City Council Memorandum

City of Arts & Innovation

TO: HONORABLE MAYOR AND CITY COUNCIL **DATE: JUNE 15, 2021**

FROM: FINANCE DEPARTMENT **WARDS: ALL**

SUBJECT: FISCAL YEAR 2020/21 THIRD QUARTER FINANCIAL UPDATE

ISSUE:

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

RECOMMENDATION:

That the City Council receive and provide input on the Fiscal Year 2020/21 Third 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. Throughout the fiscal year, the City's Chief Financial Officer has provided updates to the City Council via a standing item on the weekly agenda.

On October 27, 2020, the City Council 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 April 13, 2021, the City Council received the FY 2020/21 Second Quarter Financial Update.

DISCUSSION:

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 third 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. This update spans the period of July 2020 through March 2021. 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). This update spans the period of July 2020 through March 2021.

<u>COVID-19 Fiscal Impact</u>

On March 4, 2020, Governor Newsom declared a state of emergency in California as a result 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.

On March 11, 2021, President Biden signed the America Rescue Plan Act (ARPA) which provided additional relief to both individuals and businesses suffering from the impact of the pandemic. The City expects to receive one-time funding of approximately $73 million from ARPA, subject to audit and validation that the funds are used for approved purposes as outlined in the ARPA and implementation guidelines issued by the United States Department of the Treasury (USDT). Funds may be used to offset revenue losses resulting from the pandemic as compared to FY 2018/19 actual revenues, as well as expenditures incurred as a result of the City's response to the pandemic.

Refer to the Fiscal Update (Attachment 1) for a discussion of current social and economic impacts of the pandemic on City finances, identified areas of fiscal risk, and third quarter results for the City's major funds (General Fund, Measure Z, Electric, Water, Refuse, and Sewer).

<u>General Fund</u>

The third quarter analysis presents a positive FY 2020/21 outlook for the General Fund, with revenues performing better than anticipated and expenditures trending within budgeted appropriation limits.

Adopted Budget: The adopted FY 2020/21 Emergency Budget for the General Fund included a $15.6 million balancing measure in the form of vacancy savings targets to offset a projected structural deficit. As a result of the pandemic, original revenue projections were reduced by 10% ($28 million) to buffer against the potential impacts of the pandemic on City revenues. This presented a new gap in the proposed budget which was largely filled with the following balancing measures:

- Projected savings of $7 million from the issuance of a Pension Obligation Bond (POB) (savings achieved in FY 2020/21).
- Maintain Measure Z support level to the General Fund commensurate with the FY 2019/20 support (reverted the $6.5 million programmed FY 2020/21 reduction in Measure Z support).
- Allocate $6 million of unspent funding from the Measure Z contingency spending line item to the General Fund.
- Planned withdrawal of $6.2 million from the Section 115 Pension Trust to offset a portion of the required FY 2020/21 payment of the unfunded accrued liability (UAL).

Revenues: FY 2020/21 General Fund revenues recorded through March 2021 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. Third quarter analysis reveals that total General Fund revenue projections may exceed emergency budget revenue estimates by $10 million. Some revenue sources continue to be impacted by the shut-down or reduction in City services, but the adopted contingency revenue reduction and positive revenue performance in other areas appear sufficient to fully offset those revenue shortfalls. Additionally, CARES Act funding that was unexpended on planned items within the required timeframe was used to offset public 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.

General Fund Revenue Analysis

	Pre-COVID Projection	Contingency Reduction	Adopted Budget	Quarter 3 Projection
Property Taxes	$72,300,744	$(1,446,015)	$70,854,729	$72,585,000
Sales and Use Tax	69,463,869	(9,819,584)	59,644,285	71,591,000
Utility Users Tax	30,071,801	-	30,071,801	30,395,000
Charges for Services	16,489,733	(1,100,107)	15,389,626	11,850,000
Licenses & Permits	11,603,976	(2,924,978)	8,678,998	7,822,000
Transient Occupancy Tax	7,742,400	(5,032,560)	2,709,840	4,194,000
Other Revenues	12,688,641	-	12,688,641	12,162,000
Uncategorized Contingency Reduction	-	(7,754,870)	(7,754,870)	-
General Fund Transfer	48,685,700	-	48,685,700	46,871,000
Maintain Measure Z Support Level	11,734,277		18,266,026	18,266,000
Measure Z Contingency Funds[1]	-		6,000,000	-
Section 115 Trust Withdrawal[1]	-		6,165,501	-
CARES Act Funding	-		-	5,804,000
Total Revenues and Transfers In	**$280,781,141**	**$(28,078,114)**	**$271,400,277**	**$281,540,000**

[1]Depending on fiscal year-end results, staff may recommend not enacting these balancing measures.

Expenditures: As of the third quarter, personnel savings of at least $5 million is 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.

General Fund Expenditure Analysis	Adopted Budget	Quarter 3 Projection
Personnel	$215,732,216	$195,100,000
CalPERS UAL[2]	29,883,988	11,067,000
Non-Personnel, Special Projects, Minor Capital	61,259,888	61,260,000
Debt Service[2]	18,645,440	30,204,000
Charges To/From	(43,176,378)	(41,877,000)
Fund Subsidies & Other Transfers	11,709,621	14,410,000
Balancing Measure – Vacancy Savings[1]	(15,654,498)	-
Balancing Measure – POB Savings[1]	(7,000,000)	-
Total Expenditures and Transfers Out	**$271,400,277**	**$270,164,000**

[1]Savings achieved through Balancing Measures are incorporated into projections for applicable line items (Personnel, CalPERS UAL, and Debt Service).
[2]Variance is a result of issuing the POB which was completed after budget adoption.

Summary: Due to better than expected revenue performance during the pandemic and support received from CARES Act funding, two balancing measures that were adopted in the emergency budget may not be required: the $6 million use of Measure Z contingency funding and the $6.2 million withdrawal of the Section 115 Pension Trust. Staff will return to City Council in the Fall with the fourth quarter results and a formal recommendation on these items. As currently projected, eliminating these two balancing measures from quarter three projections, the current third quarter analysis shows that the General Fund may realize an $11.4 million net operating gain as compared to the adopted emergency budget in FY 2020/21.

The City's executive team and staff have made a concerted effort to reduce spending to offset the impacts of the ongoing General Fund deficit and the effects of the pandemic. While these efforts have ensured that General Fund reserves remain intact to help address future fiscal challenges, the strain of reduced staffing levels and resources has a negative impact on departments' ability to further the City Council's strategic priorities and apply efforts toward continuous operational improvements. The implementation of Priority Based Budgeting (PBB) with the FY 2022-2024 two-year budget is expected to lay an evolving budget foundation to help staff and the City Council determine how best to align the City's limited resources with the strategic plan and eliminate the ongoing structural deficit in the General Fund. Additionally, the following challenges and their potential impact on the General Fund are currently being addressed by City leadership:

- Expiring Memorandums of Understanding (MOU) with all of the City's bargaining units; and
- Potential loss of the General Fund Transfer from the Electric fund and a monthly accrual of the ongoing liability of approximately $2.6 million per month which occurs until the issue is resolved.

The potential impact of the American Rescue Plan Act on the General Fund is yet to be determined.

<u>Measure Z</u>

Measure Z is projected to end the fiscal year with approximately $21.2 million in unallocated fund reserves. This is before the final determination of the $6 million contingency balancing measure item in Measure Z incorporated into the general fund emergency budget. As previously noted, this item may not be necessary due to the better than anticipated general fund revenues results.

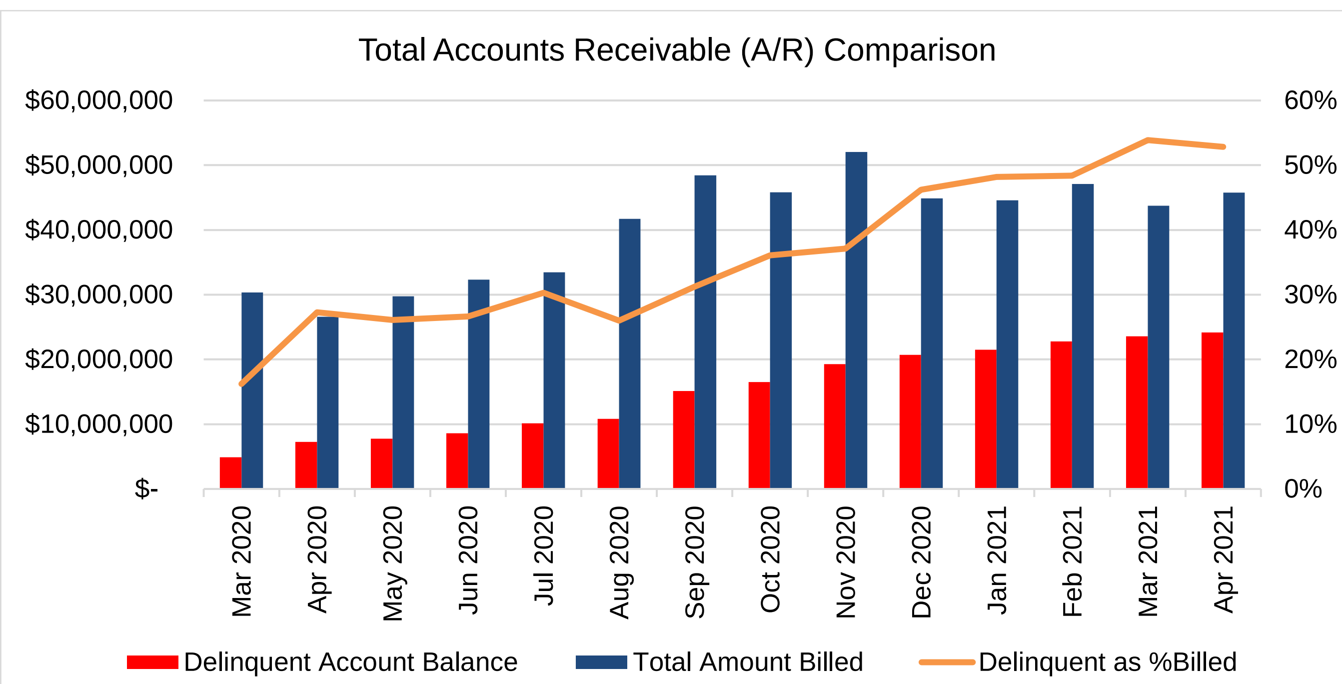
Should the $6 million balancing measure item from Measure Z not be needed, the ending available fund balance in Measure Z will increase by this amount or projected at approximately $27.2 million at year end. Separately, $5 million is held in contingency reserves per the adopted Measure Z Reserve Policy to ensure sufficient funding for ongoing costs in the event of under-performing revenues.

Revenues: The FY 2020/21 emergency budget included a 10% contingency reduction for Measure Z revenues with the expectation of significant pandemic impacts on Transaction and Use Tax revenue. The pre-COVID revenue estimate was $62.9 million; the revised revenue estimate based on performance to date and estimates from HdL, the City’s sales tax advisor, is approximately $64.4 million, inclusive of interest earnings. The increase represents a 1.9% growth rate over FY 2019/20 revenues.

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. As of the third quarter, no additional spending measures had been approved during the fiscal year. The Measure Z Spending Contingency, adopted at $6 million to provide support for General Fund revenue losses resulting from the pandemic, may not be required depending on final General Fund performance at fiscal year-end. Any unexpended amount would be returned to Measure Z unallocated fund reserves and could increase the projected ending unallocated fund reserves to a total of $27.2 million.

<u>Enterprise Funds Overview</u>

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 increased by 51% or $15.4 million from $30.3 million in March 2020 to $45.7 million on April 27, 2021. During the same period, delinquent accounts receivable increased 391% or $19.2 million from $4.9 million in March 2020 to $24.1 million on April 27, 2021. It is likely that a portion of these accounts will ultimately remain uncollectable and will have to be written off, reducing fund resources.



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. Some delinquent revenue is expected to be collected when the suspension of the utility shutoffs is lifted and assistance from the ERAP program is provided.

In March 2020, Riverside Public Utilities developed the Emergency Recovery Assistance Program (ERAP). This program was established in response to the COVID pandemic, providing a one-time $400 bill credit (assistance) for residential utility customers whose incomes have been negatively impacted due to the pandemic. Consistent with its approval, this program will remain in operation until three months after the local emergency has been terminated. As of the preparation of this report, 4,699 customer accounts have benefitted from the ERAP program since May 20, 2020, with assistance totaling $1,879,600.

Sewer Fund

The overall financial position of the Sewer Enterprise fund is in line 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 fund $14 million of planned capital projects. Based on an analysis of Quarter 3 performance to date, the Sewer Fund is on track to meet projections.

Revenues: At the end of the third fiscal quarter, 71.8% of projected revenues have been recorded, although the number of delinquent accounts has risen during the pandemic. As of April 27, 2021, delinquent accounts in the Sewer Fund totaled approximately $3.3 million, as compared to approximately $713,500 in delinquent accounts in March 2020. Approximately $3.0 million of delinquent accounts are in the residential category with 48% ($1.46 million) more than four months past due. As per City Council direction, accounts for which payment is not being received are not being shut off, and services are continuing uninterrupted.

Expenditures: Operating expenditures are 72.8% of total budget at the end of the third quarter and are expected to remain within adopted appropriation limits through the fiscal year.

Refuse Fund

The Refuse Enterprise fund was 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 expected to be offset by increased recycling and disposal costs that are higher than anticipated, resulting in the fund likely ending the fiscal year near the original budgeted operating deficit of $1.4 million. These challenges are expected to continue into FY 2021/22; however, with the adopted rate increases, staff projects that the fund will achieve financial stability in FY 2022/23.

Revenues: At the end of the third quarter, 75.6% of projected revenues have been recorded, although the number of delinquent accounts has risen during the pandemic. As of April 27, 2021, delinquent accounts in the Refuse Fund total approximately $1.2 million as compared to approximately $246,000 in delinquent accounts in March 2020, with 51% more than four months past due. As per City Council direction, accounts for which payment is not being received are not being shut off, and services are continuing uninterrupted.

Expenditures: Operating expenditures are 71.5% of total budget at the third quarter end. 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. Additionally, 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, offsetting revenue gains from the rate increase.

<u>Electric Fund</u>

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 third 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.

Revenues: As of the end of the third quarter, operating revenues are at 74.4% of budgeted projections. Mild temperatures in the third quarter and the impacts of the pandemic (higher residential and lower commercial consumption) are contributing to lagging retail sales. Electric retail sales revenues as of the third quarter end are $4.8 million (1.9%) lower than anticipated, with approximately $2.1 million of this amount attributable to the delay of the rate increase that was scheduled for January 2021. As of April 27, 2021, delinquent accounts in the Electric Fund total approximately $17.3 million as compared to approximately $3.4 million in delinquent accounts in March 2020; 68% are more than four months past due. Approximately 45% ($7.7 million) of the current delinquent balance is in commercial accounts versus 55% ($9.6 million) in residential accounts.

On January 5, 2021, the City Council voted to delay the scheduled electric rate increase to March 31, 2021. 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. On April 19, 2021, the Board of Public Utilities unanimously voted to approve delaying the implementation of the third year of the Electric Rate Plan to no later than July 1, 2021, with an estimated electric fund revenue reduction of $4.4 million to meet fiscal year 2021/2022 budget assumptions. The Board recommendation will be forwarded to the City Council for consideration.

Expenditures: Electric operating expenditures are 65.8% of total budget at the end of the third quarter. Personnel expenditures are trending very low due to vacancies and attrition; the fund has carried an average vacancy rate of 18.3% and 85.3 full-time equivalent positions during the fiscal year. Power supply costs are approximately 7% 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.

<u>Water Fund</u>

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.

Revenues: As of the end of the third quarter, operating revenues are at 77.9% of budgeted projections. The pandemic has led to higher residential water usage and slightly lower than anticipated commercial and industrial water usage. Retail sales are $1.7 million (3.4%) higher than expected due to warmer than anticipated summer months and lower than expected precipitation. As of April 27, 2021, delinquent accounts in the Water Fund total approximately $5.4 million as compared to approximately $546,200 in delinquent accounts in March 2020; 54.5% are more than four months past due. Approximately 12% ($278,000) of the current delinquent balance is in commercial accounts versus 88% ($2.1 million) in residential accounts.

Expenditures: Water Fund expenditures are 67.4% of budget at the end of the third quarter. Personnel is trending slightly lower than anticipated due to vacancies and attrition; the fund has carried an average vacancy rate of 10% and 16.4 full-time equivalent positions during the fiscal year. 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.

FISCAL IMPACT:

As of the third 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. However, the success of the City of Riverside Services Protection Measure on an upcoming ballot will be critical to maintaining essential City services and alignment with the City's strategic plan.

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 overall health of the funds, but the potential write-off of delinquent accounts will reduce fund resources and could impact credit ratings for certain utilities where applicable. The Refuse Fund is expected to post an operating loss in FY 2020/21 due to higher than anticipated recycling and disposal costs, but the adopted rate increase is expected to bring financial stability to the fund by FY 2022/23.

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Attachments:
1. Fiscal Update
2. Measure Z Spending Status
3. General Fund Transfer/Parada Litigation Press Release
4. Presentation