



CITY OF NEWPORT BEACH FINANCE COMMITTEE STAFF REPORT

Agenda Item No. 5A
May 13, 2021

TO: HONORABLE CHAIRMAN AND MEMBERS OF THE COMMITTEE

FROM: Finance Department
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SUBJECT: Third Quarter Budget Update

SUMMARY:

The City of Newport Beach Finance Department prepares quarterly financial reports to review the status of revenues and expenditures for the City's funds. This report contains information on resources through the third quarter of Fiscal Year 2020-21, which is the period between January 1, 2021, and March 31, 2021. Year-to-date activity of the General Fund shows that revenues through the end of the third quarter are coming in higher than the revised budget, with expenditures projected to be lower than the revised budget. As the economy gradually improves, these trends are likely to continue; however, a great deal is unknown as the global pandemic and related restrictions are still evolving.

RECOMMENDED ACTION:

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

DISCUSSION:

Economic Overview

California's unemployment rate decreased 0.2 percentage points to 8.3 percent in March as the state's employers gained 119,600 jobs, according to data released by the California Employment Development Department (EDD). Orange County's unemployment rate stood at 6.4% at the end of March 2021 compared to 7.4% in December 2020. The largest month over month employment increase across major industry categories in California was attributable to leisure and hospitality (+42,400 jobs). This sector also had the largest employment gains in Orange County (+9,800 jobs). Hotel owners throughout the country are also reporting more advanced bookings. During most

of the pandemic, bookings have been with just a few days' notice, often by people who needed a quick "staycation." The Baird/STR Hotel Stock Index, which tracks shares of eight hotel brands and 12 hotel real estate investment trusts, jumped 22% in February, compared with less than a 2% increase for the S&P 500.

The automobile and transportation sector continues to recover as consumers treat themselves to new and often more expensive vehicles at a time when other spending opportunities have been curtailed by the COVID-19 pandemic. The average price of a new car increased 6% compared to last year as attractive financing rates sustained demand while production stoppages early in the crisis limited supply. Sales are expected to continue to grow as the economy recovers, with automotive executives hopeful the industry will return closer to normal this year. Recreational vehicle (RV) purchases continue to be a bright spot as many feel they offer a safer way to travel. Receipts for this category were up 27% in the most recent quarter; the RV Industry Association is projecting industry volume may grow by as much as another 20% in 2021, boosted by millennial buyers newly introduced to the land travel lifestyle during lockdowns.

Many economists, along with the Federal Reserve's policymakers, remain hopeful that the economy will continue to improve markedly in the second half of the calendar year as more people get vaccinated. Job growth is expected to pick up in the summer as vaccine distribution continues, better weather allows for more outdoor activities, and the State continues to loosen restrictions. Chapman University's recent Orange County third quarter (January-March 2021) Consumer Sentiment Index indicates a 42% jump in confidence over the prior quarter. The survey suggests this is due to the increasing number of vaccinations, fewer positivity rates, and the continued opening of the economy.

General Fund Revenues

Most revenue categories have performed at or higher than their budgeted levels this year due to more favorable economic conditions than anticipated when the budget was developed in April 2020. This performance trend led to a \$17.7 million budget amendment during the third quarter that aligned the budget with the higher anticipated results. This has significantly narrowed the budget-to-actual variance when compared to prior quarterly reports. Actual revenues are \$7.5 million higher than, and 67% of, the current year-to-date revised budget, which is consistent with prior year's performance. Staff will remain diligent in monitoring revenues to review if further amendments are necessary.

FY 2020-21 Actual General Fund Revenues Through Q3 (March 2021)

Revenues by Category	PY Q3 Actual	Adopted Budget Through Q3	A	B	C=B-A	D=C/A
			Revised Budget Through Q3	YTD Q3 Actual	Variance	% Variance
Property Taxes	\$ 71,054,562	\$ 74,242,007	\$ 74,242,007	\$ 75,055,220	\$ 813,213	1.1%
Sales Tax	24,202,559	17,903,627	20,828,612	21,883,103	1,054,491	5.1%
Transient Occupancy Tax	18,235,366	2,883,582	7,271,103	10,370,476	3,099,373	42.6%
Other Taxes	7,685,657	6,137,471	6,851,572	7,721,544	869,972	12.7%
Service Fees & Charges	17,326,241	13,646,084	12,550,828	13,041,680	490,852	3.9%
Parking Revenue	3,910,384	3,535,307	3,989,626	4,653,571	663,945	16.6%
Licenses & Permits	3,841,819	3,156,945	3,558,505	3,802,819	244,314	6.9%
Property Income	3,616,822	2,950,699	3,198,539	3,465,462	266,923	8.3%
Fines & Penalties	2,697,321	2,785,389	2,576,502	2,737,805	161,303	6.3%
Intergovernmental Revenues	1,524,053	823,296	3,159,548	3,259,495	99,947	3.2%
Investment Earnings	1,807,487	892,649	892,649	317,282	(575,367)	-64.5%
Miscellaneous Revenues	2,072,738	388,398	1,113,539	1,465,727	352,188	31.6%
Total Revenues	\$ 157,975,009	\$ 129,345,454	\$ 140,233,030	\$ 147,774,184	\$ 7,541,154	5.4%

Property Taxes - Property taxes are the single largest funding source and typically represent just under 50% of all General Fund revenues. Property tax revenues for FY 2020-21 were budgeted conservatively anticipating the potential for delayed payments due to economic hardship and the Governor's Executive Order (N-61-20) suspending penalties and interest of property taxes. For FY 2020-21, property taxes are \$813,213 higher than projected through the third quarter. The City's first of three unsecured property tax payments came in less than projected; however, the second payment, received in January 2021, came in higher than projected and overall unsecured property taxes are now back on track at 3.2% higher than the previous year. These are value-based taxes not secured by property (e.g., business property, boats, and airplanes) and make up only about 2.6% of property tax revenue. Supplemental taxes (levied after change in ownership or completion of new construction) continued to be down through the third quarter; however, the latest payment received in January 2021 was flat compared to the prior year. With the recent surge of home sales, this category will likely continue to improve, which bodes well for future secured property taxes. Secured property tax payments continue to come in strong, which is an indication of timely property tax payments.

Sales Tax - The second largest funding source for the General Fund is sales tax revenue, typically making up more than 15% of General Fund revenues. The City's sales tax base is largely generated from three main industry categories including Autos and Transportation, General Consumer Goods, and Restaurants/Hotels. Most of these industries are also heavily impacted by tourism. Sales Tax revenues through the third quarter of FY 2020-21 are \$1.1 million higher than anticipated. Businesses pivoted in creative ways to reach their customers as they were able to open at some capacity sooner than expected resulting in relatively strong consumer spending. For these reasons all

three main industry categories performed better than expected. Although third quarter revenues are higher than expected thus far, sales taxes receipts are still less than the prior year. The latest sales tax information shows that retail and restaurants have been hit especially hard while transportation is showing quarter over quarter increases. Also, the California Department of Tax and Fee Administration (CDTFA) has extended due dates and offered payment plans to small businesses. This has, and will continue to create, timing issues related to when revenues are received. The City's sales tax consultant has provided an updated sales tax estimate and the revised budget for sales tax is now \$34.5 million for FY 2020-21, \$5.8 million or 20.4% higher than originally budgeted, resulting from increased consumer spending, vaccination roll-out, and reduced case counts. There is still room for additional positive improvement in sales tax revenues by the end of the fiscal year; however, staff and the City's consultant remain conservative in projecting sales tax revenues and will wait to evaluate additional receipts before making additional adjustments to the sales tax revenue projection.

Transient Occupancy Tax – Transient occupancy tax (TOT) was the City's most severely impacted revenue source as the pandemic unfolded, as most major hotels within the City were temporarily closed towards the end of March 2020 and many did not start reopening until late May or early June, with some hotels remaining closed in the third quarter. Also, short term rentals were not allowed to operate in the City from early April 2020 until May 20, 2020. Although most hotels are operational, they remain well under full capacity. The Renaissance Newport Beach hotel reopened February 1, 2021. Staff had budgeted FY 2020-21 TOT revenues very conservatively expecting to realize 10%, 20%, and 25% of prior year revenue in the first, second, and third quarters respectively. The positive improvement in this category has led to year-to-date revenue collections reaching 56.7% of the prior year through the third quarter. Staff had anticipated that residential TOT would be similarly impacted economically, and in fact, the negative impact has been limited to hotel TOT, with residential TOT revenues through the first three quarters of FY 2020-21 coming in 7.2% higher than prior years. The table below illustrates a comparison of hotel TOT revenues by month this fiscal year versus the same month in the prior fiscal year. It is notable that revenues continued to improve from July through October and then had a dramatic fall in December 2020 when Governor Newsom enacted a stay at home order that largely prohibited travel. A steady improvement in revenue and occupancy rates has been seen since December, which is anticipated to continue given the current easing of restrictions and the anticipated return of more significant numbers of leisure, and ultimately business travelers in the months ahead.

In spite of the changing restrictions, revenues through the third quarter of FY 2020-21 were approximately \$3.1 million over the revised projected budget. Staff are projecting revenues to reach 60%, a level comparable to what was seen in October, by the end of

the fiscal year. For these reasons, staff currently estimates TOT revenues of \$15.2 million for FY 2020-21, which is \$8.8 million or 136.4% higher than originally budgeted.

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 & 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. This category will likely finish the year under budget due the sustained lowering of interest rates by the Federal Reserve in order to stimulate growth during this period of economic decline and uncertainty.
- 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.

Revenue accounts other than the top three were reduced by 20% across the board in the FY 2020-21 budget. This was based on historical reductions to revenues during prior recessions and with the understanding that some accounts would come in higher than projected and others would come in lower. All other revenue (excluding the top three) through March 31, 2021, is \$2.5 million higher than the revised budget. Parking revenue through the third quarter came in strong at \$664,000 over the revised budget. Property Income through the third quarter is up \$267,000 over budget due to rental property revenue coming in strong. These numbers should continue to perform well due to

deferred revenues to be received in the fourth quarter along with the reopening of leased city properties. Fines and Penalties are \$161,000 over budget as parking fines are coming in higher than projected. Other Taxes are \$870,000 above budget, with business license taxes and property transfer taxes coming in strong, while marine charter taxes are below budget. Strong home sales in the city have led the property transfer taxes to increase by 41% from the prior year, an increase of \$700,000. Licenses and Permits revenues are almost \$244,000 over budget primarily from building permits. Service Fees & Charges were coming in lower than expected in prior periods and were adjusted accordingly in the budget. This decrease is partially due to a decrease in fees from police activity (jail booking and alarm permit) and the libraries being closed, but largely results from recreation programs and contract classes being severely limited. These decreased revenues were also partially offset by Community Development Department, Public Works, and the Fire Junior Lifeguard Services Fees & Charges revenues coming in higher than projected. Also partially offsetting the decrease in recreation revenue is expenditure savings resulting from reduced contract instructor payments. The Investment Earnings category is currently below budget by \$575,000 due to the fair value adjustment required by governmental accounting standards. This adjustment is offset by a release of restricted resources from positive fair value adjustments in prior years.

The following table shows staff's projection for FY 2020-21 revenue through the end of the fiscal year and how it compares to current year budgets and prior year actuals. If revenues come in as projected below, staff estimates an additional \$1.0 million beyond the revised budget amounts and \$1.6 million more than was estimated in the second quarter

FY 2020-21 Projected General Fund Revenues

Revenues by Category	PY Actual	Adopted Budget	A Revised Budget	B Projected Actual	C=B-A Variance	D=C/A % Variance
Property Taxes	\$ 113,313,535	\$ 117,508,227	\$ 117,508,227	\$ 117,508,227	\$ -	0.0%
Sales Tax	36,232,969	28,690,831	34,540,800	34,540,800	\$ -	0.0%
Transient Occupancy Tax	20,847,883	6,434,115	15,209,156	15,209,156	\$ -	0.0%
Other Taxes	11,846,082	9,652,973	11,081,175	11,501,162	\$ 419,987	3.8%
Service Fees & Charges	20,913,897	17,350,903	14,898,375	15,900,048	\$ 1,001,673	6.7%
Parking Revenue	5,503,053	4,599,800	5,503,097	5,619,263	\$ 116,166	2.1%
Licenses & Permits	4,752,252	4,239,333	5,042,454	5,042,454	\$ -	0.0%
Property Income	4,619,106	3,892,635	4,341,939	4,341,939	\$ -	0.0%
Fines & Penalties	3,659,011	3,681,031	3,263,257	3,295,392	\$ 32,135	1.0%
Intergovernmental Revenues	3,910,305	1,646,716	5,105,269	5,105,269	\$ -	0.0%
Investment Earnings	1,295,547	1,112,200	1,112,200	543,912	\$ (568,288)	-51.1%
Miscellaneous Revenues	3,059,377	775,140	1,577,982	1,600,176	\$ 22,194	1.4%
Total Revenues	\$ 229,953,017	\$ 199,583,904	\$ 219,183,931	\$ 220,207,798	\$ 1,023,867	0.5%

It should also be noted that the City has received approximately \$4.0 million of CARES Act funding between fiscal years 2019-20 and 2020-21. Between March 2020 and September 30, 2020, a total of \$3.5 million of CARES Act funding was received, with

another \$529,569 received in October of 2020. Of the total \$4.0 million received to date, \$72,314 was from the U.S. Department of Health & Human Services as part of the Provider Relief Fund to be used for healthcare related expenses or lost revenues; \$2.1 million was from the County of Orange to provide grants to small business impacted by the pandemic; \$769,758 from the County of Orange, and \$1.0 million from the State of California were both used to offset public safety activities during the pandemic. In addition to the CARES Act Funding, the City also filed a \$565,000 claim to the Federal Emergency Management Agency (FEMA), which given recent actions by the Biden Administration will be revised to request reimbursement for additional eligible costs and to increase the amount requested to 100% of the City's costs. However, the disposition of this claim will not be known for some time. The City also received \$290,000 from the County of Orange during the third quarter for economic support initiatives for the community's small businesses. Depending on the source and guidance associated with the different allocations of pandemic-related funding, certain portions will ultimately be transferred to the General Fund and provide additional resources to further offset pandemic-related costs.

General Fund Expenditures

With 75% of the year complete, FY 2020-21 General Fund expenditures total \$152.6 million and are at 67% of the revised budget, which is 2.3% lower than projected. Some departments incur a greater or lower level of expenditures in the first half of the year than in the second half due to the timing and seasonality of their operations or programs, and the trends in the current fiscal year are generally consistent with prior years. Existing appropriations are on target to fund all current operational expenditures and likely generate year-end budget savings, with no further adjustments to the expenditure budget needed as of the end of the third quarter.

Significant expenditure budget updates include the following (all currently expected to be covered with existing revised budget appropriations):

- Many departments have seen an increase in operating costs for janitorial and cleaning expenses related to COVID-19, including street sweeping, beach clean-up and park maintenance, public facilities and restroom janitorial services, day porter services at the Central Library, power washing for public spaces and sidewalks including temporary outdoor dining, and additional weekly cleaning of city vehicles (mainly Public Safety departments). The current budget can fund all expenditures as of the end of Q3.
- The Fire Department continues to provide staffing for Strike Team deployments and have incurred \$775,000 in strike team and mutual aid costs through the end of the third quarter. Reimbursement has been received from Cal OES and has offset this cost with increased revenues.
- Public Safety has seen increased expenditures relating to COVID-19 for disposable medicine/EMS supplies for personal protective equipment, emergency

cleaning services, and related supplies. These costs are expected to be fully absorbed, with CARES Act & FEMA reimbursement expected to offset any overages in department budgets at year-end.

- Departments have seen increased overtime costs relating to the pandemic for emergency clean-up services such as beach and street clean-up relating to more people enjoying the beach for outdoor recreational activities due to the shutdown orders, and staffing COVID-19 testing sites and vaccinations PODs.

FY 2020-21 Projected General Fund Expenditures

Expenditures by Category	Adopted Budget	A Revised Budget	B Projected Actual	C=B-A Variance	D=C/A % Variance
Salary & Benefits	\$ 149,193,631	\$ 154,429,781	\$ 154,105,447	\$ (324,334)	-0.21%
Contract Services	24,088,461	25,372,748	24,978,360	(394,388)	-1.55%
Grant Operating	600,000	1,166,409	1,083,225	(83,184)	-7.13%
Utilities	2,961,757	2,932,409	3,411,455	479,046	16.34%
Supplies & Materials	3,740,696	4,435,375	4,279,810	(155,565)	-3.51%
Maintenance & Repair	8,822,276	8,987,338	8,952,305	(35,033)	-0.39%
Travel & Training	813,368	809,309	541,355	(267,954)	-33.11%
General Expenses	2,125,501	2,295,759	2,031,745	(264,014)	-11.50%
Internal Svc Charge	25,977,295	25,977,295	25,977,295	-	0.00%
Risk Management	750,915	750,915	695,480	(55,435)	-7.38%
Capital Expenditures	785,138	894,412	738,390	(156,022)	-17.44%
Total	\$ 219,859,038	\$ 228,051,750	\$ 226,794,867	\$ (1,256,883)	-0.55%

While the table reflects nearly \$1.3 million of budget savings, which is \$0.8 million more than in the prior quarter. It is anticipated that year-end budget savings will exceed this amount. However, it is important to note that the non-personnel budget was reduced by \$2.7 million prior to adoption and \$2.0 million of salary savings is already assumed. Savings are therefore likely to be less than what is seen in a typical fiscal year.

Proposed Budget Adjustments – Transfers In

Staff will recommend for City Council approval a budget amendment that transfers \$281,611 and \$446,656 (\$728,267.00 total) from the Special Improvement District No. 95-1 and 800mhz Funds, respectively, to the General Fund.

The City of Newport Beach Special Improvement District No. 95-1 (the “District”) was formed by the City on June 12, 1995, for the purpose of financing certain facilities for the benefit of the District. Between 1995 and 2001, the City issued bonds on behalf of the District to finance facilities, which have since been repaid in full. The City has therefore ceased levying the special taxes. Following the final payment on the bonds, the City had \$1.6 million of excess special tax funds remaining on hand. The City has since made a good faith effort to refund these monies to the property owners within the district and has returned all but \$281,611. Because the City has exhausted all efforts to refund the

remaining funds and the statute of limitations has expired, staff proposes to sweep the remaining funds into the General Fund at this time so that the District can be closed out.

The City maintains an 800 MHz coordinated communications system (CCCS) and an associated equipment replacement fund to support the City's share of the countywide cost of this program. The CCCS is Orange County's analog/digital trunked public safety radio communications system that provides radio communication services and interoperability among City and County law enforcement, fire services, public works, and lifeguard/marine safety departments in Orange County. Like the City's other equipment internal service funds, the 800Mhz fund receives annual contributions from departments to fund the regular replacement of equipment. The County recently updated its charging methodology whereby the City is no longer required to save for and acquire its own equipment. In the future, the County will assess the City for its share of the CCCS replacement on an annual basis for its eventual replacement. The City's related internal service fund is therefore no longer necessary. There is currently \$446,656 in the fund that can be returned to the General Fund at this time.

General Fund Reserves

We are fortunate that the City was in excellent financial health prior to the global pandemic. Conservative budgeting and sound financial policies have resulted in a trend of General Fund operating surpluses and strong reserve levels for several years. This is still no less the case even amid the significant economic downturn the City is experiencing. Conservative budgeting practices coupled with better than expected consumer demand have resulted in higher revenues and lower expenditures than budgeted. This has contributed towards the realization of projected unrestricted General Fund resources of \$30.6 million at the end of Fiscal Year 2020-21 as shown in the table to follow, an improvement of \$3.1 million versus the second quarter projection.

General Fund Sources and Uses

	A			B		C=B-A	D=C/A
	2019-20	2020-21	2020-21	2020-21			
	Actual	Adopted	Revised	Projected	Variance	% Variance	
Sources							
Beginning Unrestricted Fund Balance	23,119,513	14,425,558	24,081,225	24,081,225	9,655,667	66.9%	
Operating Revenues	229,953,017	199,583,904	219,183,931	220,207,798	20,623,894	10.3%	
Less: Restricted Revenues	(2,785,622)	(730,967)	(815,145)	(815,145)	(84,178)	11.5%	
Prior Year Resources Carried Forward	1,744,227	-	2,075,632	2,075,632	2,075,632	-	
Release of Restricted Funds	2,492,301	20,000	3,645,023	3,645,023	3,625,023	18125.1%	
Transfers In from Other Funds	12,970,571	17,560,543	17,846,785	18,574,821	1,014,278	5.8%	
Total Sources	\$ 267,494,007	\$ 230,859,038	\$ 266,017,451	\$ 267,769,354	\$ 36,910,316	16.0%	
Uses							
Operating Expenditures	211,066,539	219,859,038	228,051,765	226,794,867	6,935,829	3.2%	
Transfers Out	32,346,243	11,000,000	10,398,018	10,422,340	(577,660)	-5.3%	
Total Uses	243,412,782	230,859,038	238,449,783	237,217,207	6,358,169	2.8%	
Ending Unrestricted Fund Balance	\$ 24,081,225	\$ -	\$ 27,567,668	\$ 30,552,147	\$ 30,552,147	-	
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Contingency Reserve	\$ 52,618,059	\$ 50,313,660	\$ 52,618,059	\$ 52,618,059	\$ 2,304,399	4.6%	

As the data presented in this report reflects 75% of the fiscal year, there remain opportunities for positive or negative variances. The risks associated with variances are further amplified by the pandemic and related restrictions. The degree to which these restrictions are lifted or reinstated for the balance of the fiscal year will have a material impact on revenues and possibly expenditures. While this report reflects the best information currently available to staff, variances will occur. Staff therefore recommends caution when viewing the projected ending unrestricted fund balance (surplus) of \$30.6 million, which is still very much subject to revision as the year progresses.

The Tiered Budget Balancing Framework

The strategy employed to balance the budget for FY 2020-21 includes utilization of a tiered budget balancing framework, which is illustrated below.

	Tier 1 Operating Cuts	Tier 2 Temporary Hiring Freeze	Tier 3 Deferred Capital	Tier 4 ISF Charge Reductions	Tier 5 Contingency Reserve	Tier 6 Service Level Cuts	Total
Professional and Contract Svcs.	\$ 1,621,760	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 1,621,760
Other Non-Personnel Budgets	1,136,807	-	-	-	-	-	1,136,807
Personnel Services	-	2,000,000	-	-	-	-	2,000,000
Transfers Out	-	-	18,477,137	500,000	-	-	18,977,137
Capital Budgets	-	-	2,500,000	-	-	-	2,500,000
Insurance	-	-	-	2,000,000	-	-	2,000,000
Equipment Replacement	-	-	-	2,500,000	-	-	2,500,000
Contingency Reserve Draw	-	-	-	-	2,304,399	-	2,304,399
Total	\$ 2,758,567	\$ 2,000,000	\$ 20,977,137	\$ 5,000,000	\$ 2,304,399	\$ -	\$ 33,040,103
Cuts Restored in First Quarter	-	-	-	(500,000)	(2,304,399)	-	(2,804,399)
Revised Total	\$ 2,758,567	\$ 2,000,000	\$ 20,977,137	\$ 4,500,000	\$ -	\$ -	\$ 30,235,704

Tier 5 – Contingency Reserve

Per City Council Reserve Policy F-2, the Contingency Reserve shall have a target balance of 25 percent of the General Fund operating budget as originally adopted, excluding the amount allocated for additional discretionary pension payments. In order to balance the budget and under the emergency provisions of Policy F-2, this current year budget has a \$2.3 million draw from the Contingency Reserve. Pursuant to policy, staff must present a plan to City Council to replenish the reserve within five years after the economy has stabilized. Based on the positive budget to actual variances realized in FY 2019-20 that resulted in a surplus, the better than expected quarter one results, and the positive revenue results projected for FY 2020-21, Council approved the replenishment of the \$2.3 million Contingency Reserve at the November 24, 2020, Council meeting. The Contingency Reserve is now fully funded pursuant to Council Policy F-2 for the FY 2020-21 fiscal year.

Tier 4 – Internal Service Fund Charges

Funds in the amount of \$4.5 million were transferred in from other funds to partially backfill the anticipated General Fund revenue shortfall for FY 2020-21. These funds derived from prior year internal service funds (ISF) charges that originated from the General Fund.

These charges are intended to reimburse ISF operations related to equipment replacement charges, or centrally managed insurance reserves and most were returned without significantly impacting the replacement schedule or funding for liabilities. At the November 24, 2020, Council meeting, Council approved the replenishment of the \$500,000 taken from the Equipment Replacement Fund, which improves the percent of that Fund's reserve that is set aside to cover the accumulated depreciation. No further changes to the Tier 4 reductions are recommended at this time. However, staff will be making recommendations concurrently with the City Council's review of the proposed FY 2021-22 budget regarding to what extent further restoration of Tier 4 cuts is required.

Tier 3 – Deferred Capital Funding

Staff recommends maintaining the reductions at this time. A review of the CIP program is underway in the context of developing the FY 2021-22 budget. This will be discussed in more detail as the FY 2021-22 budget is being presented to the Council, at which time certain deferred capital projects would be approved for funding.

Tier 2 – Temporary Hiring Freeze

Staff recommends the continuation of selected hiring with approval by City Manager, with the City targeting an estimated \$2 million in personnel savings. Current projections are that this savings will be achieved.

Tier 1 – Operating Reductions

No changes are recommended at this time. Departments have indicated that they can complete the fiscal year without restoration of any of these reductions.

Other Funds

Other funds that are subject to revenue volatility include Tidelands, Gas Tax, Measure M, SB1 RMRA (Road Maintenance and Rehabilitation Account), and the Water and Wastewater funds. An analysis of the budget performance for these funds through the third quarter of this fiscal year indicates that no budget adjustments are currently necessary. Staff will continue to monitor these and all funds on a monthly basis.

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 May 25, 2021, City Council meeting, at which time this report will next be presented.

Prepared and Submitted by:

/s/ Steve Montano

Steve Montano
Deputy Finance Director