



# NEWPORT BEACH

## City Council Staff Report

February 27, 2024  
Agenda Item No. 14

**TO:** HONORABLE MAYOR AND MEMBERS OF THE CITY COUNCIL

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**TITLE:** Fiscal Year 2023-24 Second Quarter Financial Report

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### **ABSTRACT:**

The Finance Department prepares quarterly financial reports to review the status of revenues and expenditures for the City of Newport Beach General Fund and to monitor budgetary trends in other City funds. This report contains information on revenues, expenditures, and estimated fund balance for the second quarter of Fiscal Year 2023-24, which was reviewed and discussed with the Finance Committee on February 15, 2023. The FY 2023-24 second quarter financial report reflects a \$7.7 million General Fund operating surplus based on analysis of the City's financial activity from July through December 2023.

### **RECOMMENDATIONS:**

- a) Determine this action is exempt from the California Environmental Quality Act (CEQA) pursuant to Sections 15060(c)(2) and 15060(c)(3) of the CEQA Guidelines because this action will not result in a physical change to the environment, directly or indirectly;
- b) Authorize the City Manager, or designee, to appropriate American Rescue Plan Act funds and to transfer related savings to the Facilities Financing Plan Fund consistent with the spending plan outlined within the staff report; and
- c) Receive and file the attached report of budget amendments for the second quarter.

### **DISCUSSION:**

#### **Economic Overview**

After 29 months of post-pandemic jobs growth in the State of California dating back to April 2021, employment growth in California was flat in September 2023 and declined in October 2023. Unemployment is rising, and California consumers and businesses are dialing back spending. Additionally, home sales continue to decline amid rising mortgage rates, which has resulted in higher home prices.

The current median price of a single-family residence in Newport Beach is \$3,050,000, which is the highest in Orange County. Although the City is projecting a decline in sales tax revenue that is largely due to a shift in consumer spending from taxable goods to nontaxable items, the economic outlook for Newport Beach remains bright, which is primarily due to consistent and vigorous demand for real estate in Newport Beach that drives assessed property values higher in spite of a slowdown in home sales. For example, the City has never seen a decline in assessed values over the last 20 years – even during the Great Recession, which is a significant contributor to the City’s fiscal stability.

**General Fund Revenues**

Most revenue categories performed at or higher than their budgeted levels last year due to more favorable economic conditions than what was originally anticipated in the adopted budget. Growth in many areas has led to a \$0.6 million projected increase in General Fund revenues than what is estimated in the current budget. Projections for property taxes, other taxes, and service fees are offset by a decrease in sales tax projections.

The following table summarizes the changes to projected General Fund revenues versus the revised budget for FY 2023-24. Details highlighting the reasons for the material variances follow.

**FY 2023-24 Projected General Fund Revenues**

| Revenues by Category    | PY Actual          | A                  | B                   | C = B-A        | D = C/A     |
|-------------------------|--------------------|--------------------|---------------------|----------------|-------------|
|                         |                    | Revised Budget     | Q2 Projected Actual | Variance       | % Variance  |
| Property Taxes          | 138,358,730        | 142,715,981        | 143,556,945         | 840,964        | 0.6%        |
| Sales Tax               | 46,552,459         | 45,257,552         | 43,684,691          | (1,572,861)    | -3.5%       |
| Transient Occupancy Tax | 30,201,648         | 31,986,150         | 31,986,150          | -              | 0.0%        |
| Other Taxes             | 10,079,710         | 8,937,999          | 9,922,292           | 984,293        | 11.0%       |
| Service Fees & Charges  | 25,187,124         | 24,429,291         | 24,629,291          | 200,000        | 0.8%        |
| Parking Revenue         | 7,420,314          | 7,900,099          | 7,900,099           | -              | 0.0%        |
| Licenses and Permits    | 5,676,619          | 5,746,027          | 5,746,027           | -              | 0.0%        |
| Property Income         | 7,530,393          | 9,425,682          | 9,565,682           | 140,000        | 1.5%        |
| Fines & Penalties       | 3,838,752          | 3,799,784          | 3,799,784           | -              | 0.0%        |
| Intergovernmental       | 4,379,680          | 4,606,840          | 4,606,840           | -              | 0.0%        |
| Investment Earnings     | 1,690,399          | 1,750,000          | 1,750,000           | -              | 0.0%        |
| Misc Revenues           | 3,394,938          | 437,412            | 437,412             | -              | 0.0%        |
| Operating Transfers In  | 18,428,263         | 21,251,267         | 21,251,267          | -              | 0.0%        |
| <b>Total Revenues</b>   | <b>302,739,030</b> | <b>308,244,084</b> | <b>308,836,480</b>  | <b>592,396</b> | <b>0.2%</b> |

**Property Tax** - Property taxes are the City’s single largest General Fund revenue and represent approximately 50% of all General Fund revenues. As reported in the first quarter budget update, property tax revenue was projected to grow to \$142.7 million in FY 2023-24, which assumed \$4.4 million in growth or 3.1% over the prior year. However, property tax revenue for FY 2023-24 is currently projected to be \$143.6 million, which projects \$5.2 million in growth or 3.8% over the prior year. Therefore, property tax revenue is projected to be \$0.8 million higher than forecasted, which is due to cash receipts for supplemental property taxes coming in higher than previously forecasted.

**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 four industry groups — autos and transportation, general consumer goods, restaurants/hotels, and the State & County Pools. As reported in the first quarter budget update, sales tax revenue was projected at \$45.3 million in FY 2023-24, which assumed a \$1.3 million or 2.8% decline over the prior year due to a shift in consumer spending from taxable goods, such as new car sales, to nontaxable items, such as travel, leisure and entertainment. For example, sales from autos and transportation (the City's largest source of sales tax revenue) were projected to be down \$0.8 million or 5.5% due to a decrease in demand for new vehicles, which is largely related to higher interest rates. However, sales from autos and transportation are currently projected to be down approximately 14% (compared to the previously projected decline of 5.5%), which is due, in part, to the temporary closure of a luxury automobile dealership while it is currently undergoing a construction renovation project. Overall, sales tax revenue for FY 2023-24 is currently projected to be \$43.7 million, which projects a \$2.9 million or 6.2% decline over the prior year. As previously stated, the decline in sales tax revenue is partly due to a decrease in the forecast for sales from autos and transportation. In addition, sales from the State & County Pools are projected to be approximately \$0.6 million lower, which is largely due to a decrease in the City's point of sales relative to point of sales for other agencies in the State & County Pools. Therefore, sales tax revenue is projected to be \$1.6 million lower than previously forecasted.

**Transient Occupancy Tax (TOT)** – The third largest funding source for the General Fund is TOT, making up more than 10% of General Fund revenues. Approximately three-fourths of TOT revenue is derived from hotels, with the balance coming from short-term lodging. While TOT receipts from short-term lodging more than doubled over the four-year period from Fiscal Year 2018-19 through Fiscal Year 2022-23, short-term lodging revenue is projected to be 1% higher over the prior year, whereas 5% growth was reflected in the original forecast for both short-term lodging and hotels. However, TOT revenue from hotels is projected to be 7.8% higher, and is due in part to the Pendry, which opened in late September 2023. Therefore, the overall projection for the second quarter is in line with the budgeted revenues.

**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 other taxes, service fees and charges, parking revenue, licenses and permits, property income, fines and penalties, intergovernmental revenues, investment earnings, and miscellaneous revenues. Material changes in projected amounts were made to other taxes and service fees and charges:

- Other Taxes consists of real property transfer taxes, business license taxes, marine charter taxes and franchise fees. This category is anticipated to have increased revenues of \$984,000 from business licenses and franchise fees based on prior year actuals and year-to-date cash receipts.
- Service Fees and Charges consists of plan check fees, recreation classes, emergency medical services fees and numerous other cost-of-service fees. It is anticipated that fees will bring in an additional \$600,000 in revenue above the adopted budget, largely from fees that were increased in the latest fee study approved by the City Council after the budget was adopted. This increased projection is offset by a projected decrease in Plan Check Fees of \$400,000.

**General Fund Expenditures**

The FY 2023-24 General Fund expenditure budget totals \$309.5 million. Spending trends in FY 2023-24 are generally consistent with prior years and do not indicate any cause for concern. Total expenditure savings of \$4.7 million are projected at this time due to year-to-date savings from vacancies.

The following table summarizes the changes to the adopted expenditure budget for FY 2023-24, as well as expenditure savings by budget category. Details highlighting the reasons for the material variances follow.

**FY 2023-24 Projected General Fund Expenditures**

| Expenditures by Category  | A<br>Revised<br>Budget | B<br>Q2 Projected<br>Actual | C = A-B<br>Savings<br>(Overage) | D = C/A<br>% Variance |
|---------------------------|------------------------|-----------------------------|---------------------------------|-----------------------|
| Salary & Benefits         | \$179,228,885          | \$174,483,937               | \$4,744,947                     | 2.6%                  |
| Contract Services         | 33,774,340             | 33,774,340                  | -                               | 0.0%                  |
| Grant Operating           | 1,444,144              | 1,444,144                   | -                               | 0.0%                  |
| Utilities                 | 4,365,888              | 4,365,888                   | -                               | 0.0%                  |
| Supplies & Materials      | 4,750,243              | 4,750,243                   | -                               | 0.0%                  |
| Maintenance & Repair      | 15,239,986             | 15,239,986                  | -                               | 0.0%                  |
| Travel & Training         | 868,771                | 868,771                     | -                               | 0.0%                  |
| General Expenses          | 3,949,158              | 3,949,158                   | -                               | 0.0%                  |
| Internal Svc Charge       | 29,422,570             | 29,422,570                  | -                               | 0.0%                  |
| Capital Expenditures      | 1,975,489              | 1,975,489                   | -                               | 0.0%                  |
| Operating Transfers Out   | 34,489,271             | \$34,489,271                | -                               | 0.0%                  |
| <b>Total Expenditures</b> | <b>\$309,508,745</b>   | <b>\$304,763,798</b>        | <b>\$4,744,947</b>              | <b>1.5%</b>           |

The revised salary and benefits budget totals \$179.2 million, an increase of \$5.5 million over the adopted budget. The increase is primarily due to the appropriation of \$5.0 million from the FY 2023-24 structural budget surplus as an additional discretionary payment to CalPERS to further reduce the City’s unfunded pension liability. An analysis of salary and benefit activity for quarter one indicates that \$4.7 million in personnel savings have been realized as of December 31, 2023. These savings are due to vacancies as well as lower than budgeted costs for employee benefits.

**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 high levels of services to the community while targeting surplus resources to key priorities each year. It is currently projected that unrestricted General Fund resources will total \$7.7 million at the end of FY 2023-24. As is the case each year, staff anticipates 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, current year activity, and the projected year-end results.

### FY 2023-24 Projected General Fund Sources, Uses, and Budget Surplus

| Category                                        | A<br>Revised Budget | B<br>Q2 Projection  | C=B-A<br>Variance   | D=C/A<br>% Variance |
|-------------------------------------------------|---------------------|---------------------|---------------------|---------------------|
| <b>Beginning Fund Balance Reserves</b>          | \$ 15,254,999       | \$ 15,254,999       | \$ -                | 0.0%                |
| <b>Operating Resources:</b>                     |                     |                     |                     |                     |
| Operating Revenues                              | 286,992,817         | 287,585,213         | 592,396             | 0.2%                |
| Prior Year Resources Carried Forward            | 5,465,426           | 5,465,426           | -                   | 0.0%                |
| Transfers In from Other Funds                   | 21,251,267          | 21,251,267          | -                   | 0.0%                |
| Repayment of Advances                           | 1,250,000           | 1,250,000           | -                   | 0.0%                |
| <b>Total Operating Resources</b>                | <b>314,959,510</b>  | <b>315,551,906</b>  | <b>592,396</b>      | <b>0.2%</b>         |
| <b>Operating Uses:</b>                          |                     |                     |                     |                     |
| Operating Expenditures                          | 275,019,474         | 270,274,527         | (4,744,947)         | -1.7%               |
| Transfers Out                                   | 34,489,271          | 34,489,271          | -                   | 0.0%                |
| <b>Total Operating Uses</b>                     | <b>309,508,745</b>  | <b>304,763,798</b>  | <b>(4,744,947)</b>  | <b>-1.5%</b>        |
| <b>Net Operating Surplus</b>                    | <b>5,450,764</b>    | <b>10,788,108</b>   | <b>5,337,344</b>    | <b>97.9%</b>        |
| <b>Non-Operating Resources &amp; Uses</b>       |                     |                     |                     |                     |
| Transfers Out                                   | (18,293,751)        | (18,293,751)        | -                   | 0%                  |
| Transfer in ARPA Funds                          |                     | 5,226,643           | 5,226,643           | -                   |
| Transfer out to FFP                             |                     | (5,226,643)         | (5,226,643)         | -                   |
| <b>Total Non-Operating Resources &amp; Uses</b> | <b>(18,293,751)</b> | <b>(18,293,751)</b> | <b>-</b>            | <b>0.0%</b>         |
| Net Change in Fund Balance                      | (12,842,987)        | (7,505,643)         | 5,337,344           | -41.6%              |
| <b>Ending Fund Balance Reserves</b>             | <b>\$ 2,412,012</b> | <b>\$ 7,749,356</b> | <b>\$ 5,337,344</b> | <b>221.3%</b>       |

### American Rescue Plan Act (ARPA) Funds

The American Rescue Plan Act of 2021 (ARPA) was established in March 2021, which included \$350 billion in aid for state and local governments. \$10.1 million was allocated to the City, which must be obligated by December 31, 2024, and must be expended by December 31, 2026. An eligible use of ARPA includes, but is not limited to, providing government services to the extent of revenue loss due to the pandemic. The City had \$18 million in lost revenue related to the pandemic. Therefore, the City may expend the full amount awarded to the City for the provision of government services, which can include but is not limited to maintenance of infrastructure, health services, and public safety services.

The current spending plan includes \$5.2 million that is allocated to the Junior Lifeguards Building Project (19F13) and the related parking lot improvements and \$4.9 million that is allocated to the City Yard Fueling Station Project (20F14). The City Yard Fueling Station Project is not expected to be far enough along to allow ARPA funds to be obligated by December 31, 2024. In addition, a portion of the funds allocated to the Junior Lifeguards Building may not be fully expended. Therefore, the City needs to reallocate approximately \$5.2 million to another eligible use. It is recommended that the \$5.2 million of ARPA be allocated to reimbursing the City for public safety services incurred during the year on fire operations. Staff will execute a budget amendment to transfer a projected total of \$5.2 million to the General Fund when the final amount of unspent funds is known from the Junior Lifeguard Building.

General Fund operating savings that result from the reimbursement of ARPA funds will be transferred to the Facilities Financing Plan Fund (Fund 513) to be used for future capital projects. Approximately \$127,000 of these funds will be needed to fund the remaining contingency for the Junior Lifeguard Building Project. A budget amendment will be prepared to effectuate the proposed changes to the ARPA spending plan.

**Other Funds**

Staff has evaluated the fiscal condition of the City's other major operating funds (Tidelands and Water). 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.

**FISCAL IMPACT:**

As a result of the budget amendment that staff will prepare and process administratively once the final remaining ARPA amount is known, approximately \$5.2 million will be transferred into the General Fund to reimburse the City for public safety services incurred during the year on fire operations. General Fund operating savings that results from the reimbursement of ARPA funds will be transferred to the Facilities Financing Plan Fund (Fund 513) to be used for future capital projects.

**ENVIRONMENTAL REVIEW:**

Staff recommends the City Council find this action is not subject to the California Environmental Quality Act (CEQA) pursuant to Sections 15060(c)(2) (the activity will not result in a direct or reasonably foreseeable indirect physical change in the environment) and 15060(c)(3) (the activity is not a project as defined in Section 15378) of the CEQA Guidelines, California Code of Regulations, Title 14, Chapter 3, because it has no potential for resulting in physical change to the environment, directly or indirectly.

**NOTICING:**

The agenda item has been noticed according to the Brown Act (72 hours in advance of the meeting at which the City Council considers the item).

**ATTACHMENT:**

Attachment A – Budget Amendments for the Second Quarter