CITY OF NEWPORT BEACH
FINANCE COMMITTEE
STAFF REPORT

Agenda Item No. 5A
October 14, 2021

TO: HONORABLE CHAIRMAN AND MEMBERS OF THE COMMITTEE

FROM: Finance Department
Scott Catlett, Finance Director/City Treasurer
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SUBJECT: **Fiscal Year 2020-21 Fourth Quarter Financial Report**

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 preliminary information on revenues, expenditures, and estimated fund balance for the fourth quarter of the fiscal year ending June 30, 2021. 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.

Year-to-date activity of the General Fund shows that revenues through the end of the fourth quarter came in higher, and expenditures lower, than the revised budget. This is a reflection of both the City's conservative budgeting and projection methodologies, consistent with City Council Policy F-3, and a more rapid improvement in the economy than had been anticipated.

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 remained at 7.6% in July as the state's employers added 114,400 non-farm payroll jobs, according to data released August 20th by the California Employment Development Department (EDD). Orange County's unemployment rate stood at 6.3% at the end of July 2021 compared to 6.4% in March 2021. Nonfarm payrolls in California have increased over the past year in all eleven industry sectors with leisure and hospitality growing the most at 25.1 percent. Newport Beach's hotel occupancy rate stands at 60.7% as of August 21st and is 37.9% higher than at the same time last year. When California finally reopened its economy in mid-June and dropped several COVID-related restrictions, hotel occupancy shot up. In Anaheim, the home of Disneyland, hotel occupancy was at 70% in June, compared to 45% the previous year, according to the global hospitality data and analytics company STR. However, the spread of the more highly contagious Delta-variant and a surge of new COVID-19 cases and hospitalizations, mainly among the unvaccinated, has some hoteliers concerned about the possible impact on tourism and a return of business travelers.

Automobile sales as a major industry group has experienced a classical V-shaped recovery in the aftermath of the COVID-19 recession. New car sales dropped 68% or more at many dealers around the State in the initial weeks after the State's pandemic shutdown order in March 2020. Sales have since steadily rebounded and are now in 2021 13% higher than the same period in 2019, a year before the crisis began. Limited supply has been overwhelmed by strong demand. Consumers are treating themselves to more expensive models, with new cars reported to be 8% more costly this year. The California New Car Dealers Association reports that Porsche, Mercedes, and Tesla have been the most sought-after brands in 2021. S&P Global and other research firms are forecasting continued growth in the 15% range for the remainder of the year before sales begin to flatten out in 2022.

The Conference Board expects consumer spending to continue to improve in the second half of 2021, especially on in-person services, but the overall growth contribution derived from consumer spending will moderate as much of the recovery in this facet of the economy has already been achieved. However, the rapid surge in new COVID-19 cases presents a downside risk to consumer spending. While it is unlikely that a new round of severe government-mandated mobility restrictions will be implemented to contain the new Delta-variant, the resurgence in cases does have the potential to affect consumer confidence and in-person spending.

General Fund Revenues

Most revenue categories 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 projected at that time. This narrowed the budget-to-actual variance when compared to prior quarterly reports; however, actual revenues were still $16.9 million or 7.7% higher than the current year-to-date revised budget. When compared to the third quarter projected actual revenues of $220.2 million, actual revenues were $15.4 million or 7.0% higher than anticipated. As discussed in more detail below, the primary positive variances were in sales tax and service fees & charges.

FY 2020-21 Actual General Fund Revenues Through Q4 *

Revenues by Category	PY Actual	Adopted Budget	A Revised Budget	B Actuals	C=B-A Variance	D=C/A % Variance
Property Taxes	$ 113,313,535	$ 117,508,227	$ 117,508,227	$ 119,157,540	$ 1,649,313	1.4%
Sales Tax	36,232,969	28,690,831	34,540,800	38,956,275	4,415,475	12.8%
Transient Occupancy Tax	20,847,883	6,434,115	15,209,156	16,886,197	1,677,041	11.0%
Other Taxes	11,846,082	9,652,973	11,081,175	12,849,340	1,768,165	16.0%
Service Fees & Charges	20,913,897	17,350,903	14,407,566	18,264,952	3,857,386	26.8%
Parking Revenue	5,529,753	4,621,160	5,529,797	7,074,853	1,545,056	27.9%
Licenses & Permits	4,752,252	4,239,333	5,042,454	5,133,399	90,945	1.8%
Property Income	4,866,828	4,088,259	4,583,939	5,115,255	531,316	11.6%
Fines & Penalties	3,659,011	3,681,031	3,263,257	4,012,568	749,311	23.0%
Intergovernmental Revenues	3,910,305	1,646,716	5,109,769	5,175,738	65,970	1.3%
Investment Earnings	1,295,547	1,112,200	1,112,200	1,598,624	486,424	43.7%
Miscellaneous Revenues	2,784,955	558,156	1,259,282	1,359,034	99,752	7.9%
Total Revenues	**$ 229,953,017**	**$ 199,583,904**	**$ 218,647,622**	**$ 235,583,776**	**$ 16,936,154**	**7.7%**

**** Based on preliminary year-end close data available as of August 30, 2021***

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 suspending penalties and interest of property taxes. For FY 2020-21, property taxes came in $1,649,313 or 1.4% higher than budgeted. Despite new record price levels, statewide growth in home sales slowed and pending sales dropped in the second quarter of 2021 for the first time since May 2020. Higher priced markets like Newport Beach continued to do well while sales of lower priced properties remained below last year's levels. The median home sales price of detached single-family residences in Newport Beach was $3.1 million on June 30, 2021, up 15.9% from the prior quarter and 25% higher than the prior year. Secured property tax payments came in strong, $1.2 million over budget, which is an indication of timely property tax payments and higher valuations. With the recent surge of home prices, this category will likely continue to improve, which bodes well for future secured property tax revenues.

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. The latest sales tax information shows that retail and restaurants have been hit especially hard this past year while autos and 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 provided an updated sales tax estimate at the end of the third quarter, which resulted in an upwardly revised sales tax budget of $34.5 million. This came as the result of increased consumer spending amid an environment of declining COVID-19 cases. Actual Sales Tax revenues came in $4,415,475 or 12.8% higher than anticipated and surpassed the previous highest annual sales tax revenues in FY 2018-19 of $38.5 million and the prior year receipts of $36.2 million. 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, with particularly strong growth seen in the fourth quarter.

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 didn't 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. All but one hotel are now operational, and the latest tax receipts (July) indicate several hotels are reporting their highest monthly tax receipts ever. 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. Staff had anticipated that residential TOT would be similarly impacted economically, but in fact, the negative impact has been limited to hotel TOT, with residential TOT revenues coming in at just under $1 million higher than budgeted. The table below illustrates a comparison of hotel TOT revenues by fiscal year and quarter. It is remarkable to note the precipitous revenue increase during in the last quarter accounted for 38.6% of revenue for FY 2020-21. The fourth quarter receipts are much higher than the previous year and somewhat narrowed the revenue loss gap when compared to prior years. The positive improvement in this category has led to year-end revenue collections for this category reaching 81% of the prior year actuals.

Transient Occupancy Tax Receipts by Quarter FY18-FY21

	Fiscal Year 2020 - 21		Fiscal Year 2019 - 20		Fiscal Year 2018 - 19		Fiscal Year 2017 - 18	
	Actual Received	% of Actuals	Actual Received	% of Actuals	Actual Received	% of Actuals	Actual Received	% of Actuals
1st Quarter	2,267,092	13.43%	4,959,179	23.79%	4,820,281	19.52%	4,340,572	19.01%
2nd Quarter	5,523,645	32.71%	7,730,446	37.08%	6,313,511	25.56%	5,962,939	26.11%
3rd Quarter	2,579,739	15.28%	5,545,740	26.60%	5,759,862	23.32%	5,217,752	22.85%
4th Quarter	6,515,721	38.59%	2,612,517	12.53%	7,803,792	31.60%	7,312,352	32.02%
TOTAL	**$16,886,197**	**100%**	**$20,847,883**	**100%**	**$24,697,446**	**100%**	**$22,833,614**	**100%**

A steady improvement in revenue and occupancy rates combined with daily room rates that have been consistently higher than in recent years have 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 end of the fiscal year were approximately $1.7 million or 11.0% over the revised budget.

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.
- 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) came in $9.2 million higher than the revised budget. This was primarily the result of the following key variances.

Parking revenue through the fiscal year end came in strong at $1.5 million or 27.9% above the revised budget, reflecting a continued increase in day travelers visiting the City and beaches. Other Taxes came in $1.8 million or 16.0% over 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 75% from the prior year, an increase of $1.7 million. Lastly, Service Fees & Charges came in $3.9 million or 26.8% over budget, primarily due to plan check fees coming in higher than anticipated due to steady activity in the construction field, including large projects such as the Marriot renovation and other developments. Additionally, the City received $1.6 million higher than budgeted revenues for the paramedic service fee due to a higher number of transports and a reduction in collection times for these fees.

It is important to note that the significant variance between adopted and revised budget for intergovernmental revenues is partially attributable to COVID-19-related financial assistance provided to the City from the Federal, State, and County governments. As of June 2021, the City has received a total of $4.4 million of CARES Act funding, and is expecting to receive another $860,000, bringing the total funding from CARES to approximately $5.2 million. In addition to the CARES Act Funding, the City is planning to file a claim to the Federal Emergency Management Agency (FEMA), 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.

During the fourth quarter, the City received $5.1 million from the U.S. Department of Treasury as part of the American Rescue Plan Act (ARPA) and will receive another $5.1 million in the fourth quarter of fiscal year 2021-22. Staff have documented General Fund revenue losses that exceed the total $10.1 million amount of ARPA funds allocated to the City, which have been set aside in a Special Revenue Fund pending action by the Council to allocate these funds. These funds are discussed later in this report in conjunction with recommendations for the disposition of the unrestricted General Fund reserves on hand in excess of the City's 25% contingency reserve requirement.

General Fund Expenditures

FY 2020-21 General Fund expenditures total $220.7 million and came in 3.1% below the revised budget, a savings of $7.0 million. Existing appropriations were enough to cover all necessary expenditures during the fiscal year, with savings realized for salary and benefits due to vacancies, professional and contract services, and maintenance and repairs.

FY 2020-21 Actual General Fund Expenditures *

Expenditures by Category	Adopted Budget	A Revised Budget	B Actuals	C=B-A Variance	D=C/A % Variance
Salary & Benefits	$ 149,193,631	$ 153,841,452	$ 152,365,914	$ (1,475,538)	-1.0%
Contract Services	24,088,461	25,635,070	21,894,363	(3,740,706)	-14.6%
Grant operating	600,000	1,166,409	1,046,476	(119,933)	-10.3%
Utilities	2,961,757	2,932,409	3,579,524	647,115	22.1%
Supplies & Materials	3,740,696	4,363,610	3,868,801	(494,809)	-11.3%
Maintenance & Repair	8,822,276	8,987,338	8,531,515	(455,823)	-5.1%
Travel & Training	813,368	807,792	445,276	(362,516)	-44.9%
General Expenses	2,125,501	2,299,060	2,079,421	(219,640)	-9.6%
Internal Svc Charge	25,977,295	25,977,295	25,977,295	(0)	0.0%
Risk management	750,915	750,915	383,068	(367,847)	-49.0%
Capital Expenditures	785,138	940,144	533,597	(406,548)	-43.2%
Total	**$ 219,859,038**	**$ 227,701,494**	**$ 220,705,249**	**$ (6,996,245)**	**-3.1%**

**** Based on preliminary year-end close data available as of August 30, 2021***

Significant expenditures for FY 2020-21 included:

- The current year budget covered increases 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 Fire Department provided staffing for Strike Team deployments and has incurred $1.2 million in strike team and mutual aid costs through the end of the third quarter. Reimbursement will be received from Cal OES, and these reimbursements over time offset these costs with corresponding revenue.
- Public Safety saw increased expenditures relating to COVID-19 for disposable medicine/EMS supplies for personal protective equipment, emergency cleaning services, and related supplies. These costs were fully absorbed in the current year budget, with CARES Act & FEMA reimbursement expected to offset the additional expenditures.
- 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 testing sites and vaccinations PODs that were able to be absorbed due to other salary savings relating to vacancies.

Significant savings for FY 2020-21 included:

- Savings were achieved in salary and benefits. The City budgeted for $2.0 million in salary savings and achieved an additional $1.5 million in savings at year end due to vacancies and attrition.
- Contract Services realized savings for various professional service contracts, including Recreation contract instructors due to some programs not being able to run due to restrictions relating to the pandemic. A corresponding revenue decrease was realized in Service Fees & Charges for these contract class expenditure savings. Other contract savings were related to a delay in the City's parking meter upgrade, which will occur in FY 2021-22.
- The Utilities spending category came in over budget due to increases in electricity rates due to Southern California Edison raising rates during the year for wildfire insurance premiums. The FY 2021-22 budget has been adjusted accordingly to adequately fund future electricity expenditures, including for street lights. Other increases in Utilities costs include water rate increases from the Irvine Ranch Water District, which will be addressed in the fiscal year 2021-22 quarter one staff report.

The Tiered Budget Balancing Framework

The strategy employed to balance the budget for FY 2020-21 included a 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)
Cuts To be Restored							
Transfer to FFP	-	-	(8,500,000)	-	-	-	(8,500,000)
Transfer to Harbor Capital	-	-	(4,500,000)	-	-	-	(4,500,000)
Neighborhood Enhancement	-	-	(2,366,000)	-	-	-	(2,366,000)
Restoration Not Required	(2,758,567)	(2,000,000)	(5,611,137)	(4,500,000)	-	-	(14,869,704)
Remaining Cuts in Place	**$ -**	**$ -**	**$ -**	**$ -**	**$ -**	**$ -**	**$ -**

At the onset of budget adoption, $33.0 million of reductions were approved. $2.8 million of reductions were restored in the first quarter which includes the tier 4 and tier 5 reductions, with $4.8 million of tier 1 and tier 2 spending reductions achieved during the year. At the end of the third quarter, $15.4 million of reductions were restored, including the $8.5 million contribution to the Facilities Financing Plan (FFP), $4.5 million contribution to Harbor CIP, and $2.4 million of Neighborhood Enhancement projects. $10.1 million of the cuts implemented through the tiered budget balancing framework did not need to be restored during the fiscal year, including $5.6 million of CIP projects not ready to move forward, $2.0 million of fund balance returned from insurance funds, $2.0 million of fund balance returned from the information technology fund, and $500,000 relating to the facilities maintenance plan. With these restorations, all appropriate budget reductions were addressed and restored by the end of the fourth quarter.

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. At the end of FY 2019-20, the City had $24.1 million of prior year surplus funds on hand, with approximately half of these funds attributable to FY 2018-19 operational savings and half attributable to FY 2019-20 operational savings. Consistent with City Council Policy F-5, General Fund Surplus Utilization, these funds would have normally been allocated to paying down long-term obligations and funding infrastructure or neighborhood capital improvements. However, given the strong evidence in early 2020 that the pandemic would have significant financial impacts on the City, the FY 2018-19 surplus funds on hand were redeployed to assist in balancing the FY 2020-21 budget along with the reductions outlined in the Tiered Budget Balancing Framework. The FY 2019-20 surplus funds were realized several months after adoption of the FY 2020-21 budget once the books were closed for FY 2019-20, and these funds were also set aside as a resource to respond to any additional negative budget impacts from the pandemic.

Conservative budgeting practices coupled with better than expected consumer demand have resulted in higher revenues and lower expenditures than budgeted in FY 2020-21. Projected unrestricted General Fund resources of $30.6 million were forecasted in the third quarter. The $16.9 million of tiered budget reductions restored during the budget process, combined with appropriations made at that time by the Council toward permanent supportive housing ($1.0 million), continued funding for the General Plan Update project ($0.7 million), and the required contribution to the contingency reserve to maintain a 25% reserve level in line with the increased FY 2021-22 budget ($2.7 million), were projected to decrease the $30.6 million balance to $11.0 million.

Actual revenues exceeded budget by $16.9 million and exceeded the final projection shared with the Council during the FY 2021-22 budget adoption process by $15.4 million. Actual expenditures were below budget by $7.0 million and were below the final projection by $6.1 million. As a result of the additional revenue received and expenditure budget savings, as well as other adjustments outlined in the table below, unrestricted General Fund resources are projected to be $31.0 million, an increase of $7.0 million versus the start of the fiscal year.

General Fund Sources and Uses *

Category	FY 20 Actual	FY 21 Q3 Projection	FY 21 Final Projection	FY 21 Actual	FY 21 Variance	FY 21 % Variance
BEGINNING UNRESTRICTED FUND BALANCE	**$ 23,119,513**	**$ 24,081,225**	**$ 24,081,225**	**$ 24,081,225**	**$ -**	
SOURCES:						
Operating Revenues	229,953,017	220,207,798	220,207,798	235,583,776	15,375,978	7.0%
Less: Restricted Revenues	(2,785,622)	(815,145)	(815,145)	(958,152)	(143,007)	17.5%
Prior Year Resources Carried Forward	1,744,227	2,075,632	2,075,632	2,075,632	-	----
Release of Restricted Funds	2,492,301	3,645,023	3,645,023	2,392,197	(1,252,826)	(34.4%)
Transfers In from Other Funds	12,970,571	18,574,821	18,574,821	21,804,961	3,230,140	17.4%
TOTAL SOURCES	**244,374,494**	**243,688,129**	**243,688,129**	**260,898,414**	**17,210,285**	**7.1%**
USES:						
Operating Expenditures	211,066,539	226,794,867	226,794,867	220,705,249	(6,089,618)	(2.7%)
Transfers Out	32,346,243	10,422,340	27,298,413	27,467,575	169,162	0.6%
Resources Carried Forward to FY 2021-22	-	-	-	3,072,666	3,072,666	----
Addition to 25% Contingency Reserve	-	-	2,697,265	2,697,265	-	----
TOTAL USES	**243,412,782**	**237,217,207**	**256,790,545**	**253,942,755**	**(2,847,790)**	**(1.1%)**
ENDING UNRESTRICTED FUND BALANCE	**$ 24,081,225**	**$ 30,552,147**	**$ 10,978,809**	**$ 31,036,884**	**$ 20,058,075**	**182.7%**
CHANGE IN FUND BALANCE	**$ 961,712**	**$ 6,470,922**	**$ (13,102,416)**	**$ 6,955,659**		

**** Based on preliminary year-end close data available as of August 30, 2021***

It is important to emphasize that the net change in unrestricted fund balance for the year was only $7.0 million, with the remainder of the $31.0 million budget surplus being composed of the carried forward budget surpluses from FY 2018-19 and FY 2019-20. While originally those funds had been set aside to address the fiscal impact of the pandemic, they ultimately were not needed to balance the FY 2020-21 budget due to the faster than anticipated recovery of the economy. It should also be noted that the FY 2021-22 budget is balanced as adopted, with revenues only $31,975 higher than expenditures. The $31.0 million of surplus funds on hand are therefore entirely one-time in nature and do not reflect an ongoing excess of revenues over expenditures.

Recommended Uses for Unrestricted General Fund Resources
Historically, year-end surplus funds have been held over until the end of the following fiscal year for allocation. These allocations are made consistent with 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 with the Council during the adoption of the FY 2021-22 budget, staff is recommending that action be taken sooner on a go-forward basis as part of this year-end budget discussion. This approach facilitates the allocation of resources on a timelier basis to liabilities as well as enhances the ability to plan for capital projects during the upcoming budget process.

As discussed, $31.0 million of unrestricted General Fund resources are available for use at the Council's discretion at this time. Consistent with City Council Policy F-5, staff recommend that these funds be allocated 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 & Beaches CIP. These funds would be set aside now, with specific allocations recommended as part of the upcoming FY 2022-23 budget process. Staff are in the process of reviewing the City’s facilities and infrastructure replacement needs to ensure that the project list is comprehensive and the funding adequate. It is likely that there will be a need for additional funding once this analysis is complete, and this $10.5 million will be part of the solution to this issue. Staff are also evaluating whether it is appropriate to index the currently flat annual contributions to facilities replacement and maintenance to inflation, which will ensure that adequate funds are set aside on an ongoing basis as costs or particularly needs in any given year increase.

3. **CIP and Neighborhood Enhancements** – $15.5 million toward the FY 2022-23 capital improvement program, to include neighborhood enhancement projects. These funds would be set aside now, with specific allocations recommended as part of the upcoming FY 2022-23 budget process.

As discussed earlier in this report, the City has $10.1 million of ARPA funds on hand as well that have been allocated to the revenue loss expenditure category under the program’s guidelines. This facilitates using these funds for any eligible infrastructure project or projects. It is staff’s recommendation that the full $10.1 million of ARPA funds also be allocated to the FY 2022-23 capital improvement program, with specific allocations recommended as part of the upcoming FY 2022-23 budget process.

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 fourth quarter of this fiscal year indicates that no budget adjustments are necessary and variances between budgeted and actual amounts are within reason.

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 October 26, 2021, City Council meeting, at which time this report will be presented.

Prepared and Submitted by:

/s/ Steve Montano

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Steve Montano
Deputy Finance Director