COUNCIL REPORT

CITY OF MOUNTAIN VIEW

DATE: May 5, 2020

CATEGORY: New Business

DEPT.: City Manager's Office
Finance and Administrative Services

TITLE: **Fiscal Year 2019-20 General Operating Fund (GOF) Budget Status Update Report on the Impacts of COVID-19**

RECOMMENDATION

1. Receive the Fiscal Year 2019-20 General Operating Fund Budget Status Update Report on the Impacts of COVID-19.

2. Approve reversal of a budgeted $3.0 million transfer from the General Operating Fund to the Capital Improvement Program Reserve in the Fiscal Year 2019-20 Adopted Budget in order to maintain a balanced budget in Fiscal Year 2019-20. (Five votes required)

3. Approve the recommended framework for development of the Fiscal Year 2020-21 Operating Budget.

4. Direct staff to provide the City Council with quarterly budget updates in Fiscal Year 2020-21 to assess the potential ongoing financial impacts of COVID-19.

BACKGROUND

This report provides an update of the City's budgetary position for the current fiscal year in light of the estimated financial impacts of the COVID-19 crisis and provides a framework for development of the Fiscal Year 2020-21 Proposed Budget taking into account the ensuing fiscal climate.

The General Operating Fund (GOF) is the single largest City fund and provides funding for core services, including Police, Fire, Parks, Recreation, Library, Planning, Public Works, and all City Administration functions. The City's financial health, and the GOF in particular, is shaped in large part by positive and negative economic forces. Many of the City's revenues are driven by the economic climate of Silicon Valley, the greater Bay Area, and the State.

During the dot-com boom, City revenues, most notably Sales Tax revenue, grew significantly and then, just as significantly, declined with the dot-com bust in 2002. During the Great Recession of 2008, the City's GOF faced structural deficits before corrective actions were taken for four consecutive fiscal years.

In strategically and proactively addressing the ongoing structural deficits during the Great Recession, the City was able to better position itself for the economic recovery in the ensuing years leading up to today. In addition, the City's long history of sound fiscal practices and budget discipline have allowed the City to maintain its AAA credit rating, a status only a fraction of other California cities can claim.

In the Midyear Report presented to the City Council on February 11, 2020, staff noted that revenues were continuing to grow but at a slower pace. At that time, there were signs of a general slowing that were reflected in the preliminary GOF forecast for Fiscal Year 2020-21. Since the Midyear Report, there is even more uncertainty regarding the overall economic outlook and impact to the City's budget due to the COVID-19 global pandemic, which is poised to become the steepest economic downturn since the Great Depression.

In the last few weeks, the economic impact to the Federal, State, and regional economies has been unparalleled and continues to remain uncertain. At the end of April, more than 26 million Americans lost their jobs and filed for unemployment benefits, including more than 3.5 million Californians. In Mountain View, businesses have closed, and thousands of residents have lost their jobs. The stock market has lost several trillion dollars in a few short weeks; the Federal Open Market Committee (FOMC) reacted sharply with a 50-basis-point reduction in the Federal Funds Discount Rate (Discount Rate) on March 3, 2020 and again on March 15, 2020 with an additional 100-basis-point reduction, impacting the City's investment income.

The City declared a local emergency on March 12, 2020, and a Countywide shelter-in-place order began on March 17, 2020. Since the shelter-in-place order was implemented, the City's revenues have been negatively impacted. Sales tax revenue has sharply declined as nonessential businesses and some restaurants have closed or ceased providing services. Conferences, business travel, and large group gatherings have been halted or canceled, impacting hotel stays and reducing Transient Occupancy Tax (TOT) revenue. In addition, Charges for Service revenue has also been impacted as Recreation events and classes were canceled and refunds processed.

Due to the timing of when these revenues are received, staff can only make assumptions on the potential full impact of COVID-19. In making these assumptions, staff received information from the City's revenue consultants and reviewed how the City's revenues were impacted in prior recessions, taking into consideration how revenues may be impacted differently due to the unique and unprecedented circumstances of COVID-19.

ANALYSIS

Staff continually monitors GOF revenues and expenditures throughout the year. Notably, estimates at this time are difficult to confidently project due to the uncertainty of the current economic climate and length of time the shelter-in-place order will continue, as both the short- and long-term impacts on the State and regional economy are unknown. For this update, staff is using best estimates and will continue to modify assumptions over the next several months as additional information becomes available.

Summary of Fiscal Year 2019-20 Financial Position

In February, GOF revenues were estimated to be approximately $149.0 million and are now estimated to be $141.3 million, a $7.7 million decrease from the Midyear Estimate, and $7.0 million (4.7 percent) lower than Adopted.

In February, GOF expenditures were estimated to be $134.7 million and are now estimated to be $134.1 million, a $600,000 decrease from the Midyear Estimate and $1.3 million (1.0 percent) lower than Adopted.

The Adopted Budget includes a $4.0 million additional pension contribution to the California Public Employees' Retirement System (CalPERS), which has already been paid, and transfers of $1.0 million to the General Non-Operating Fund for the Sustainability Capital Project, $2.0 million to the General Fund Reserve bringing the reserve just above the minimum 20 percent reserve threshold, and $3.0 million to the Capital Improvement Reserve.

A positive net operating balance, coupled with estimated expenditure savings, offsets a portion of the lower revenue estimate; however, not all of the previously adopted reserve transfers can be made while still maintaining a balanced budget. Therefore, staff recommends reversing the $3.0 million adopted transfer to the Capital Improvement Reserve, which is not needed for capital operations in Fiscal Year 2020-21, in order for the GOF to remain balanced at fiscal year-end. With this recommendation, the Fiscal Year 2019-20 budget is projected to have a $175,000 net operating balance.

A comparison of the current fiscal year Adopted, Midyear Estimated, and Updated Estimated (dollars in thousands) is shown below.

	2019-20 Adopted Budget	2019-20 Midyear Estimated	2019-20 Updated Estimated	Variance of Updated from Midyear	Percent Change
Revenues	$148,324	$148,959	$141,300	$(7,659)	(5.1%)
Expenditures[1]	(135,415)	(134,724)	(134,125)	599	0.4%
Operating Balance	12,909	14,235	7,175	(7,060)	(49.6%)
Transfer to GNOF[2]	(1,000)	(1,000)	(1,000)	-0-	0.0%
Transfer to GF Reserve	(2,000)	(2,000)	(2,000)	-0-	0.0%
Transfer to Cap Imp Res	(3,000)	(3,000)	-0-	3,000	100.0%
CalPERS Contribution	(4,000)	(4,000)	(4,000)	-0-	0.0%
Ending Balance	$ 2,909	$ 4,235	$ 175	$(4,060)	(95.9%)

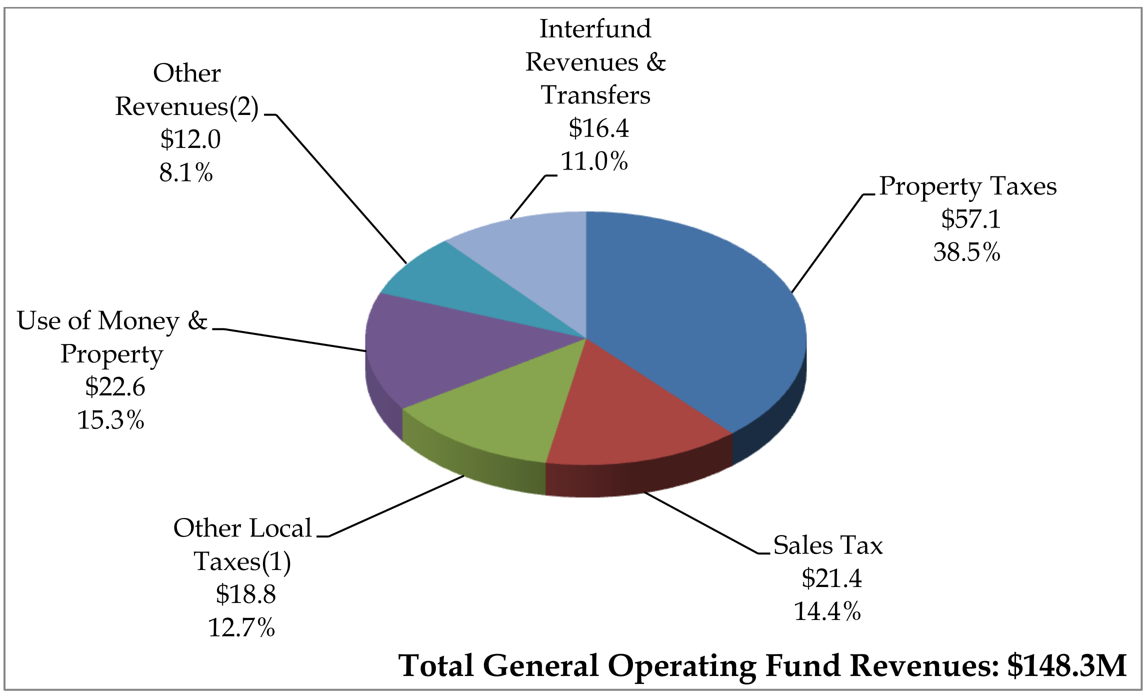
(1) Adopted Budget includes $2.3 million in estimated budget savings.
(2) Additional $1.0 million for total $7.5 million for the Sustainability Capital Project.

Revenues

Overall, total GOF revenues for Fiscal Year 2019-20 are currently estimated to be $7.7 million (5.1 percent) lower than the Midyear estimated and $7.0 million (4.7 percent) lower than adopted revenues.

A summary of the major categories of GOF Revenues for the Fiscal Year 2019-20 Adopted Budget is as follows:

Fiscal Year 2019-20 General Operating Fund Adopted Revenues
(dollars in millions)



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[1] Other Local Taxes consist of Transient Occupancy Tax, Business Licenses, and Utility Users Tax.
[2] Other Revenues consist of Licenses, Permits & Franchise Fees, Fines & Forfeitures, Intergovernmental, Charges for Services, and Miscellaneous Revenues.

The table below is a comparison of the Fiscal Year 2019-20 Adopted, Midyear Estimated, and Updated Estimated for GOF major revenue categories (dollars in thousands).

	2019-20 Adopted Budget	2019-20 Midyear Estimated	2019-20 Updated Estimated	Variance of Updated from Midyear	Percent Change
Property Taxes	$ 57,091	$ 54,673	$ 54,230	$ (443)	(0.8%)
Sales Tax	21,433	22,656	19,417	(3,239)	(14.3%)
Other Local Taxes	18,771	18,535	15,698	(2,837)	(15.3%)
Use of Money and Property	22,657	22,987	22,171	(816)	(3.5%)
Licenses, Permits, and Fees/Fines and Forfeitures	6,420	6,424	6,334	(90)	(1.4%)
Intergovernmental	522	668	824	156	23.4%
Charges for Service	3,081	2,997	2,200	(797)	(26.6%)
Miscellaneous Revenues	1,989	3,023	3,140	117	3.9%
Interfund Revenues and Transfers	16,360	16,996	17,286	290	1.7%
Total Operating Revenues	$148,324	$148,959	$141,300	$(7,659)	(5.1%)

A brief explanation of the assumptions and changes for Fiscal Year 2019-20 follows:

Property Taxes are the largest contributor to the City's revenue stream, accounting for almost 39.0 percent of the City's GOF revenue. Property tax revenue is estimated at $54.2 million, slightly lower than the Midyear estimate of $54.7 million and $2.9 million (5.0 percent) below budget. Secured and unsecured property taxes are based on assessed value as of January 1, 2019 and, therefore, Fiscal Year 2019-20 revenues are not impacted by COVID-19. The Assessor's Office expects increases in unsubstantiated appeals due to layoffs, bad economic news, and difficulty servicing debt though Fiscal Year 2020-21. At this time, Governor Newsom has not indicated that there will be State action to defer property tax payments to local agencies. Should this occur, the negative impact to the City would be significant and immediate unless the State provided a backfill for any revenue deferral; however, since the last recession, additional Constitutional protections were enacted for local governments, making it more difficult for the State to divert local revenues.

Use of Money and Property is the second largest contributor of the City's revenue stream, representing approximately 15.0 percent of GOF revenues. This revenue is comprised of Investment Earnings and Rents and Leases and is estimated at $22.2 million, $816,000 (3.5 percent) lower than the Midyear estimated and $486,000 (2.1 percent) below budget.

Investment Earnings revenue is estimated to be essentially the same as Midyear. As noted previously, the FOMC reduced the benchmark interest 150 basis points in March 2020. However, the impact will be more significant in future years as investments mature and are replaced with lower-yielding investments.

Rents and Leases revenue is estimated to be $869,000 (4.4 percent) lower than Midyear. While most of the long-term leases are expected to continue without disruption, there have been requests to defer several lease payments due to the impact of COVID-19 and the City's shutdown of rental facilities. The update assumes no short-term facility rental revenue for the remainder of the fiscal year.

Sales Tax revenue is the third largest contributor to the GOF revenue stream, representing approximately 14.0 percent of the budget. This revenue is estimated to be the most negatively impacted by COVID-19, primarily due to the closure of retail stores and restrictions on restaurants. Sales tax is currently estimated at $19.4 million, $3.2 million (14.3 percent) lower than Midyear and $2.0 million (9.4 percent) below budget. The updated estimate assumes the shelter-in-place mandate will continue through May. Additionally, on April 2, 2020, Governor Newsom announced the State would allow small businesses with less than $5.0 million in taxable annual sales to defer payment of sales and use taxes up to $50,000 for up to 12 months. The estimate includes the State's recent actions related to deferral of these sales tax payments. This payment deferral is expected to be remitted in Fiscal Year 2020-21.

Other Local Taxes revenue is estimated at $15.7 million in total, $2.8 million (15.3 percent) lower than the Midyear estimated and $3.1 million (16.4 percent) below budget.

Transient Occupancy Tax (TOT) revenue will be severely impacted by COVID-19 as hotel occupancy has plummeted, room rates have declined, business travel has halted, and conferences and large events have been canceled. The updated estimated is $2.9 million (34.5 percent) lower than Midyear and assumes 50.0 percent of expected remittances for the quarter January through March, and 10.0 percent of expected remittances for the quarter April through June.

Utility Users Tax (UUT) revenue is estimated to be essentially the same as Midyear.

Business License revenue is estimated to be essentially the same as Midyear as most of this tax is paid once a year with renewals in January.

Licenses, Permits, and Fees/Fines and Forfeitures revenue is estimated to be $90,000 (1.4 percent) lower than Midyear primarily due to decreased Franchise Fee revenue from Recology due to less construction activity, lower debris box revenue, and businesses that have closed, resulting in lower garbage service revenue.

Intergovernmental revenue is estimated $156,000 (23.4 percent) higher than Midyear due to the City once again assigning an Officer to the Regional Auto Theft Task Force (RATTF) in November which will be reimbursed from the Santa Clara County Specialized Enforcement Team Task Force.

Charges for Services revenue is generated by fees assessed for Recreation and other types of services and is estimated to be $797,000 (26.6 percent) lower than Midyear primarily due to canceled Recreation programs. This is in addition to the Midyear estimated lower than budget revenue of $143,000 due to Short-Term Rental (STR) registration decreases.

Miscellaneous Revenues were estimated at Midyear to be $1.0 million (52.0 percent) higher than the Adopted primarily due to grants, donations, and expenditure reimbursements received that are not budgeted due to the uncertainty of receipt. The updated estimate is $117,000 (3.9 percent) higher than the Midyear estimate due to the net of more expected donations and reimbursements, offset primarily by no Amphitheatre reimbursements from Live Nation and no Center for the Performing Arts services for the remainder of the fiscal year.

Interfund Revenues and Transfers are estimated $290,000 higher than Midyear due to higher capital improvement project overhead trending and a City Council-approved midyear transfer of $225,100 from the General Fund Reserve for the Community Stabilization and Fair Rent Act amendments.

Expenditures

Total operating expenditures for Fiscal Year 2019-20 are estimated to be lower than the Midyear estimated and Adopted Budget.

Salaries and Benefits expenditures are estimated at $103.9 million, $4.2 million (3.9 percent) and $3.9 million (3.6 percent) below the Adopted and Adjusted Budgets, respectively. This is the result of vacant positions and some personnel turnover during the first half of the fiscal year. There are currently 74 vacancies and 25 active recruitments to fill 41 current and anticipated vacancies. Recruiting has slowed down as Human Resources staff are filling positions now on a case-by-case basis, prioritizing sworn safety positions, essential service positions, or other positions that are critical in responding to the COVID-19 pandemic. Although some savings are expected annually and included in the Adopted Budget, it is not possible to precisely predict the level and impact of vacancies.

Although all of the additional expenditures related to COVID-19 are not yet known, some funding allocations have been made for programs to help residents and businesses. The City Council has authorized $1.6 million for rent relief from Housing and Community Development Block Grant funds, with another $1.0 million of potential funding on tonight's agenda from Successor Agency funds. Another $800,000 was authorized from the General Non-Operating Fund for small business assistance, landlord assistance, safe parking, utility bill relief, mobile hygiene and sanitation services, and food voucher programs.

Additional employee costs, such as overtime, may be eligible for reimbursement from the Federal Emergency Management Agency (FEMA). The City's Emergency Operations Center (EOC) has distributed forms for departments to track time and specific tasks related to the COVID-19 response effort. It is anticipated that any overtime incurred by City employees will be requested for reimbursement by FEMA; up to 75 percent reimbursement is normally allowed. Certain supply costs may also be reimbursed by FEMA, including safety and hygiene supplies. Approximately $470,000 of General Operating Funds have been used due to COVID-19-related expenditures.

It is impossible at this point to determine how much funding, if any, will ultimately be available to the City for COVID-19-related costs. At the time of this report, there was no Federal stimulus package yet available to provide funding to cities with less than 500,000 residents; staff continues to monitor developments at the Federal level and is actively working with our Federal legislative delegation to advocate for Federal funding for COVID-19-related activities and services.

Due to the estimated $7.7 million revenue decline this fiscal year, all the transfers included in the Adopted Budget can no longer be afforded. As previously mentioned, staff recommends reversing the $3.0 million transfer to the Capital Improvement Reserve in order for the GOF to remain balanced. With this recommendation, the GOF is estimated to have a $175,000 ending balance.

Although the City generally ends the fiscal year with an operating balance greater than budgeted, that is likely not to be the case this fiscal year. It is important to note the carryover balance is the funding source for key organizational needs, such as limited-period (one-time) expenditures in the next fiscal year, replenishing reserve levels, funding one-time capital projects, and contributions towards unfunded liabilities.

<u>Potential California Public Employees' Retirement System (CalPERS) Impact</u>

CalPERS portfolio earnings have been significantly impacted by the COVID-19 crisis. For the first six months of the fiscal year, the CalPERS portfolio investment earnings were nearly 6.0 percent but are now currently negative 4.0 percent year to date. Actual returns for Fiscal Year 2019-20 will be reported in July 2020 and, although the market did recover some of the initial losses from a couple of months ago, it is expected that the returns will remain negative.

In comparison, with the downturn in the market in Fiscal Year 2008-09, CalPERS investment losses were 28 percent. Since that time, CalPERS has positioned itself to cushion such market volatility by reducing the discount rate (the assumed investment rate of return) from 7.5 percent to 7.0 percent, among other strategies.

In June 2019, the CalPERS Investment Committee began preparing for another market downturn and implemented a long-term investment plan, which includes more diversified investments and maintaining liquidity. CalPERS has indicated that it is not considering possible changes to the discount rate in the short term, but possible changes will be considered in future scheduled reviews.

The City's annual total expected pension contribution is $29.4 million for Fiscal Year 2021-21. CalPERS will determine future City pension contributions in the annual valuations, which typically are received in November. The CalPERS investment losses experienced this fiscal year will impact the City's annual required contribution in Fiscal Year 2022-23. Investment losses are amortized over 20 years with a five-year ramp-up period to soften the impact, then level amortization the next 15 years. A 5.0 percent CalPERS investment loss is estimated to increase the City's rates (absolute rate change, not percentage rate change) 6.5 percent for the Miscellaneous Plan and 11.5 percent for the Safety Plan by the end of the five-year ramp-up period (Fiscal Year 2026-27).

For Fiscal Year 2020-21, which is based on the valuation for the year ending June 30, 2018, the City's Miscellaneous Plan funded status is 71.8 percent and for the Safety Plan is 69.4 percent (average for both Miscellaneous and Safety plans is 70.7 percent). A 5.0 percent investment loss could reduce the City's funded status by approximately 8.0

percent to 63.8 percent and 61.4 percent for Miscellaneous and Safety, respectively, based on information provided by CalPERS. The City has made great strides in funding the CalPERS liability and will continue to do so as funds are available.

Fiscal Year 2020-21 Impacts and Budget Development

The City Council has a history of taking intentional, proactive, and strategic steps to ensure the City's fiscal sustainability, including diversifying its revenue base, adopting a structurally balanced annual budget, funding long-term needs, and maintaining healthy reserve levels. These practices have positioned the City to fare better than some agencies in the economic disruption caused by the COVID-19 pandemic.

Consequently, current projections indicate the City can maintain current service levels in Fiscal Year 2020-21 with sufficient revenues to fund operating expenditures, including salary and benefit costs and other priorities. Notably, unlike in past years, there is expected to be a limited amount of funding available for long-term liabilities and strategic reserves.

The Fiscal Year 2019-20 revenue impacts discussed earlier in this report are expected to continue into Fiscal Year 2020-21, and there is a high degree of uncertainty as to the ultimate magnitude and duration of these impacts. Compared to the preliminary Fiscal Year 2020-21 forecast presented with the Midyear Report, GOF revenue for next fiscal year is now forecast to be $7.1 million lower (reduced from $152.6 million to $145.5 million). This is based on the assumption that the shelter-in-place order will end before June 30, 2020, followed by a transition period before businesses are able to resume. If the resumption of local economic activity is delayed further, there will be greater reductions to GOF revenue, with Sales Tax, Transient Occupancy Tax, Recreation Revenues, Rents and Leases, and Business License Tax revenues decreasing further the longer the situation persists.

Given the financial impacts and uncertainty related to COVID-19, staff is developing the Fiscal Year 2020-21 Proposed Budget as largely status quo with some exceptions for limited-period, critical, operating needs and resources necessary to respond to community and organizational priorities (as summarized below).

Taking into account the ongoing crisis we are currently experiencing, development of the Fiscal Year 2020-21 Proposed Budget incorporates the following priority areas:

- Essential service delivery and COVID-19 community response efforts, including services for the vulnerable population

- Return or recovery of Citywide operations once the shelter-in-place order is modified

- Economic development and small business strategy efforts

- Public communications, engagement, and community-building

- Strategic planning for the future, with an emphasis on innovation, efficiency, and operational improvements designed to better serve the community and achieve desired outcomes as we adapt to the crisis and the "next normal"

If additional adjustments for Fiscal Year 2020-21 are determined to be necessary, they may be requested and assessed at midyear, or sooner, if essential and feasible based on the City's fiscal condition. To maintain a focus on the fiscal condition, staff recommends bringing quarterly updates to Council to maintain an ongoing conversation regarding potential budget impacts and necessary adjustments.

To the greatest extent possible, staff will continue to address the City Council's Major Goals Work Plan in the Proposed Budget and in the months ahead; however, the COVID-19 situation has dominated staff workloads during the past couple of months and will continue to do so over the next fiscal year. For that reason, departments are currently assessing the Council Major Goals Work Plan to determine the feasibility of previously adopted time frames and deliverables for the 70 existing projects and initiatives in the work plan; some adjustments will need to be made and certain projects postponed. The updated work plan will be brought to the City Council for consideration with the Proposed Fiscal Year 2020-21 Budget on June 9, 2020.

Projected Future Budget Shortfalls

The City is fortunate to have experienced a number of years of significant revenue growth which has enabled it to make additional annual contributions towards unfunded pension liabilities and adequately fund essential reserves. The City's history of being fiscally prudent and maintaining financial discipline will help the City in weathering the current economic downturn in the near term over the next fiscal year; however, budget deficits are projected in future years beyond Fiscal Year 2020-21.

Forecasting revenue shortfalls has become increasingly difficult given the uncertainty surrounding the duration and impacts that COVID-19 will have in the short and long term. The forecast is currently being developed at a time of extreme uncertainty and does not include additional COVID-19 related expenditures that are yet unknown and may occur as the City continues to respond to the current emergency.

At this time, preliminary analysis of the budget indicates the City will experience a budget deficit starting in Fiscal Year 2021-22 of approximately $1.5 million and grow to approximately $2.4 million in Fiscal Year 2022-23. Staff is continuing to refine the City's five-year forecast, and these projections will change as more information is known. Staff will present more detailed information on the forecast with the Fiscal Year 2020-21 Proposed Budget in June.

FISCAL IMPACT

The various fiscal impacts are identified and discussed within this report.

ALTERNATIVES

1. Do not acknowledge and file the Fiscal Year 2019-20 GOF Budget Status Update Report on the Impacts of COVID-19.

2. Provide other direction.

PUBLIC NOTICING—Agenda posting.

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