



Budget Engagement Commission

City of Arts & Innovation

TO: HONORABLE COMMISSIONERS **DATE: APRIL 15, 2021**
FROM: FINANCE DEPARTMENT **WARDS: ALL**
SUBJECT: FISCAL YEAR 2020/21 SECOND QUARTER FINANCIAL UPDATE

ISSUE:

Receive and provide input on the Fiscal Year 2020/21 Second Quarter Financial Update.

RECOMMENDATION:

That the Budget Engagement Commission receive and provide input on the Fiscal Year 2020/21 Second Quarter financial update.

BACKGROUND:

On June 16, 2020, the City Council adopted Resolution No. 23592 approving the Fiscal Year (FY) 2020-2021 (Emergency) Annual Budget. The adopted budget was the product of a truncated budget process prompted by the COVID-19 pandemic and Orders that limited the City's ability to receive the usual level of engagement in the budget process. Further, the impacts of the COVID-19 pandemic on City finances were largely unknown at the time of budget adoption due to the ongoing shut-down Order and uncertainty at all levels of the economy. As a part of the adoption of the emergency budget, staff committed to the City Council and the public that interim reports and recommendations to the adopted budget would be made as needed.

On November 12, 2020, the Budget Engagement Commission received an interim financial update that reported on the preliminary results of fiscal year ending June 30, 2020 as well as economic developments observed since the adoption of the FY 2020/21 emergency budget. On January 14, 2021, the BEC received the FY 2019/20 Fourth Quarter Update and voted unanimously to recommend that City Council to designate surplus reserves be set aside for future balancing measures. On January 19, 2021, the City Council voted unanimously to set aside approximately \$15.6 of projected General Fund surplus reserves to address future fiscal issues of the General Fund, including the potential impacts of COVID-19 and the potential loss of the General Fund Transfer (GFT).

DISCUSSION:

This financial update spans the period of July through December 2020. Vacancy saving targets resulting from the uncertain impact of the pandemic and the ongoing structural deficit impacted

the Finance Department's ability to meet the usual timelines for closing the previous fiscal year, completing the financial audit, and performing the accounting processes that are necessary for the compilation of quarterly financial reports. However, the City Council received relevant verbal updates from the City's Chief Financial Officer under the City Council's standing agenda item titled "California Public Employees Retirement System challenge/financial solvency update". During the current fiscal year, these updates included information on the economy, sales tax revenue, CalPERS returns, actual and potential impacts of COVID-19, the Electric General Fund Transfer, and other information related to the City's financial health.

Financial Report

Throughout the fiscal year, City departments and the Budget Office monitor and analyze all City funds for potential issues that require attention and mitigating action. For the second quarter report, City departments analyzed the financial status for all funds and appropriations under their purview. City departments also evaluated the potential effect of COVID-19 on departmental finances to the extent possible. The results of the City's major funds as well as areas of concern in other funds (if any) are reported in the Fiscal Update (Attachment 1).

COVID-19 Fiscal Impact

On March 4, 2020, Governor Newsom declared a state of emergency in California because of COVID-19. On March 13, 2020, the City of Riverside declared a local emergency and closed non-essential facilities to the public. Temporary stay-at-home orders followed from the State and City in mid-March 2020 and were again reinstated in December 2020 for approximately seven weeks. Fortunately, the impact of the pandemic to the City's budget has not been as drastic as originally expected.

Refer to the Fiscal Update (Attachment 1) for a discussion of the most influential social and economic impacts on City finances as a result of COVID-19, identified areas of fiscal risk, and second quarter results for the City's major funds (General Fund, Measure Z, Electric, Water, Refuse, and Sewer).

General Fund

The second quarter analysis presents a positive FY 2021/22 outlook for the General Fund, with revenues performing better than anticipated and expenditures trending within budgeted appropriation limits.

Revenues: FY 2020/21 General Fund revenues were reviewed in context of FY 2019/20 actual results, performance to date, and potential COVID-19 impacts through the end of the fiscal year. The pre-pandemic budget projected minimal revenue growth of less than 1% over FY 2019/20 revenues based on economic conditions and historical trends. The pandemic presented a significant – yet largely unpredictable – challenge to local agencies nationwide and prompted agencies in the Southern California region to drastically reduce revenue projections and adopt severe austerity measures, including a significant reduction of workforce levels. However, an analysis of Riverside demographics in relation to its revenue base did not support such severe measures for the City and the 10% contingency revenue reduction (\$28 million) in the adopted budget has thus far provided a sufficient cushion for the City to weather the impacts of the pandemic. FY 2020/21 second quarter analysis reveals that total General Fund revenue projections may match the prior year and exceed emergency budget revenue estimates by at least \$10 million. This is largely due to balancing measures adopted in the emergency budget and positive performance in sales tax which is trending 4% higher than the previous year as of the

second quarter. The county sales tax pool continues to exceed estimates and is trending 44.7% over the same period in the prior year. Some revenue sources continue to be impacted by the shut-down or reduction in City services, including Library, Parks and Recreation, and other charges for services. However, the adopted contingency revenue reduction and positive revenue performance in other areas appear sufficient to fully offset those revenue shortfalls as of the second quarter. Additionally, CARES Act funding that was unexpended on planned items within the required timeframe was used to offset safety personnel costs, adding approximately \$5.8 million of revenues to the General Fund. Rather than lose the funding due to spending time constraints, the unspent balance was used to offset public safety personnel costs which is a permitted expense under the CARES Act.

Expenditures: As of the second quarter, a savings in General Fund expenditures is expected. Personnel savings of at least \$5 million are projected, largely due to the closures (and therefore vacancies in temporary and part-time personnel) in Library and Parks & Recreation; vacancies occurring in the normal course of business; and the City Manager’s managed hiring initiative. Some savings will be offset by increased subsidies to the Convention Center and Entertainment Fund (both venues have remained closed through the pandemic). Additionally, capital project activity is less than expected due to the pandemic, causing less staff time than budgeted to be charged out to capital projects; as a result, the staff costs will remain in the General Fund and partially offset personnel savings.

In summary, the General Fund is stable and operating within budgeted appropriations for FY 2020/21. Prudent contingency planning for the pandemic, positive revenue performance, and CARES Act funding will likely result in savings at the end of the fiscal year. Despite the positive outlook for the current fiscal year, the long-term financial health of the General Fund continues to be at risk due to an ongoing structural deficit and the potential loss of the Electric GFT. Vacancy savings targets to address the structural deficit will continue to impact City operations and the ability of departments to maintain ongoing alignment with the City’s strategic priorities. How the American Rescue Plan Act of 2021 and revenue generation efforts by the City will impact the City’s financial health is yet to be determined. These impacts are a part of discussions for the development of the FY 2021/22 budget.

Measure Z

As of June 30, 2020, Measure Z held \$24.9 million in unallocated fund reserves, net of unexpended amounts (\$28.2 million) carried forward into FY 2020/21. Separately, \$5 million is held in contingency reserves per the adopted Measure Z Reserve Policy to ensure sufficient funding for ongoing costs in the event of under-performing revenues. Strong revenues in the previous and current fiscal years are contributing to healthy unallocated reserves, projected at approximately \$13.5 million for the fiscal year ending 2020/21.

Revenues: The FY 2020/21 emergency budget included a 10% contingency reduction for Measure Z revenues with the expectation of significant pandemic impacts on the Transaction and Use Tax revenue. However, the revenue is currently 4.5% higher as of the second quarter as compared to the same point in the previous fiscal year.

Expenditures: Measure Z funds include many projects and one-time expenditures, causing expenditures to appear to be trending behind budget. However, spending is progressing as planned and within appropriation limits.

Review of the Measure Z Spending Plan in context of the City’s financial health continues. The FY 2021/22 baseline Measure Z budget was presented to the Budget Engagement Commission

(BEC) on December 17, 2020, and to the Financial Performance and Budget Committee on January 8, 2021. On January 14, 2021, the BEC reviewed and received department feedback on the status of numerous spending items. The BEC unanimously voted to recommend no changes to the spending allocations for the items reviewed, with the exception of Police Officer Lateral Hire Incentives and Recruitment Costs: for this item, the BEC recommended to retain the annual allocation of \$200K, to be further addressed and discussed during budget development for each budget year.

Enterprise Funds Overview

The Sewer, Refuse, Electric, and Water funds have been similarly impacted by the suspension of utility shutoffs in response to the pandemic. The combined accounts receivable for the four utilities is approximately \$47 million as compared to \$25 million for the same period in the last fiscal year. Delinquent accounts have increased to \$22 million in FY 2020/21 as compared to \$4 million for the same period in FY 2019/20. In March 2020, Riverside Public Utilities developed the Emergency Recovery Assistance Program (ERAP) in response to the COVID-19 pandemic to assist active residential utility customers that have experienced reduced income due to loss of employment or reduced hours as a result of COVID-19. Customers eligible for ERAP assistance will be issued a one-time \$400 credit towards their utility bill. In March 2021, the City received a direct allocation of Emergency Rental Assistance (ERA) funding from the US Department of Treasury to assist eligible households with rental assistance and utilities to ensure housing stability. The delinquent revenue is expected to be collected when the suspension of the utility shutoffs is lifted and with assistance from the ERAP program.

Sewer Fund

The overall financial position of the Sewer Enterprise fund is in step with the Sewer Fund Reserve Policy objectives. The FY 2020/21 adopted budget projects a net operating gain of \$7.6 million, which will help to fund \$14 million of planned capital projects. On July 21, 2020, the City Council approved all volumes of the 2019 Master Plan for Wastewater Collections and Treatment Facilities and Environmental Review. The Public Works Department is actively working with a consultant to complete the financial and user rate study aspects of the Wastewater Master Plan Update. The results of the updated Master Plan will inform future discussions on Sewer rates and funding for the projects identified in the Master Plan.

At the end of the second fiscal quarter, 46.5% of projected revenues have been recorded, although the number of delinquent accounts has risen during the pandemic. As of March 9, 2021, delinquent accounts in the Sewer Fund total approximately \$2.86 million. As per City Council direction, accounts for which payment is not being received are not being shut off, and services are continuing uninterrupted.

Operating expenditures are 49% of total budget at the end of the second quarter largely due to the timing of debt obligations and are expected to remain within adopted appropriation limits through the fiscal year.

Refuse Fund

The Refuse Enterprise fund originally projected to end FY 2020/21 in a deficit of approximately \$1.4 million. However, the approval of the Solid Waste Rate Plan, which took effect on January 1, 2021, resulted in a \$2.3 million increase to revenue forecasts resulting in a projected surplus

rather than the originally projected deficit. Unfortunately, revenues resulting from the rate increase are being offset by increased recycling and disposal costs.

At the end of the second fiscal quarter, 49.7% of projected revenues have been recorded, although the number of delinquent accounts has risen during the pandemic. As of March 9, 2021, delinquent accounts in the Refuse Fund total approximately \$1.1 million. As per City Council direction, accounts for which payment is not being received are not being shut off, and services are continuing uninterrupted.

Operating expenditures are 46% of total budget at second quarter end largely due to the timing of debt obligations and are expected to exceed budget by fiscal year end due to increased disposal and recycling costs. Changes in the recycling market have resulted in revenues no longer offsetting the cost of processing, transportation, and residual disposal and have resulted in the implementation of new organics processing and recycling rates. In previous discussions with the City Council, staff shared projections of \$1.5 million of increased costs associated with residential recycling. However, the recycling impacts have carried over to the commercial sector as well. As a result, the cost of processing recyclable materials was added to the City's waste processing agreement with the Agua Mansa Transfer Material Recovery Facility (MRF). Lastly, an increase in residential tonnage was an unanticipated effect of the pandemic and is likely attributed to more residents being quarantined in their homes. The combination of these issues is projected to cost an additional \$2.5 million at fiscal year-end; a supplemental appropriation is requested to cover this cost increase. The addition of a new commercial organics processing and recycling rate implemented January 1, 2021, in addition to the residential component of the Solid Waste Rate Plan, should help offset future costs.

Electric Fund

The FY 2020/21 adopted budget for the Electric Fund includes a programmed \$16.3 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. Reserve levels as of the second quarter are within established policy levels. In March 2021, the Board of Public Utilities and City Council approved an increase to the Sharing Households Assist Riverside Program (SHARE) from \$150 to \$250 per year for low-income residential electric customers for the duration of the COVID-19 pandemic.

Electric revenues are trending higher than anticipated at the end of the second quarter due to warmer summer months and higher consumption than anticipated. The pandemic has led to higher residential usage and lower commercial and industrial usage. Overall, retail sales are 2.4% (\$4.3 million) higher than anticipated, and \$11.9 million (7%) higher than the same period in the previous fiscal year. The revenues are expected to offset the three-month delay in the implementation of the third year of the approved electric rate increases that were scheduled to go into effect on January 1, 2021. On January 5, 2021, the City Council voted to delay the scheduled rate increase to March 31, 2021, with a projected fiscal impact of \$2.1 million lower electric revenues. On March 23, 2021, the City Council directed staff to delay the implementation of the third year of the electric rate plan and referred it back to the Board of Public Utilities to develop an implementation plan. The estimated impact of the action is an approximately \$4.4 million reduction in electric revenues through the end of the fiscal year.

Electric expenditures are 41% of total budget at the end of the second quarter. Personnel expenditures are trending low due to vacancies and attrition. Power supply costs are 4.1% lower than projected, and other costs vary in their timing throughout the fiscal year. Overall, electric expenditures are projected to remain within the budgeted appropriation limit at fiscal year-end.

Water Fund

The Water Fund is in a healthy position with reserve levels (including the available line of credit) within the required policy reserve range. Budgeted operating gains of \$7.1 million are anticipated to be used to fund capital projects in FY 2020/21, supplemented by a \$1.1 million draw on reserves and \$22.4 million of bond proceeds.

The pandemic has led to higher residential water usage and slightly lower than anticipated commercial and industrial water usage. As of the end of the second quarter, operating revenues are at 58% of budgeted projections. Retail sales are 4.3% higher than expected due to warmer than anticipated summer months and lower than expected precipitation in the later months of the year. Current year retail sales are \$4.2 million (11.6%) higher than those for the same period in the prior fiscal year.

Water Fund expenditures are 44% of budget at the end of the second quarter. Personnel is trending slightly lower than anticipated due to vacancies and attrition; other expenditures vary in their timing throughout the fiscal year. Overall, water expenditures are projected to remain within the budgeted appropriation limit at fiscal year-end.

Interfund Transfers and Supplemental Appropriations

Riverside Municipal Code Sec. 1104 requires the affirmative vote of at least five City Council members to authorize the transfer of appropriations between City funds and to authorize supplemental appropriations. The following transfers and supplemental appropriations are recommended for City Council approval:

- **Capital Projects Fund transfer to the General Fund \$4,808.95:** In FY 2018/19, the Parks, Recreation & Community Services Department (PRCSD) transferred \$20,000 from their General Fund operating budget to the Hunter Park Improvements project to cover estimated costs required to complete the project. The project is complete and needs to be closed. Staff recommends transferring unused funds totaling \$4,808.95 back to the General Fund PRCSD budget.
- **Refuse Fund \$2,500,000 Supplemental Appropriation:** To cover the cost increases associated with recycling and disposal costs as previously described in this report.

FISCAL IMPACT:

As of the second quarter, the General Fund is anticipated to end the fiscal year with savings. Despite the positive outlook for the current fiscal year, the long-term financial health of the General Fund continues to be at risk due to an ongoing structural deficit and the potential loss of the Electric GFT. This will challenge the ability of City departments to maintain service levels as well as alignment with the City's strategic priorities. Measure Z revenues continue at a level sufficient to fund approved spending items as well as help manage General Fund fiscal challenges, should that become necessary. Staff will continue to monitor the funds and recommend both short-term and long-term financial strategies during the development of City budgets for the upcoming fiscal year.

The City's major enterprise funds are experiencing similar impacts resulting from the pandemic, with much higher delinquent account balances and lower commercial/industrial revenues. To

date, these impacts have not affected the health of the funds, but challenges remain. Other factors affecting the Refuse Fund (as previously described) have prompted a request for supplemental appropriations totaling \$2.5 million. Staff will continue to monitor this fund and recommend additional mitigating fiscal actions as needed.

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Attachments:

1. Fiscal Update
2. Measure Z Spending Status
3. Presentation