

City of Garden Grove

INTER-DEPARTMENT MEMORANDUM

To: Scott C. Stiles
From: Patricia Song
Dept: City Manager
Dept: Finance
Subject: Financial Update for FY2019-20 and FY2020-21
Date: May 12, 2020

OBJECTIVE

For the City Council to receive timely financial updates reflecting the rapidly changing economic conditions caused by the COVID-19 pandemic, and evaluate options to balance Fiscal Year 2020-21 General Fund budget.

BACKGROUND

Due to the COVID-19 pandemic, the state of economy is experiencing significant uncertainty, which caused a direct impact to the City's finances. Finance staff is diligently evaluating its impact on our financial condition to timely formulate strategies to contain cost, maintain cash flow, and explore options to balance our budget. This is the third financial update since the beginning of the pandemic.

DISCUSSION

As of April 30, 2020, staff's assessment of total damage caused by COVID-19 pandemic is \$12.8 million for Fiscal Year 2019-20. Over 92% of the total damage is due to estimated loss of sales tax and transient occupancy tax revenues. The estimated loss on sales tax is \$5.1 million for the current fiscal year. This amount was derived by comparing projections performed by HdL, the City's sales tax consultant, in February 2020 to HdL's updated estimate on April 6, 2020. Loss of Transient Occupancy Tax (TOT) revenue of \$6.3 million was estimated through end of May 2020, based on actuals for the same months from last year.

As of April 30, 2020, the City has incurred \$1.0 million in direct costs associated with the pandemic since the declaration of local emergency on March 16, 2020. This amount includes purchase orders issued and credit card purchases for personal protective equipment (PPE), emergency services, sanitary supplies for disinfection and decontamination, and equipment to facilitate telecommuting, as well as \$699,000 in salaries and overtime incurred by City staff responding to the pandemic. Our Emergency Operations Center team is tracking and documenting all of these costs in order to apply for potential reimbursement of direct COVID-19 costs to the City.

The revenue shortfall has a significant impact on the City's General Fund. As of April 30, 2020, staff estimates FY2019-20 will end with a modest surplus of \$3.2 million. However, based on current information, we project a deficit for FY2020-21.

In our April 28, 2020, update, we projected the City's General Fund will have a deficit of \$5.4M. Two major assumptions were made on Sales Tax and TOT revenues:

1. Sales tax revenue estimate was provided by HdL in early April, which is approximately 15% lower comparing to FY2018-19 actual revenue, with Measure O at \$18.3 million.
2. TOT revenue was estimated to be 20% lower than FY2018-19 actual.

Table 1 below shows our April 2020 projection, with audited actual amounts from FY2018-19.

Table 1 – General Fund Revenue and Expenditure

City of Garden Grove					
General Fund Revenue and Expenditure					
(amounts in \$'000)					
	FY2018-19 Actual	FY2019-20		FY2020-21	
		Adopted/ Current ¹	Estimated FY (as of 4/16/20)	Adopted	Estimated FY (as of 4/16/20)
Revenue					
Sales Tax - Bradley Burns	\$ 24,612	\$ 22,668	\$ 21,510	\$ 23,006	\$ 20,994
Sales Tax - Measure O	4,759	19,000	18,325	19,285	17,654
Property Tax	31,158	28,543	31,064	29,311	29,311
Transient Occupancy Tax	26,285	26,477	18,189	27,007	21,028
Other Taxes	18,313	18,922	19,024	19,574	19,574
Franchise Fees	2,405	2,500	2,400	2,500	2,500
Building Permits & Plan Check	4,115	2,200	2,800	2,200	2,200
Business Tax	2,828	2,500	2,200	2,500	2,500
General Fund Street Loan	2,453	2,484	2,516	2,516	2,516
Parking & Traffic Fines	1,625	1,800	1,621	1,800	1,800
Investment Income	1,213	300	1,000	500	500
Admin Service Charge	3,844	3,422	3,422	3,422	3,422
Other Revenue	4,579	3,364	3,527	3,375	3,375
Land Sale Proceeds	500	-	1,782	-	-
Total Revenue	128,689	134,180	129,380	136,996	127,374
Expenditure					
Salaries and Benefits	83,625	81,462	77,962	83,836	84,130
Contractual	10,424	30,014	30,014	33,634	33,634
Commodities	1,743	2,027	2,577	1,736	1,736
Internal Service & Debt Service	13,379	12,144	12,144	12,035	12,035
Capital	3,326	2,071	2,071	96	96
Transfers	793	1,446	1,446	1,133	1,133
Total Expenditure	113,290	129,164	126,214	132,470	132,764
Surplus/(Deficit)	\$ 15,399 ²	\$ 5,016	\$ 3,166	\$ 4,526	\$ (5,390)

¹ FY2019-20 Revenue amounts are adopted budget amount; Expenditure amounts are current budget, including carryover of \$1.2 million from the prior year.

² Surplus shown for FY2018-19 differs from amount reported in the CAFR, since all amounts listed in the table are for Fund 111 only.

In an update provided by UCLA Anderson Forecast on April 27, 2020, they cited a recovery period of 18 months, through end of 2021. Retail will not fully recover, especially the brick and mortar retailers, which will have a direct negative impact to our Measure O local sales tax. In addition, the leisure and hospitality industries will have struggles coming back. The sales tax and TOT revenues account for nearly 50% of the total of the General Fund’s revenue. We therefore prepared a sensitivity analysis for FY2020-21 budget, presenting two additional scenarios focusing on these two major revenue sources:

- Scenario 1
 - Sales tax revenue is 5% lower than HdL’s April estimate, or approximately 80% of FY2018-19 actual; and
 - TOT revenue is 70% of FY2018-19 actual.
- Scenario 2
 - Sales tax revenue is 10% lower than HdL’s April estimate, or approximately 75% of FY2018-19 actual; and
 - TOT revenue is 60% of FY2018-19 actual.

Baseline scenario is the projection we prepared in our April 28, 2020, City Council update, presented in FY2020-21 Estimated FY in Table 1 above.

Table 2 below shows the deficit amounts under each scenario:

Table 2 – General Fund Sensitivity Analysis

FY2020-21 General Fund Sensitivity Analysis				
	Adopted Budget	Baseline (April Estimate)	Scenario 1	Scenario 2
Revenue				
Sales Tax	\$ 42,291	\$ 38,648	\$ 36,716	\$ 34,783
Transient Occupancy Tax	27,007	21,028	18,400	15,771
Property Tax	29,311	29,311	29,311	29,311
Other	38,387	38,387	38,387	38,387
Total Revenue	136,996	127,374	122,813	118,252
Expenditure + Transfer	132,470	132,764	132,764	132,764
Estimated Deficit	\$ 4,526	\$ (5,390)	\$ (9,951)	\$ (14,512)

As shown in Table 2, a 5% drop in sales tax and 10% drop in TOT would result in \$4.6 million increase in deficit. A 10% drop in sales tax and 20% drop in TOT would cause \$9.1 million additional deficit to our baseline estimate.

Staff has been exploring various balancing measures to bridge the anticipated gap in the General Fund for FY2020-21. Table 3 below shows various options under all three scenarios.

Table 3 – FY2020-21 Budget Balancing Measures

City of Garden Grove				
General Fund Budget Balancing Measures - FY2020-21				
(amounts in \$'000)				
	Baseline	Scenario 1	Scenario 2	
	(April Estimate)			
Estimated Deficit	\$ (5,390)	\$ (9,951)	\$ (14,512)	
Balancing Measures:				
<u>Anticipated Budget Savings</u>				
Labor Savings from Vacancy	\$ 1,900	\$ 1,900	\$ 1,900	
OCFA Contract	270	270	270	
Total Anticipated Cost Savings	2,170	\$ 2,170	\$ 2,170	
<u>Proposed Cost Reductions</u>				
Fleet Internal Service Charge		836	836	16% reduction
Part-time/Temporary Staff		126	126	25% reduction
Conference & Training	58	58	58	30% reduction
Approved Non-mandated Supplementals:				
Holiday Lighting Upgrade		37	37	
Main Street Parking Lot Project		96	96	
Cost Recovery Fee Study (CEDD)		20	20	
Parks Reseeding Project		15	15	
Total Proposed Cost Reductions	58	1,188	1,188	
<u>Other Sources - One-time Funds</u>				
FY2019-20 Estimated Surplus	3,166	3,166	3,166	
Reserve for Property Tax Lawsuit		500	500	¹
Fleet Fund Reserve for Fire Equipment Replacement		2,549	2,549	²
General Fund Unreserved Fund Balance	-	377	4,938	³
Total Other One-time Sources	3,166	6,592	11,153	
Total Balancing Measures	\$ 5,394	\$ 9,951	\$ 14,512	

¹ The \$500,000 was set aside for potential lawsuit in prior years. Due to the creation of General Fund Reserve Policy, this reserve is no long necessary.

² Included in the current Fleet Fund's fund balance is \$2,549,414 set aside for Fire equipment replacement. With the City's Fire Department transition to OCFA, this reserve fund is no longer needed, and can be transferred to the General Fund as one-time money to close the budget gap.

³ As of July 1, 2019, the unreserved fund balance is sufficient to cover the one-time use under both scenarios.

Under the Baseline Scenario, estimated budget deficit is \$5.4 million. This budget gap can be partially closed by anticipated budget savings from vacancies equivalent to \$1.9 million and OCFA contract cost reduction of \$270,000. The \$1.9 million savings from vacancy do not include vacancies for the Police sworn positions. With a 30% or \$57,734 reduction in conferences and training budget, and the use of estimated surplus from FY2019-20 in the amount of \$3.2 million, funds available for balancing the budget for FY2020-21 totaled \$5.4 million, sufficient to cover the anticipated shortfall for FY2020-21.

Under Scenario 1, estimated budget deficit is \$10.0 million. In addition to the anticipated budget savings and FY2019-20 surplus, we are considering proposing cost reduction in the amount of \$1.2 million, and the use of certain one-time funds totaling \$6.6 million, to balance FY2019-20's budget.

These cost reductions follow the City Manager's April 3, 2020 memo on cost containment, which include:

- 30% reduction in conference, training and travel;
- 16% reduction in internal service charge for Fleet rental charge¹;
- 25% reduction in part-time, temporary and seasonal employee cost due to reduced programs;
- Deferral of Annual Holiday Lighting upgrade project;
- Deferral of Main Street Parking Lot project;
- Deferral of cost recovery fee study; and
- Deferral of City parks reseeding project.

¹ *Each year, the Fleet Management internal service fund charges user departments a pre-established rental rate that covers the fund's operating cost for the year and a portion of replacement reserve requirement. The Fleet Management internal service fund had a healthy reserve that covered 125% of the assets' original acquisition costs as of June 30, 2019. Staff is recommending to reduce the Fleet rental charge by 16% for FY2020-21 to help close the anticipated budget deficit.*

The one-time funding sources in addition to FY2019-20 surplus include:

- Removal of \$500,000 reserve for potential lawsuit. With the establishment of the City's General Fund Reserves Policy, sporadic reserves are no longer necessary;
- Reduce Fleet internal service fund's fund balance in the amount of \$2.5 million and return to the General Fund. This money was collected from the General Fund over the years to fund for Fire equipment replacement. With the OCFA transition, these funds can be returned to the General Fund; and
- Use of unreserved fund balance in the amount \$377,000. The fund balance is the accumulation of all prior years' net change to the bottom line of the fund, including excess or deficiency of revenues over or under expenditures, transfers, and other sources or uses. The unreserved portion can be used for any purposes, following the guidelines established by the City's Administrative Policy No. 200-07, General Fund Reserve.

Under Scenario 2, estimated budget deficit is \$14.5 million. In addition to the budget savings, cost reductions and one-time funds described above, it is necessary to use the unreserved fund balance in the amount of \$4.9 million to balance FY2020-21's budget.

As an alternative, the City could use the newly established Stability Reserve to balance the budget. Stability Reserve balance as of July 1, 2019 was \$22.5 million. The use of the Stability Reserve requires Council approval, a replenishment schedule is to be approved simultaneously, and per Council policy requirement, replenishment of the Stability Reserve shall begin no later than 5 years from the year of the "borrowing" and be completed within 10 years.

The above analysis does not include upcoming supplemental requests, which staff will be reviewing in the next few weeks. For FY2020-21, due to revenue constraints, supplemental funding requests are limited to three categories:

- City Council, State, and/or Federal Mandates. These include increases to contracts already approved by City Council or projects that are legally required to be completed by the City.
- Revenue-Enhancing Projects. Due to the cash flow constraints that COVID-19 has placed on the City's operations, only revenue-enhancing projects that will bring positive cash flow to the City within 12 months following the initial cash outflow will be considered.
- Grant Awards. These are previously awarded grants that requires matching fund from the City. New grants requiring General Fund matching in FY2020-21 will be considered on a case by case basis.

We will continue to monitor the state of economy and the impact to the City's revenue bases. In the next update, FY2020-21 preliminary supplemental appropriations will be included, and other options to close the budget gaps will be discussed accordingly.

FINANCIAL IMPACT

This report is intended to update the City Council and our community on the City's financial situation of the City in light of the COVID-19 pandemic. There is no fiscal impact to receive and file this report. The next update will be agendized for May 26, 2020, in preparation for the June 2, 2020 budget study session, with the approval of the FY2020-21 Continuation Budget no later than June 23, 2020.

RECOMMENDATION

It is recommended that the City Council receive and file this report.