

City of Garden Grove

INTER-DEPARTMENT MEMORANDUM

To: Scott C. Stiles
Dept: City Manager
Subject: Financial Update for FY2019-20 and FY2020-21

From: Patricia Song
Dept: Finance
Date: May 26, 2020

OBJECTIVE

Continue to update the City Council on financial impacts 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 costs, maintain cash flow, and explore options to balance our budget. This is the 4th financial update since the beginning of the pandemic.

DISCUSSION

As of May 14, 2020, staff's assessment on total damage caused by COVID-19 pandemic is \$15.8 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 \$9.0 million was estimated based on actuals for the same months from last year.

As of May 14, 2020, the City has incurred \$1.2 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 \$825,000 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 May 14, 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 May 12, 2020 update, we presented three scenarios based on revenue projections for FY2020-21. Our Community and Economic Development Department has been working closely with the City’s hotel operators to obtain a more realistic projection on hotel occupancy rate and the corresponding revenue. In the most recent discussion, the consensus amongst the hotels within the City is that occupancy rate will slowly ramp up during next fiscal year, from 15% in July 2020 to 65% in June 2021 comparing to FY2018-19’s actual occupancy. Based on this new information, staff revised Scenario 2 to reflect estimated TOT revenue at 40% of the FY2018-19 actual. The three scenarios are summarized below in Table 1:

Table 1 – FY2020-21 Revenue Forecast Scenarios

Scenario	Sales Tax	Transient Occupancy Tax
Baseline	15% lower than FY2018-19 actual*	20% lower than FY2018-19 actual
Scenario 1	20% lower than FY2018-19 actual	30% lower than FY2018-19 actual
Scenario 2	25% lower than FY2018-19 actual	60% lower than FY2018-19 actual

* HdL’s latest estimate dated April 6, 2020 showed a decrease in sales tax equivalent to 15% FY2018-19 actual revenue reported, with Measure O revenue at \$18.3 million.

In addition to revising TOT revenue estimates, supplemental requests for FY2020-21 fund also have an impact to the projected deficit. The supplemental requests included in this update are limited to contractual and state mandate, and items that have immediate positive net cash flow impact. Total supplemental requests to be funded by the General Fund is approximately \$594,000, including \$294,000 in mandated costs such as state required training and contractual obligations, and \$300,000 in staff augmentation that the costs will be offset by additional revenue generated.

Table 2 below presents the estimated deficit under each scenario with supplemental requests included:

Table 2 – General Fund Sensitivity Analysis
 (Amount in \$’000)

	Adopted Budget	Baseline (4/28/20 Est)	Scenario 1 (5/12/20 Est)	Scenario 2 (5/26/20 Est)
Revenue				
Sales Tax	\$ 42,291	\$ 38,648	\$ 36,716	\$ 34,783
Transient Occupancy Tax	27,007	21,028	18,400	10,514
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	112,995
Adopted Expenditure + Transfer	132,470	132,764	132,764	132,764
Supplemental Reuquests	594	594	594	594
Estimated Deficit	\$ 3,932	\$ (5,984)	\$ (10,545)	\$ (20,363)

Under the Baseline Scenario and Scenario 1, estimated deficit increased slightly by \$594,000 from our May 12th update, due to the inclusion of supplemental funding requests. Under Scenario 2, estimated deficit increased by \$5.8 million to \$20.4 million. As previously discussed, this is due to the revision to TOT revenue projection. In the May 12th update, staff estimated TOT revenue would be 40% lower than FY2018-19, under the revised Scenario 2, the percentage of revenue reduction is 60%, translating to \$5.3M in additional deficit.

When exploring balancing measures, staff is following best practices to look into three broad categories in the following order:

1. Budget Savings. The budget savings are created by vacant positions, or decreased contractual obligations. With the implementation of City Manager Cost Containment order, many vacant positions will be temporarily placed on hold for hiring, funds appropriated for these position will be removed from the operating budget, resulting in budget savings.

Staff anticipates \$1.9 million in budget savings by temporarily removing 22 vacant position funded by the General Fund. These vacancies do not include public safety sworn positions.

2. Cost Reductions. Consistent with the Cost Containment order, staff re-evaluated the adopted FY2020-21 budget, and identified several areas where costs can be temporarily reduced or postponed, such as travel and training, part-time staffing, professional services, and capital projects.
3. One-time Sources including Fund Balance. The fund balance includes both unreserved and reserved amounts ("rainy day fund"). One-time funds should only be used when there is no other options to balance the budget. During economic uncertainties, keeping reserve amount at a minimum policy level is crucial to avoid interruption to services.

Table 3 on the next page presents balancing efforts in all three categories.

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	\$ (5,933)	\$ (10,494)	\$ (20,363)	
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:				
Main Street Parking Lot Project		96	96	
Cost Recovery Fee Study (CEDD)		20	20	
Total Proposed Cost Reductions	58	1,136	1,136	
<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	-	972	10,841	³
Total Other One-time Sources	3,166	7,187	17,056	
Total Balancing Measures	\$ 5,394	\$ 10,494	\$ 20,363	

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.

In addition to the budget savings from vacancies in the amount of \$1.9 million, the City is anticipating a net savings of \$270,000 from the OCFA contract.

The proposed cost reductions are consistent with 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 Main Street Parking Lot project; and
- Deferral of cost recovery fee study.

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:

- \$500,000 reserved for potential lawsuit. With the establishment of the City's General Fund Reserves Policy, sporadic reserves are no longer necessary;
- \$2.5 million from the Fleet internal service fund's fund balance that can be returned 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. 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.

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 proposed balancing measures will be presented in our upcoming budget study session for consideration.

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 update will also provide some basis for discussion in the June 2, 2020 budget study session. The approval of the FY2020-21 Continuation Budget is scheduled no later than June 23, 2020.

RECOMMENDATION

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