



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

Agenda Item No. 5C  
November 4, 2021

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

**FROM:** Finance Department  
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**SUBJECT: Fiscal Year 2021-22 First Quarter Financial Report**

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**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 first quarter of the fiscal year ending June 30, 2022.

The first financial report of FY 2021-22 provides an analysis of the financial activity of the City from the months of July through September 2021. 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 that will accompany this report on the City Council's agenda. 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**

California's unemployment rate remained steady at 7.5% in September, as the state's employers added 47,400 non-farm payroll jobs, according to data released on October 22, 2021, by the California Employment Development Department (EDD). Orange County's unemployment rate was 5.0% at the end of September 2021 compared to 6.3% in July 2021. Nonfarm payrolls in California have increased over the past year in all eleven industry sectors with leisure and hospitality growing the most at 21.7%. Unemployment trends are expected to improve gradually as the economy recovers from the widespread impacts of COVID-19.

Newport Beach's hotel occupancy rate stood at 62.2% as of the last week of September and was 19.6% higher than at the same time last year, while room rates were 15.5% higher than the same time last year. When California finally reopened its economy in June and lifted various COVID-related restrictions, hotel occupancy increased significantly. The City is continuing to see a resulting increase in transient occupancy tax (TOT) revenues, which are quickly trending toward revenue levels seen prior to the COVID-19 pandemic.

Federal and State stimulus has inflated consumer ability and willingness to spend on taxable goods. The Consumer Price Index was up 5.4% year-over-year in September of 2021, unchanged on a year-over-year basis from June. Retail sales are exhibiting the fastest growth since 2015, with the outlook for local tax revenues remaining positive despite supply chain, pricing, and labor concerns.

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. New car and boat sales have since steadily rebounded and are now 22% higher than the same period in 2019, a year before the crisis began. The inventory and supply of new vehicles has been overwhelmed by strong demand due to low financing rates and government stimulus payments. It is expected that the inventory shortfall will influence second quarter growth, following a strong sales spike in the month of July. Higher prices will, however, moderate the impact. This sector is expected to increase at 3% annual growth through fiscal year 2026-27.

The economy is expected to continue to grow through the remainder of the fiscal year. However, it is likely that the hardest hit industries will continue to see the highest recovery as a return to normal consumer behavior spurs recovery in sales associated with restaurants, hotels, and general consumer goods purchased in brick-and-mortar establishments.

**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. Compared to the first quarter of last fiscal year, the City is continuing to see positive increases in the categories of sales tax, transient occupancy tax, and service fees and charges. However, it is important to remember that the first quarter of last fiscal year was in the midst of the initial stages of the pandemic.

**Property Taxes** - Property taxes are the City's single largest General Fund revenue and typically represent just under 50% of all General Fund revenues. With the recent surge of home prices, this category is expected to continue to perform strongly, which bodes well for future secured property tax revenues. The stay-at-home orders, business closures and other economic impacts affected 2021-22 growth by reducing the annual CPI adjustment from the maximum 2% to 1.036%. The City therefore experienced a net taxable value increase of 4.1% for the FY 2021/22 tax roll and the assessed value increase between FY 2020-21 and FY 2021-22 was \$2.6 billion. The largest growth in assessed values related to prior year transfer of ownership, which accounted for \$1.7 billion, or 64.1% of all growth experienced in the City. The second largest change was attributed to the 1.036% Proposition 13 adjustment, which was \$579 million and accounted for 22% of the overall growth. As FY 2021-22 assessed values are established in January of 2021 and based on the prior calendar year, a strengthening of home sales in the summer of 2020 resulted in a positive impact to the tax roll that mitigated to some extent the smaller CPI adjustment.

For FY 2020-21, secured property tax payments came in strong, \$1.2 million over budget, which is an indication of timely property tax payments and higher valuations. Based on the higher prior year total assessed valuation, staff recommend increasing the property tax revenue estimate for FY 2021-22 in the first quarter budget amendment by \$1.6 million.

A greater percent change in sales transactions was realized in the first eight months of the calendar year through August of 2021 at 2.67% growth, vs. an average of 2.60% for the entire year in the two previous years. Increased prices regionally were driven by lower inventory and declining interest rates for home loans. The median sale price of a residential home from January to August was \$3,020,000, which represents a \$432,500 or 16.71% increase in median sale price from calendar year 2020. The assessed value of sold homes also increased by 52%, which was the second highest increase seen in the last five years. Due to these positive changes, the City is on track to see closer to 5% property tax growth in FY 2022-23.

**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. Because these revenues are remitted to the City by

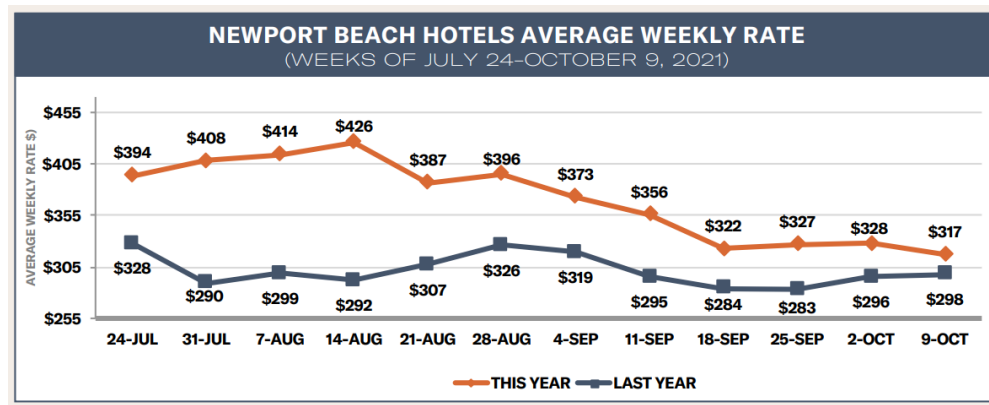
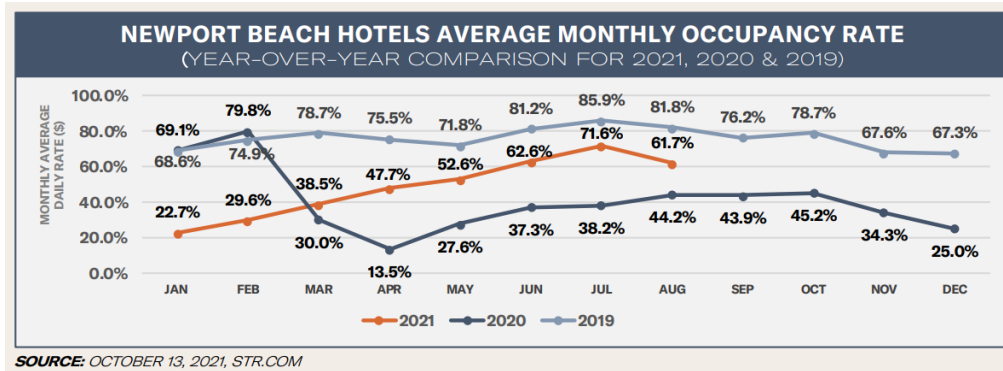
the State several months after they are paid by consumers, staff have limited FY 2021-22 information on which to report in the first quarter. Receipts from April through June of 2021 were 39.4% above the second quarter of FY 2019-20, similar to the statewide average. Limited inventory and higher demands led Autos and Transportation to continue to show quarter over quarter increases, mainly due to a surge of retail sales along with increased prices in March and April of this year. This category is expected to plateau in the upcoming quarters, with anticipated inventory limitations offset by higher prices. The largest categories showing growth through the end of June included the hardest hit areas during the pandemic, specifically restaurants, hotels, and general consumer goods. Fuel and service stations also saw increased growth due to rising consumption and fuel prices. Building and construction revenues increase by 20.9%, with contractor activity expected to increase in the second quarter.

Compared to the same quarter in 2019 prior to the pandemic, an overall 9.5% increase in the City's sales tax revenues has been seen. Autos and Transportation are up 22% from the second quarter of 2019, due to the aforementioned strong car sales as well as increased yacht sales due to additional interest in recreational boating. Allocations from the State and County Pool have increased 44% during that time, which in part is attributable to the Wayfair/AB147 legislation change that allowed for taxation of additional internet sales. This growth in pool revenues is also indicative of the shift that occurred to online shopping habits during the pandemic, which at least in part is expected to remain once the economy has fully returned to normal. The three industry sectors hardest hit during the pandemic have only experienced 7% growth, including business-industrial, fuel and service stations, and restaurant/hotel receipts.

The outlook for local tax revenues remains positive despite supply chain, pricing, and labor concerns, and the City expects to see continued growth for the remainder of the fiscal year. As it is early in the year, staff are not recommending a revision to the sales tax revenue estimate at this time.

**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. The City has seen a steady rebound and comeback for TOT revenues in the months since. Short term rental revenues have steadily increased and did not decline significantly even at the depths of the pandemic. As leisure travelers have returned, several hotel properties in the City have reported record TOT tax receipts in the summer months. Higher occupancy rates, combined with higher average room rates, have resulted in TOT revenues that have exceeded the revenue estimate included in the adopted budget year-to-date. Data

provided by Visit Newport Beach illustrates this very positive trend in both occupancy and room rates:



While the Fashion Island Hotel remains closed and the Marriot remains under renovation, both properties are expected to reopen fully in the months ahead with new branding that should command higher room rates. These reopenings, combined with the expected return of more business travelers, are anticipated to have additional positive impact on the City's TOT revenues. Staff remain cautious, however, to predict the exact timing of these trends and the reopening date for the Fashion Island Hotel has yet to be announced.

When crafting the TOT revenue estimate for FY 2021-22, staff assumed that short term rental-related TOT revenues would continue to grow from their FY 2020-21 levels and that hotel TOT would start the year at 60% of pre-pandemic revenue levels and end the year at 80% of pre-pandemic revenue levels. As can be seen in the charts above provided by Visit Newport Beach, occupancy levels were at 83% of pre-pandemic levels in August and 75% for September. During those same two months, average room rates were higher than in recent years. While the Fashion Island Hotel remains closed, these are very encouraging signs that indicate a trend that will likely result in TOT revenues exceeding the current revenue estimate. The table below illustrates a comparison of hotel

TOT revenues by fiscal year and quarter showing the strong growth in the first quarter of FY 2021-22 and how it compares to the prior three years.

**Transient Occupancy Tax Receipts by Quarter for FY 2018-19 – FY 2021-22**

	Fiscal Year 2021 - 22		Fiscal Year 2020 – 21		Fiscal Year 2019 - 20		Fiscal Year 2018 - 19	
	Actual Received	% of Actuals	Actual Received	% of Actuals	Actual Received	% of Actuals	Actual Received	% of Actuals
1st Quarter	5,331,038	100.00%	2,267,092	13.43%	4,959,179	23.79%	4,820,281	19.52%
2nd Quarter	-	0.00%	5,523,645	32.71%	7,730,446	37.08%	6,313,511	25.56%
3rd Quarter	-	0.00%	2,579,739	15.28%	5,545,740	26.60%	5,759,862	23.32%
4th Quarter	-	0.00%	6,515,721	38.59%	2,612,517	12.53%	7,803,792	31.60%
<b>TOTAL</b>	<b>\$5,331,038</b>	<b>100%</b>	<b>\$16,886,197</b>	<b>100%</b>	<b>\$20,847,883</b>	<b>100%</b>	<b>\$24,697,446</b>	<b>100%</b>

While staff believes that these positive trends are likely to continue as the fiscal year progresses, conservatism is warranted given the pandemic-related impacts to tourism and business travel that have been seen over the past two years. Staff are therefore not recommending a revision to the TOT revenue estimate at this time.

**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 \$1.1 million. This is primarily due to increased revenue received from recreation fee-based classes and the Junior Lifeguard program. As a result of the strong interest that has been seen in returning to in-person activities, the original revenue estimates included in the adopted budget for fee-based recreation classes must be adjusted upward. A related revenue estimate increase in facility rental revenues of \$183,000 is also proposed.

Intergovernmental revenues are projected to exceed the adopted budget by \$714,000. The City participates in the California Fire Service and Rescue Emergency Mutual Aid System, which reimburses agencies for their emergency assistance to the State of California and to Federal Fire Agencies. In the first quarter of Fiscal Year 2021-22 the City received \$280,875 from the State of California for staff assigned to strike team deployments. Staff seek to align the FY 2021-22 budget with actual revenues received through the first quarter, which includes increasing revenue estimates & expenditure appropriations by \$280,875 and is reflected as an increase in intergovernmental revenues. The City is also expected to receive \$433,244 from the State of California Department of Housing and Community Development for the SB 2 Permanent Local Housing Allocation (PLHA) program grant, which will be used to offset the City's General Fund contribution to the Mind OC Mobile Crisis Response Team. Revenue is expected to be received in the current fiscal year, has been reflected in the revised projection for intergovernmental revenues, and will be appropriated when received.

Overall, the positive adjustment to property tax revenues, revenue from fee-based classes, intergovernmental revenues, and several other categories of revenue will have a positive impact on the expected year-end results for FY 2021-22, as illustrated in the following table, with total General Fund revenues now projected to exceed the adopted budget by \$3.7 million.

### FY 2021-22 Projected General Fund Revenues

Revenues by Category	PY Actual	Adopted Budget	A Revised Budget	B Projected Actual	C = B-A Variance	D = C/A %
Property Taxes	\$ 119,157,540	\$ 122,229,980	\$ 122,229,980	\$ 123,833,217	\$ 1,603,237	1.3%
Sales Tax	38,956,275	40,275,670	40,275,670	40,275,670	-	0.0%
Transient Occupancy Tax	16,886,197	19,027,493	19,027,493	19,027,493	-	0.0%
Other Taxes	12,849,340	10,815,117	10,815,117	10,815,117	-	0.0%
Service Fees & Charges	18,264,952	19,046,329	18,897,329	20,010,449	1,113,120	5.9%
Parking Revenue	7,074,853	5,681,942	5,681,942	5,681,942	-	0.0%
Licenses and Permits	5,133,399	5,106,646	5,106,646	5,106,646	-	0.0%
Property Income	5,115,255	5,044,403	5,044,403	5,227,203	182,800	3.6%
Fines & Penalties	4,012,568	3,292,102	3,292,102	3,292,102	-	0.0%
Intergovernmental	5,175,738	1,760,934	1,797,764	2,511,883	714,119	39.7%
Investment Earnings	1,598,624	1,112,200	1,112,200	1,112,200	-	0.0%
Misc Revenues	1,359,034	734,148	978,648	978,648	-	0.0%
<b>Total Revenues</b>	<b>\$ 235,583,776</b>	<b>\$ 234,126,964</b>	<b>\$ 234,259,294</b>	<b>\$ 237,872,570</b>	<b>\$ 3,613,276</b>	<b>1.5%</b>

### General Fund Expenditures

The FY 2021-22 General Fund revised expenditure budget totals \$234.8 million. Year to date expenditures of \$46.9 million equate to approximately 20% of the budget. 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.

Significant expenditure budget updates include the following:

- **Recreation and Senior Services:** During the previous fiscal year, the 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, staff is seeking to restore expenditure appropriations back to pre-COVID levels due to the reinstatement of cancelled classes. The department anticipates an additional \$1.3 million of class revenues with a corresponding \$637,000 needed of expenditure appropriations for contract instructors.



- Last fiscal year, as part of the response to the anticipated reduction in revenues due to the coronavirus pandemic, the City employed a tiered budget reduction strategy to balance the budget. Included in the first tier of cuts to the operating budget was a reduction to utility budgets. The water budget for the Public Works Department related to City Parks was previously reduced by \$237,000 as part of this budget balancing strategy. This reduction was not restored with the adoption of the FY 2021-22 budget. Staff projects current budget levels will be insufficient for the current fiscal year and recommends the restoration of the \$237,000 previously cut from this budget line item to cover expenditures in the current fiscal year.
- As discussed earlier in this report, an expenditure appropriation of \$280,875 is required to align with additional revenues from the California Fire Service and Rescue Emergency Mutual Aid System.

Other than these limited appropriations that are fully offset by the proposed revenue estimate adjustments, no expenditure budget adjustments have been identified that require attention at this time.

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

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

The following table illustrates the year-end projection at this time, which includes the recommended budget adjustments and appropriations from prior year surplus. As it is early in the year, staff is not yet projecting any budget savings, though as is the case each year, additional savings are anticipated to materialize as the fiscal year progresses.

### FY 2021-22 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	\$ 151,713,101	\$ 156,823,806	\$ 157,104,681	\$ 280,875	0.2%
Contract Services	24,702,901	26,446,235	26,983,294	537,059	2.0%
Grant Operating	600,000	608,358	608,358	-	0.0%
Utilities	3,011,315	3,011,315	3,248,516	237,201	7.9%
Supplies & Materials	3,739,730	4,370,114	4,405,664	35,550	0.8%
Maintenance & Repair	12,640,923	13,500,392	13,540,092	39,700	0.3%
Travel & Training	814,868	813,128	833,079	19,951	2.5%
General Expenses	2,130,552	2,304,295	2,306,795	2,500	0.1%
Internal Svc Charge	25,078,890	25,093,732	25,093,732	-	0.0%
Risk Management	750,915	750,915	750,915	-	0.0%
Capital Expenditures	780,438	1,068,472	1,071,143	2,672	0.3%
<b>Total Expenditures</b>	<b>\$ 225,963,632</b>	<b>\$ 234,790,764</b>	<b>\$ 235,946,271</b>	<b>\$ 1,155,508</b>	<b>0.5%</b>

### 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. As the economy emerges from the pandemic, 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 \$1.1 million at the end of Fiscal Year 2021-22, an improvement of \$1.1 million versus the adopted budget surplus of \$32,000. 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.

### General Fund Sources and Uses

Category	FY 2020-21 Actual	A FY 2021-22 Adopted	FY 2021-22 Revised	B FY 2021-22 Projected	C=B-A Variance	D=C/A % Variance
<b>BEGINNING UNRESTRICTED FUND BALANCE</b>	<b>\$ 24,081,225</b>	<b>\$ 31,036,884</b>	<b>\$ 31,036,884</b>	<b>\$ 31,036,884</b>	<b>\$ -</b>	<b>0.0%</b>
<b>SOURCES:</b>						
Operating Revenues	235,583,776	234,126,964	234,259,294	237,872,570	3,745,606	1.6%
Less: Restricted Revenues	(958,152)	(1,128,513)	(1,128,513)	(1,128,513)	-	0.0%
Prior Year Resources Carried Forward	2,075,632	-	3,072,666	3,072,666	3,072,666	0.0%
Release of Restricted Funds	2,392,197	1,220,000	1,220,000	1,220,000	-	0.0%
Transfers In from Other Funds	21,804,961	11,977,157	11,977,157	11,977,157	-	0.0%
<b>TOTAL SOURCES</b>	<b>260,898,414</b>	<b>246,195,608</b>	<b>249,400,604</b>	<b>253,013,880</b>	<b>6,818,272</b>	<b>2.8%</b>
<b>USES:</b>						
Operating Expenditures	220,705,249	225,963,632	234,790,764	235,946,271	9,982,639	4.4%
Transfers Out	27,467,575	20,200,000	47,030,300	47,030,300	26,830,300	132.8%
Resources Carried Forward to FY 2021-22	3,072,666	-	-	-	-	0.0%
Addition to 25% Contingency Reserve	2,697,265	-	-	-	-	0.0%
<b>TOTAL USES</b>	<b>253,942,755</b>	<b>246,163,632</b>	<b>281,821,064</b>	<b>282,976,571</b>	<b>36,812,939</b>	<b>15.0%</b>
<b>ENDING UNRESTRICTED FUND BALANCE</b>	<b>\$ 31,036,884</b>	<b>\$ 31,068,860</b>	<b>\$ (1,383,576)</b>	<b>\$ 1,074,193</b>	<b>\$ (29,994,667)</b>	<b>-96.5%</b>
<b>CHANGE IN FUND BALANCE</b>	<b>\$ 6,955,659</b>	<b>\$ 31,976</b>	<b>\$ (32,420,460)</b>	<b>\$ (29,962,691)</b>	<b>\$ (29,994,667)</b>	

As the data presented in this report reflects only 25% of the fiscal year, there remain opportunities for positive or negative variances. The risks associated with variances are further amplified by the lingering effects of the pandemic. 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 \$38 million, which is still very much subject to revision as the year progresses.

#### 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 first 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 November 9, 2021, City Council meeting, at which time this report will be presented.

Prepared and Submitted by:

/s/ Scott Catlett

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Scott Catlett  
Finance Director / Treasurer