



City of Arts & Innovation

Financial Performance and Budget Committee

**TO: FINANCIAL PERFORMANCE AND
BUDGET COMMITTEE MEMBERS**

DATE: JANUARY 8, 2021

FROM: FINANCE DEPARTMENT

WARDS: ALL

**SUBJECT: FISCAL YEAR 2021/22 BASELINE BUDGETS FOR THE GENERAL FUND AND
MEASURE Z - DIRECT SUBMITTAL**

ISSUE:

Receive and provide input on the Fiscal Year (FY) 2021/22 General Fund and Measure Z Baseline Budgets, budget development strategies, and potential balancing measures.

RECOMMENDATION:

That the Financial Performance and Budget Committee receive and provide input on the FY 2021/22 General Fund and Measure Z Baseline Budgets, budget development strategies, and potential balancing measures.

COMMISSION RECOMMENDATION:

On December 17, 2020, the Budget Engagement Commission (BEC) met with 14 members present and received a report on the FY 2021/22 General Fund and Measure Z Baseline Budgets, budget development strategies, and potential balancing measures. While no action was taken on the report and no formal recommendations were made, the commissioners discussed excluding the Measure Z balancing measure discussed in this report to show the General Fund deficit prior to the balancing measure.

BACKGROUND:

As a result of the COVID-19 Pandemic, the City adopted a one-year emergency budget on June 16, 2020 for FY 2020/21. The emergency budget addressed the potential impacts of the COVID-19 pandemic, incorporating a 10% reduction in General Fund and Measure Z revenue projections, increasing Measure Z contributions to the General Fund, and adopting a variety of balancing measures to balance the General Fund budget.

On October 27, 2020, the City Council received an interim update on General Fund finances which included a preliminary report on FY 2019/20 results. Across California, the impact of the pandemic on municipal agency sales tax revenues in FY 2019/20 was far less than expected. Although an

external audit of the City's financials is ongoing as of the compilation of this report, the City anticipates expenditure savings of approximately \$17 million as a result of total General Fund revenues coming in nearly on target with pre-COVID-19 estimates and expenditure savings resulting from managed hiring, a suspension of recruitment, and spending restrictions in response to the pandemic.

DISCUSSION:

The City intends to adopt a one-year budget for FY 2021/22 before returning to a two-year budget cycle for FY 2022-2024. Adopting a one-year budget will allow the City to focus on immediate fiscal challenges and balancing measures while we work to transition to a priority based budgeting (PBB) process for FY 2022-2024. The PBB budgeting methodology is expected to result in targeted and high-impact actions that will better align the City's limited resources with the City's strategic priorities.

FY 2021/22 Budget Goals

Two primary goals have been established for the FY 2021/22 budget development cycle:

1. Address the General Fund structural deficit and the potential impacts of the pandemic on City finances.
2. Prepare a contingency plan in the event that the General Fund Transfer from the Electric Fund is invalidated by a trial court, in an amount to be determined.

General Fund Structural Deficit and Pandemic Impacts

Over the past decade, the City has experienced stagnating revenues and rising costs which have presented a structural deficit in the General Fund budget. Inherited budget strategies that masked the structural deficit included:

- Adopting a managed savings goal without reducing line-item budgets.
- Budgeting one-time miscellaneous revenues that were not specifically identified as to a source, nor guaranteed to be received.
- Budgeting significant revenues for sales of City property that often did not occur as anticipated due to long escrow periods or for other reasons.
- Did not include accurate overtime expenses in budgets.

Additionally, the finances of the General Fund were not readily transparent due to the inclusion of capital projects, grants, special districts, convention center, and entertainment venues in the General Fund. Over the past three years, staff has moved the items that do not represent the core operations of the General Fund into more appropriate funds, such as the Grants and Restricted Programs Fund, Special Districts Fund, Convention Center Fund, and Entertainment Fund. What remains is a clearer picture of General Fund operations as well as General Fund subsidies to other funds that reduce resources available for General Fund operations.

In addition to the structural deficit, the potential impacts of the pandemic must be addressed. The FY 2020/21 emergency budget incorporated a 10% contingency reduction in total General Fund revenues. However, the two largest revenues – sales tax and property tax – suffered no ill effects as compared to original revenue projections in FY 2019/20 as a result of the pandemic, despite the Stay at Home Order and restrictions on business operations. In FY 2020/21, sales tax

revenues to date are 5.4% above the revenue collections at the same point in time in the previous fiscal year. The economic impact of property tax revenues lag two years; the City's property tax advisor, HdL, projects a 5.7% increase in FY 2020/21 property tax revenues over FY 2019/20 actuals and a 4% increase in FY 2021/22 over the FY 2020/21 projection. Despite this good news, other City revenues including Transient Occupancy Tax, Parks and Recreation revenue, and Planning revenues have been significantly impacted by the pandemic and are expected to experience a prolonged recovery.

Baseline Budget Projections

The following summarizes the methodologies, assumptions, and balancing strategies applied to the development of the General Fund baseline budget (Attachment 1). Line-item assumptions applied to create the General Fund baseline budget are listed in Attachment 1.

Revenue projections in the General Fund baseline budget (Attachment 1) were developed based on a review of FY 2019/20 actual (unaudited) results, FY 2020/21 fiscal year-to-date performance, trend analysis, consultant advice, consideration of potential pandemic impacts, and other resources. In total, the FY 2021/22 baseline revenue budget is projected 4.2% higher than FY 2019/20 actuals.

Expenditures in the baseline budget were based on current employee demographics and active MOU requirements; a 2% CPI increase in personnel costs for potential impacts of future labor negotiations; current debt obligations; updated self-insurance rates for worker's compensation and general liability; and other known items. Three discretionary line items under the purview of departmental budgets (Non-personnel, Special Programs, and Minor Capital) are flat against the FY 2019/2020 adopted budget. Fund subsidies for the Convention Center and Entertainment funds are based on "normal", pre-pandemic conditions.

Two balancing measures were incorporated into the FY 2021/22 baseline budget to address the structural deficit of approximately \$14.5 million and potential pandemic impacts, producing a balanced budget resulting with a potential \$2.8 million surplus prior to contingency planning for the potential loss of the GFT revenue source:

1. \$12 million savings through the suspension of recruitment of vacant positions; and
2. \$6 million additional Measure Z contribution to the General Fund, resulting in a total contribution of \$24.3 million.

BEC commissioners discussed excluding the Measure Z balancing measure to show the General Fund deficit prior to the balancing measure. The before and after impact of the two balancing measures is as follows:

Baseline Report Surplus/Deficit, as presented	\$2,888,000
Remove Measure Z Balancing Measure	\$(6,000,000)
Baseline Report Surplus/Deficit, revised	\$(3,112,000)
Remove Vacancy Savings Balancing Measure:	
Vacancy Savings	\$(12,000,000)
2% CPI on reinstated vacancy savings	(240,000)
Impact on Cost Allocation Plan	2,400,000
Baseline Report Surplus/Deficit, revised	\$(12,952,000)

Fund Reserves

On October 27, 2020, the City Council received an interim financial report which stated that savings of approximately \$17 million may be achieved in FY 2019/20 (unaudited estimate). The use of these savings has not been incorporated into the baseline budget. Following the conclusion of the financial audit, staff will return to the BEC and City Council for recommendations on the use of any surplus reserves.

The FY 2020/21 adopted emergency budget was balanced through a variety of measures and a use of surplus reserves is not anticipated. Revised revenue projections present a potential \$15.6 million increase in fund balance at fiscal year-end; however, staff does not recommend incorporating use of this potential surplus into the FY 2021/22 baseline budget due to the uncertainty of the pandemic on FY 2020/21 revenues.

General Fund Transfer (GFT) from the Electric Fund

Riverside Municipal Code Article XII, Section 1204 provides for the payment of 11.5% of gross operating revenues generated by each City utility to the General Fund. The City recently received a trial court ruling in the first phase of a trial that a portion of the transfer from the Electric Fund is invalid. The trial court has not yet determined damages, which is the subject of the second phase of the trial. The court has tentatively indicated that possibly \$19 million to \$32 million of the transfer is invalid but has not yet issued a ruling on this issue. The trial court has also not yet determined a remedy. The trial court judgment, once issued, would still be subject to appeal. The City is currently assessing the financial impact of the trial court's ruling, which will not be certain until the judgment is final.

The Electric General Fund Transfer at risk for loss represents between 6.7% and 11.4% of total FY 2019/20 revenues. The magnitude of a potential revenue loss requires consideration and financial planning separate of the structural deficit and pandemic impacts. Currently, staff has achieved a balanced budget through generally minor balancing measures; a more impactful approach will be required to address a loss of any portion of the Electric transfer. Once the judgment becomes final, staff will return to the BEC with a summary of the financial impact and seek input on a plan to address the financial impact.

Measure Z Baseline Budget

The Measure Z Spending Plan (Attachment 3) has been updated to report projected (unaudited) FY 2019/20 results. FY 2019/20 revenues performed better than expected and some expenditure savings were realized, resulting in projected ending fund balance of \$22.2 million which was \$8.2 million higher than original projections. Staff proposes to use \$6 million of the surplus fund balance to offset potential pandemic impacts on General Fund revenues.

Applying a more conservative approach than the City's consultant, staff projected Measure Z FY 2020/21 revenues at a 1% loss versus HdL's projected 0.5% loss, and FY 2021/22 revenues at a conservative 2.5% growth rate over the FY 2020/21 projection as compared to HdL's projected increase of 3.3%. A conservative estimate of \$300,000 in interest revenue is also projected for FY 2021/22, as compared to FY 2019/20 actual revenues of \$750,000.

The BEC has requested the opportunity to revisit the Measure Z Spending Plan to create a long-term strategy for the use of Measure Z funding and to consider the prioritization of current spending items. Staff will seek BEC input and recommendations in this regard, which will then be applied to the development of the FY 2021/22 proposed budget.

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, anti-gang/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 1¢ transaction and use tax went into effect April 1, 2017. Since that date, Measure Z has funded critical needs including police and fire personnel, emergency vehicle replacement, homeless initiatives, street projects, tree trimming, technology programs, and the construction of a new Main Library, and many other items.

Next Steps

City departments will prepare their proposed budgets during the months of December and January, followed by review with the City Manager’s team. Based on the City Manager’s review and approval of departments’ proposed budgets, departments’ budget proposals will be presented to various Boards, Commissions, and Committees (including the BEC), and subsequently presented to the City Council at a budget workshop on April 19, 2021. The City will also explore additional options for community engagement in the budget process, which will be largely dictated by the constraints of the pandemic. Following feedback from these forums, a formal proposed budget will be developed for BEC and City Council consideration in May, with budget adoption by the City Council required in June.

FISCAL IMPACT:

There is no immediate fiscal impact as a result of this report. The input received from the Financial Performance and Budget Committee on the baseline General Fund and Measure Z budgets, budget development strategies, and potential balancing measures will be incorporated into development of the City’s FY 2021/22 budget.

Prepared by: Kristie Thomas, Budget and Revenue Manager
Approved as to
availability of funds: Edward Enriquez, Chief Financial Officer/City Treasurer
Approved by: Moises Lopez, Deputy City Manager

Attachments:

1. General Fund Baseline Budget and Assumptions
2. Measure Z Baseline Budget
3. Presentation