,206	-	0.0%
Risk Management	255,915	255,915	255,915	-	0.0%
Capital Expenditures	1,153,666	1,409,470	1,491,970	(82,500)	-5.9%
Total Expenditures	\$ 244,520,405	\$ 255,659,072	\$ 255,329,763	\$ 329,308	0.1%

*** 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 \$169.7 million, an increase of \$6.2 million over the adopted budget. The increase is primarily due to the appropriation of \$5.0 million from the Fiscal Year 2022-23 structural budget surplus as an

additional discretionary payment to CalPERS to further reduce the City's unfunded pension liability. The remaining \$1.2 million relates to recently approved contracts with the majority of 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.

- The revised contract services budget totals \$129.5 million, an increase of \$2.6 million over the adopted budget. This increase is primarily due to contract carryovers from the prior fiscal year, that pull from prior year reserved fund balances and not current year revenues. During Fiscal Year 2020-21, the Recreation and Senior Services department reduced their operational revenues and expenditure budgets in response to cancelled classes relating to the COVID-19 shutdowns. At the end of quarter one in Fiscal Year 2021-22, staff increased expenditure appropriations due to the reinstatement of cancelled classes, however, these increases were still below the pre-pandemic budget levels. Staff is seeking an amendment of \$594,000 to fully restore contract instructor budgets.
- Two new vehicle purchases that were approved as program enhancements were erroneously not included in the adopted budget. Staff seek a budget amendment to fund the purchases of these vehicles for the Fire and Utilities departments.

General Fund Sources, Uses, and Projected Surplus

The City continues to be in excellent financial health. Conservative budgeting and sound financial policies have resulted in a trend of General Fund operating surpluses and strong reserve levels for several years. The City is well positioned to continue delivering a high level of service to the community while targeting surplus resources to key priorities each year. Staff currently project that unrestricted General Fund resources will total ~~\$719,000~~ [\\$1.8 million](#) at the end of Fiscal Year 2022-23. As is the case each year, staff anticipate that additional budget savings will be realized, and the final year-end budget surplus will exceed this amount.

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

Fiscal Year 2022-23 Projected General Sources, Uses, and Budget Surplus

Category	FY 2021-22 Actual	A FY 2022-23 Adopted	B FY 2022-23 Projected	C=B-A Variance	D=C/A % Variance
BEGINNING UNRESTRICTED FUND BALANCE	\$ 31,178,957	\$ 24,093,441	\$ 24,093,441	\$ -	0.0%
SOURCES:					
Operating Revenues	261,557,218	265,030,502	268,235,791	3,205,289	1.2%
Less: Restricted Revenues	(746,728)	-	-	-	0.0%
Prior Year Resources Carried Forward	3,072,666	-	4,429,573	4,429,573	---
Release of Restricted Funds	6,476,034	-	-	-	0.0%
Transfers In from Other Funds	11,356,595	18,550,724	18,550,724	-	0.0%
TOTAL SOURCES	281,715,785	283,581,226	291,216,088	7,634,862	2.7%
USES:					
Operating Expenditures	228,023,008	244,520,405	255,329,763	10,809,359	4.4%
Transfers Out	52,813,549	31,597,269	58,140,710	26,543,441	84.0%
Resources Carried Forward to Next Fiscal Year	4,429,573	-	-	-	---
Addition to 25% Contingency Reserve	3,535,171	-	-	-	---
TOTAL USES	288,801,301	276,117,674	313,470,474	37,352,800	13.5%
ENDING UNRESTRICTED FUND BALANCE	\$ 24,093,441	\$ 31,556,994	\$ 1,839,055	\$ (29,717,938)	-94.2%

As can be seen in the table above, even with the sizable appropriations earlier this year that allocated last year's budget surplus of \$24.1 million, current projections now reflect a \$1.8 million budget surplus for the current fiscal year.

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 these funds indicates that no budget adjustments are necessary and variances between budgeted and actual amounts are within reason.

Contributions Fund

Several Capital Improvement Plan (CIP) projects in the contributions fund have received additional revenues for portions of existing projects. These revenues fully offset additional expenses but require budget amendments that are included in staff's recommendation to Council:

- Peninsula Encroachment Removal Project (22M14) – property owners were notified they could either pay the City \$7,500 for the removal of their hardscape encroachments or remove the encroachments themselves. 3 property owners entered in agreements for the City to remove their encroachments.
- East Coast Highway Pavement Rehabilitation (21R12) – Laguna Beach Water District and Orange County Sanitation District are contributing to the project for work the City did as part of the construction contract that would have been their responsibility.

- Additional unforeseen work was required on the Jamboree Road Pavement Rehabilitation project (21R15) that is the responsibility of Orange County Water District (OCWD). The City will bill OCWD for the cost of the additional work.
- Von Karman Avenue Pavement Rehabilitation (23R15) – Coronavirus Response and Relief Supplement Appropriations Act of 2021 provided funding through Department of Transportation with Orange County Transportation Authority distributing the funds. The expenditure is budgeted through the Capital Improvement Program budget. The budget amendment will add the anticipated revenue into the budget, so the contributions fund is balanced.

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 sewer bills that were unpaid during the COVID-19 pandemic bill relief period. The City received approximately \$50,000 for this wastewater arrearage program, and a budget amendment is needed to appropriate the revenues and expenses within the ARPA fund.

Conclusion

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 15th City Council meeting, at which time this report will be presented.

Prepared and Submitted by:

/s/ Shelby Burguan

Shelby Burguan
Budget Manager