



City of Arts & Innovation

# City Council Memorandum

**TO: HONORABLE MAYOR AND CITY COUNCIL      DATE: JANUARY 24, 2023**

**FROM: FINANCE DEPARTMENT      WARDS: ALL**

**SUBJECT: FISCAL YEAR 2021/22 FOURTH QUARTER REPORT AND CARRYOVER OF UNEXPENDED FUNDS**

## **ISSUE:**

Receive and provide input on the Fiscal Year 2021/22 Fourth Quarter Financial Report; approve citywide carryovers; and provide direction on the use of surplus General Fund reserves.

## **RECOMMENDATIONS:**

That the City Council:

1. Receive and provide input on the Fiscal Year 2021/22 Fourth Quarter Financial Report;
2. With at least five affirmative votes, approve a carryover of unexpended funds of approximately \$3.3 million in the General Fund and \$39.3 million in other City funds into Fiscal Year 2022/23; and
3. Approve staff's recommendation on the use of the projected \$34.7 million in surplus reserves in the General Fund.

## **BACKGROUND:**

On June 22, 2021, the City Council adopted Resolution No. 23720, approving the Fiscal Year (FY) 2021/22 Annual Budget.

On January 18, 2022, the City Council received and provided input on the FY 2021/22 First Quarter Financial Update and approved mid-cycle budget adjustments. Budget adjustments related to rescinding the adopted vacancy savings balance measure in the General Fund were not recorded because they were approved contingent upon the certification of the General Fund Transfer election results (Measure C). The City received a final ruling on the Measure C certification late in the fiscal year, which did not leave sufficient time to roll back the vacancy savings target. All positions are funded in the adopted FY 2022-2024 Biennial Budget.

On March 15, 2022, the City Council received the FY 2021/22 Second Quarter Financial Update and approved supplemental appropriations and interfund transfers.

The City Council received the FY 2021/22 Third Quarter Financial Update on June 14, 2022.

## **DISCUSSION:**

Following the close of each fiscal year, the City's independent auditor performs an audit of the City's financial statements. The FY 2021/22 Fourth Quarter Financial Report precedes the audit report and therefore presents **unaudited financial projections; however, we do not anticipate any material changes to the financial data.** The audit report is expected to be completed in late December, followed by presentations to the Financial Performance and Budget Committee and City Council.

Refer to Attachment 1 for a comprehensive Financial Report of the City's General Fund and Measure Z.

### **General Fund**

The adopted FY 2021/22 budget for the General Fund was balanced with a \$10 million balancing measure in the form of a vacancy savings target to offset a projected structural deficit. The Fire Department's \$2 million vacancy savings target was accommodated via a transfer of fourteen (14) Fire personnel to the Measure Z Fund for the adopted budget year only.

The General Fund's unaudited actuals present a net gain of \$31.45 million net of encumbrances and recommended carryovers. This result is primarily due to continued exceptional sales tax revenue performance and significant personnel savings resulting from retention and recruitment challenges. Refer to Attachment 1 for an in-depth analysis of these items.

General Fund revenues were 2.6% (\$10.77 million) higher than the total revenue estimate in the adjusted budget, excluding unbudgeted Fire Mutual Aid revenues. Sales tax projections were increased by 19% (nearly \$13 million) in the First Quarter Financial Report based on FY 2020/21 actual performance. Staff maintained that projection throughout the fiscal year, pending sales tax results of the fourth calendar quarter – the holiday season – which is a strong indicator of the stability of sales tax revenue trends. The results of the fourth calendar quarter were received late in the fiscal year, which precluded a formal revenue adjustment. Final sales tax results ended \$9.62 million above the First Quarter adjusted projection. Unlike prior year increases in sales tax revenue, which were driven by consumption, the current trend and increase in sales tax revenue is predominantly the result of inflationary factors. Sales tax revenue in the General Fund has increased by 33% since FY 2018/19.

The net result of personnel savings exceeding the \$7.89 million vacancy savings target by \$10.62 million is attributable to significantly higher vacancy rates experienced by most departments in FY 2021/22 as compared to that for FY 2020/21. The City faced retention, recruitment, and hiring issues during FY 2021/22, consistent with other public agencies per a 2022 Workforce Survey conducted by MissionSquare Research Institute in collaboration with the International Public Management Association for Human Resources (IPMA-HR) and the National Association of State Personnel Executives (NASPE). Refer to Attachment 1 for a comparison of vacancy rates per department in the last two fiscal years and HR strategies to fill position vacancies.

Encumbrances and project/grant appropriations totaling \$6.5 million are carried forward to FY 2022/23 as allowed per the Riverside Municipal Code. An additional \$3.3 million in the carryover of restricted and discretionary funds is recommended for Council approval (refer to Attachment 1,

Appendix A).

The General Fund is expected to end the fiscal year with \$34.7 million in surplus reserves. The General Fund Reserve policy adopted by City Council on September 6, 2016, states: "If at any time the Surplus Reserves exceed 10% of the General Fund expenditure budget during a fiscal year (for a total of a 25% General Fund Reserve balance), staff must present a plan to the City Council with options for appropriate uses for the excess funds to bring the General Fund Reserve balance to the 25% level or below."

In recent months, the City entered MOU negotiations with each of the City's bargaining units with a strategic fiscal plan to utilize anticipated surplus reserves to help fund salary increases and stipends for City employees over the next three fiscal years, in addition to the adopted budget surpluses of approximately \$5 million in FY 22/23 and \$7 million in FY 23/24, increases in annual sales tax projections, and other factors. The MOU impacts in the General Fund are expected to exceed \$48 million over three years. Staff recommends allocating \$15 million of surplus reserves toward future MOU impacts.

While the short-term outlook for the General Fund has improved with continuing strong performance in sales tax revenue and modest growth in other revenue sources, there are still significant financial issues that present challenges to the long-term fiscal health of the General Fund:

- The financial markets continue to impede the financial performance of the CalPERS retirement fund, which ended in negative territory with a revised 7.5% loss on investments for fiscal year ending June 30, 2022. Positive investment gains in the previous fiscal year will allow the City to face the immediate fiscal impact to the required UAL payments; however, future investment returns, if negative, will significantly increase the City's unfunded liability and annual payment requirements putting added pressure on personnel costs.
- The City needs to formally establish a long-term program for infrastructure investment in much needed deferred maintenance and capital investments. Current needs are typically addressed with one-time revenues and savings which is an unsustainable practice. While over \$1.6 billion in capital asset investments were made during the Riverside Renaissance period in the mid-2000's, planning for the ongoing maintenance of those investments was not included in subsequent budgets.
- While the City has received a temporary reprieve in the Measure C litigation, the City needs to strategically position itself against future challenges to the General Fund Transfer to mitigate the risk to City services that would result from the loss of this heavily relied upon revenue source.

Staff recommends the following use of surplus reserves which will help fund employee salary increases and two major fiscal challenges described above:

**RECOMMENDED USE OF SURPLUS RESERVES**

(in millions)

<b>Projected Surplus Reserves</b>	<b>\$ 34.70</b>
<b>Proposed Use of Surplus Reserves</b>	
MOU Impacts	\$(15.00)
Capital Replacement Fund	(10.00)
Section 115 Trust	(9.70)
<b>Total</b>	<b>\$(34.70)</b>
<b>Remaining Surplus Reserves</b>	<b>\$ 0.00</b>

A Capital Replacement Fund was established to accumulate resources for the maintenance and/or replacement of capital assets with an infusion of \$10.62 million of FY 2020/21 surplus reserves. The City needs to establish a long-term revolving program for infrastructure investment in much needed deferred maintenance and capital investments. Current needs are typically addressed with one-time revenues and savings, which is an unsustainable practice. Staff recommends setting aside additional reserves of \$10 million from FY 2021/22 surplus reserves. A policy for the ongoing use and replenishment of capital replacement reserves will be created and presented for City Council consideration at a future date.

The Section 115 Trust was established to support the long-term fiscal management of the CalPERS UAL. The establishment of the Trust will allow the City to smooth the combined UAL and POB payment requirements to avoid spikes in the payment schedules and significant pressure to General Fund finances in future years. The current value of Trust assets is \$19.4 million. Staff recommends contributing \$9.7 million from FY 2021/22 surplus reserves to the Section 115 Trust.

Measure Z

To help address the service cuts as well as a portion of the City’s critical unfunded needs, at staff’s recommendation, the Mayor and the City Council placed a measure on the November 8, 2016 ballot for a one-percent increase in the City’s sales tax rate. The November 8, 2016, Measure Z ballot presented to voters asked them to consider a yes or no vote to:

“...prevent cutting police, firefighters, paramedics, 911 emergency response, antigang/drug programs, homelessness reduction and youth after-school/senior/disabled services; to repair local streets/potholes/infrastructure; and to provide other general services, shall a one-cent transaction and use tax (sales tax) be implemented providing \$48,000,000 annually through 2036 unless extended by the voters, requiring independent audits with no funds to Sacramento, all funds remaining for Riverside?”

The residents of Riverside approved Measure Z with almost 60% approval. The Measure Z tax became effective April 1, 2017, increasing the City’s sales tax rate from 7.75% to 8.75%. Measure Z will sunset in 2037 unless it is approved again in a mandatory election in November 2036.

Total revenues for the Measure Z Fund came in \$8.81 million higher than the revised budget and 15.5% higher than the previous fiscal year. Sales tax revenue in the Measure Z fund has increased

by nearly 34% since FY 2018/19. Expenditures recorded in FY 2021/22 total \$67.86 million. Encumbrances of \$18.65M and capital carryovers of \$13.93M have been carried forward to FY 2022/23 as provided for in the Riverside Municipal Code. Staff is requesting Council approval of an additional \$16.47M in discretionary (non-capital) carryovers. Refer to Attachment 1, Appendix B for inception-to-date revenue and expenditure reporting for Measure Z.

Actual Measure Z revenues of \$83.91M and expenditures of \$67.86M produced a net increase of fund reserves of \$16.05M. Projected unallocated fund reserves (unaudited) are anticipated to total \$42.09M net of encumbrances and recommended carryovers totaling \$49.05M. The FY 2022-2024 Biennial Budget includes a Five-Year Spending Plan with a programmed draw on reserves through FY 2026/27 totaling \$33M. Staff recommends that unallocated reserves remain intact pending a mid-cycle budget update which will incorporate the fiscal impact of MOU negotiations for Measure Z's 181 funded positions.

### Electric Fund

The FY 2021/22 adopted budget for the Electric Fund included a programmed \$7.4 million operating deficit and draw on fund reserves. This is a financial strategy employed to draw reserves down to keep rate increases as low as possible. Unaudited fiscal year-end results present a budgetary operating gain of \$5.7 million, inclusive of outstanding encumbrances and carryovers of \$13.8 million.

Revenues came in \$6.91 million less than projected, primarily due to fiscal year-end accounting adjustments, including a \$10.5 million write-down of investments to market value. Retail sales came in as projected. Operating expenditures net of encumbrances and recommended carryovers are \$32.40 million (7.8%) less than total budget, primarily resulting from personnel savings of \$29.69 million due to a high vacancy rate during the fiscal year. Power supply costs that came in \$14.33 million (6.6%) higher-than-budget due to higher-than-expected energy costs. The net effect of significant expenditure savings offsetting revenue losses is an operating gain of \$5.69 million. The Electric Fund's reserve level at fiscal year-end is expected to be within established policy levels; results are pending the completion of the financial audit.

Carryovers totaling \$9.2 million are recommended for Council approval (refer to Attachment 1, Appendix A).

### Water Fund

The FY 2021/22 adopted budget for the Water Fund included a projected \$7.2 million operating gain with approximately \$3.4 million to be used to fund \$21.5 million in capital projects in FY 2021/22 supplemented by bond proceeds. Revenues are \$4.2 million (4.9%) above projections largely due to one-time unbudgeted items. Expenditures are \$8.0 million (7.6%) below budget primarily as a result of personnel savings generated by a high vacancy rate throughout the fiscal year. Unaudited fiscal year-end results present a budgetary operating gain of \$13.9 million, inclusive of outstanding encumbrances and carryovers of \$4.52 million. The Water Fund's reserve level at fiscal year-end is expected to be within established policy levels; results are pending the completion of the financial audit.

Carryovers of approximately \$966,000 are recommended for Council approval (refer to Attachment 1, Appendix A).

### Refuse Fund

The FY 2021/22 adopted budget for the Refuse fund included a projected \$1 million net operating loss due to rising costs outpacing revenues. In addition to the budgeted deficit, the carryover of FY 2020/21 unexpended operating funds totaling \$3.02 million in the form of encumbrances and carryovers presented a potential operating loss of \$3.99 million. The Refuse Fund began FY 2021/22 with fund reserves of \$6.52 million. Unaudited fiscal year-end results present a budgetary operating loss of \$3.15 million, inclusive of outstanding encumbrances and carryovers of \$4.41 million. Capital expenditures totaling \$0.04 million were recorded during the fiscal year, inclusive of \$0.02 million of encumbrances that have been carried forward to FY 2022/23 as provided for in the Riverside Municipal Code. The Refuse Fund is expected to end FY 2021/22 with \$3.33 million in fund reserves; results are pending the completion of the financial audit. In the absence of a rate increase or other corrective action, fund reserves are projected to be almost fully depleted by the end of FY 2023/24 based on the adopted FY 2022-2024 biennial budget and the estimated \$1.2 million fiscal impact of MOU negotiations over the contract period of July 1, 2022, through June 30, 2025.

In April 2022, the Public Works Department initiated the emergency services provision of its contract with Burrtec to temporarily provide additional residential solid waste collection services due to extended vacancies in the Solid Waste Division. A combination of the onboarding process for new staff, delayed equipment arrivals, and staffing availability challenges have proven to be impediments to restoring service to pre-pandemic levels. On June 28 and October 18, 2022, staff presented a comprehensive update to the City Council regarding hiring, vacancies, and the state of equipment for the Public Works Solid Waste Division.

Carryovers of approximately \$114,000 are recommended for Council approval (refer to Attachment 1, Appendix A).

### Sewer Fund

The FY 2021/22 adopted budget for the Sewer Fund Included a projected \$4.6 million net operating gain to be used alongside fund reserves to fund \$22 million of planned capital projects. Actual revenues are within 2% of projections; expenditures savings of 15% are projected at fiscal year-end and are primarily attributable to personnel savings of \$5.44 million due to vacancies and attrition. At June 30, 2022, the Sewer Fund had 21.00 FTE vacancies, representing a vacancy rate of 18%. Unaudited fiscal year-end results present a budgetary operating gain of \$4.73 million, inclusive of outstanding encumbrances and carryovers of \$10.21 million. The Sewer Fund is expected to end the fiscal year with \$55.54 million in fund reserves; results are pending the completion of the financial audit.

Carryovers of approximately \$16,000 are recommended for Council approval (refer to Attachment 1, Appendix A).

### Public Parking Fund

The Public Parking Fund has been monitored throughout FY 2021/22 as a fund with ongoing financial concerns. Public Parking Fund reserves at the beginning of FY 2021/22 are \$1.57 million, or \$0.26 million net of prior year encumbrances. The adopted FY 2021/22 budget projected a draw on fund reserves of \$0.92 million due to the lingering impacts of the pandemic on parking revenues, maintenance costs of aging infrastructure, and parking fees not keeping pace with operating costs. Actual revenues are \$650,000 (10.5%) higher than projected. A \$1.3 million American Rescue Plan Act (ARPA) allocation for revenue replacement funding helped to offset operating revenues which came in \$650,000 lower than projected. Expenditure savings of \$1.9

million (22.0%) are attributable to a personnel savings resulting from a high vacancy rate and deferred costs to help offset lagging revenues. Unaudited fiscal year end results present a budgetary operating gain of \$0.25 million after outstanding encumbrances of \$0.19 million. Ending fund reserves are projected at \$1.81 million, inclusive of \$1.3 million in ARPA revenue replacement funds.

### Entertainment Fund

The Fox Theater received a Shuttered Venue Operator Grant totaling \$3.48 million. The grant amount will be used to offset the venue's operating losses driven by the effects of the pandemic, and the excess FY 2021/22 General Fund subsidy will remain intact in the fund to address the critical unfunded capital maintenance needs of the Fox Theater.

### Carryovers

A total of \$42,625,857 is recommended for Council approval, comprised of \$4,902,211 in restricted funding and \$37,723,645 in discretionary funding.

Restricted Carryovers represent appropriations of funding designated for a specific use per a third-party agreement, including donations, endowments, and grant matches.

Discretionary Carryovers include amounts appropriated for a specific purpose in previous periods but unexpended due to timing or for other reasons. Discretionary carryovers may also include a reallocation of amounts from their original purpose to a new purpose, which was not funded in the adopted budget due to budget constraints.

Refer to Attachment 1, Appendix A for a detailed listing of carryover requests.

### **STRATEGIC PLAN ALIGNMENT:**

The reporting and presentation of financial results align with **Strategic Priority 5 – High Performing Government** and **Goal 5.3** – Enhance communication and collaboration with community members to improve transparency, build public trust and encourage shared decision-making.

Financial reporting aligns with each of the five Cross-Cutting Threads as follows:

1. **Community Trust** – Presentation of financial results provides a transparent view and communication of City finances in a forum that accommodates community engagement and the involvement of the Budget Engagement Commission.
2. **Equity** – The financial report is available to all members of the public via the City website, and the presentation of the financial report in a public forum accommodates community engagement from all members of the public.
3. **Fiscal Responsibility** – The financial report and proposed recommendations, including the use of surplus reserves, demonstrate the City's commitment to responsible management of the City's financial resources.
4. **Innovation** – The proposed recommendations, including the use of surplus reserves demonstrate innovative monitoring and management of City finances.

5. **Sustainability & Resiliency** – The financial reports, methodologies, and strategies implemented by staff, including recommendations regarding the use of surplus reserves that invest in the City’s future, demonstrate the City’s commitment to the long-term fiscal health of the City and sustainable provision of City services.

**FISCAL IMPACT:**

The General Fund ended FY 2021/22 in far better condition than the adopted FY 2021/22 budget projected, thereby allowing the City to maintain a 20% reserve level per the General Fund Reserve Policy and producing surplus reserves that will help to fund the fiscal impact of recent and ongoing MOU negotiations, as well as continue critical fiscal strategies that will contribute to the long-term financial health of the General Fund. As a result of the current year’s financial performance, General Fund surplus reserves are expected to be \$34.7 million after Council approval of carryover recommendations totaling \$3.33 million. With Council approval, the surplus reserves will be fully allocated as previously described to MOU fiscal impacts and other fiscal strategies that will enhance the City’s long-term financial health.

Following Council approval of \$16.47 million in carryovers, the Measure Z Fund is expected to end FY 2021/22 with \$41.94 million in unallocated reserves, the majority of which was allocated to critical unfunded needs during the development of the FY 2022-2024 Biennial Budget.

The City’s major enterprise funds (Electric, Water, and Sewer) are expected to end the fiscal year with positive reserve balances within established policy requirements. While the Public Parking Fund experienced a slight operating gain, it will continue to be monitored as a fund with ongoing financial concerns until a new parking rates and hour schedule is adopted. The Refuse Fund experienced an operating loss as revenues were not able to keep pace with costs and operations continue to rely on contracted collection services due to extended vacancies. The final results are pending the conclusion of the City’s financial audit.

There is no new fiscal impact for the approval of carryovers because the funding was approved by the City Council in June 2021 with the adoption of the FY 2021/22 budget.

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- Attachments:
1. Financial Report and Carryover Recommendations
  2. Presentation