



Staff Report

TO: Mayor, and City Council Members
FROM: Jeff Mohlenkamp, Finance Director
DATE: April 21, 2020
SUBJECT: **FY 2021 Budget Discussion**

Background and Analysis:

Staff is preparing the budget for FY 2021. The process has been directly impacted by the COVID-19 emergency and the resulting economic impacts. On March 17, 2020, the City Council discussed the budget process and generally acknowledged that the City would prepare a budget that contemplated moderate economic activity, necessitating some cost reductions.

Since the March 17, 2020, meeting many events have transpired that have caused a significant deterioration in the economic outlook. Most notably, State and County officials have issued guidance and orders to achieve social distancing and to slow the rate of infection. This has resulted in the significant disruption to Beaumont's business sectors. It is unclear at this time when business will resume normal operations and the degree to which Beaumont's economy will be impacted. This lack of certainty coupled with the possibility that the Nation, State and City are at the start of a deeper economic recession, has caused management to further evaluate the budget assumptions.

The City's reserve policies have been implemented to allow the weathering of limited-scale economic downturns. However, the impacts of the COVID-19 pandemic exceed the scope and scale contemplated and it is prudent to reduce expenditures in order to ensure that critical services and operations are maintained. Further, staff has re-evaluated the General Fund long term financial forecast and identified some structural financial challenges that need to be addressed to ensure long term viability of desired levels of services.

This report provides the following sections:

- Overview of the initial General Fund budget and discussion of potential reductions to ensure a balanced budget,

- Review of the General Fund long term financial forecast and the impacts of Covid-19 on the future of the City's finances,
- Overview of the Wastewater Fund budget and discussion of options to address anticipated shortfalls, and
- Review of options to address City capital facility and infrastructure needs.

FY 2020-21 General Fund Preliminary Budget

Staff has reviewed projected revenues and compiled the initial expense budget from the departments. The initial budget proposals, prior to management adjustments, provides for a budget deficit of (\$2.8 million). Initial departmental proposals typically outpace revenues and a comprehensive process is implemented to provide a balanced, sustainable budget pursuant to budgetary assumptions affirmed by the City Council. However, this year's deficit is magnified by the impending COVID-19 recession.

Revenues

For next year, the revenues most significantly impacted by the recession include sales tax and fees related to development activity. Sales tax is expected to drop by (22%) from the highs experienced in FY 2019. Development related fees have dropped in FY 2020 from previous highs during FYs 2018 and 2019 but are expected to remain lower due to the lasting impacts from COVID-19.

Property taxes are not impacted by COVID-19 for FY 2021 as the assessment was already completed January 1, 2020. Increases in property taxes along with growth in Community Financing District (CFD) funds provide for some overall growth in revenues.

Normal recurring revenues are expected to grow by 4.5% from \$31.6 million to \$33.0 million for FY 2021.

Expenses

Expenses are divided into personnel costs and operating costs. Personnel costs are currently budgeted to grow at a rate of 7.3% or \$1.45 million. This growth is driven by increases in wages at 5.1% and increases in non-wage costs such as workers compensation at 21.6%.

Budgetary proposals result in an increase to operating costs of 11.4% or \$ 1.5 million. This is driven by increases in contractual services.

Note: a significant portion of the increase in operating costs is the change in how administrative charges to the wastewater fund and transit fund are handled. In prior years they were reflected as a negative expense. Beginning with FY 2021, this will be handled as a transfer in and expenditures will not be impacted.

A summary of General Fund budgeted revenues and expenditures prior to budget reductions is included as Attachment A.

General Fund Long Term Financial Forecast

In December 2019, staff provided the City Council a 10-year forecast for the General Fund. The forecast contemplated a moderate level recession that would occur in FY 2023. Due to the COVID-19 emergency, staff has re-evaluated this forecast to demonstrate the impacts of the recession that is beginning to materialize throughout the country.

The COVID-19 driven economic impacts are far more dramatic and sudden than the recessionary trend contemplated in the earlier forecast. Staff feels that the economic impacts will be felt over the next two fiscal years, especially as the impacts of growing unemployment and decreased property values will be fully realized in FY 2022. This will result in some lingering impacts in FY 2022.

The key takeaways from the forecast are that growth in expenses are projected to outpace growth in revenues and result in annual deficits. Even with limited growth to wages and no new positions or augmentation to services these forecasted deficits could eliminate financial reserves in a matter of 4 to 5 years. To address this structural challenge in the City's finances, it will be important for the City Council to consider adjustments in both the revenue and expense sides of the equation.

The revised General Fund Long Term Financial Forecast is included as Attachment B. The assumptions used to build the forecast are included as Attachment E.

Possible Expense Reductions

To address the short-term financial challenges and the longer-term structural challenges, the City Council should consider adjustments to reduce expenditures. Staff

has been working on possible reduction scenarios that address both personnel and operating costs.

Since the more significant financial challenge facing the City is in the long term, management recommends the City Council consider reductions that will be sustainable and reduce the longer-term expenses of the City. This would suggest evaluating the following options:

- Evaluate services the City can reduce or eliminate – non-essential services, and
- Evaluate services the City can perform at a lower cost – either through bringing the service in-house or outsourcing.

Attachment C provides a few scenarios of possible reduction strategies. Note, that at this time staff has been focused on cuts that will reduce expenses in the short term. This is prudent as it will help to reduce use of reserves and provide additional time for management and the City Council to more fully evaluate the more sustainable, long-term adjustments.

Wastewater Fund Preliminary Budget

The initial Wastewater Fund budget provides for an increase in revenues of 5.2% from \$9.9 million to \$10.4 million. This is driven by a scheduled rate increase and new development. This estimate was decreased due to expected slowing of development activity and increased delinquencies.

Expenses are expected to decrease by (1.9%). This is due to savings in personnel costs and the rescheduling of capital projects, deferring them to FY 2022 and beyond. The overall budget is projected to have a surplus of \$3,311. Wastewater DIF funds of \$700,000 are scheduled for a portion of the debt service payments, as was contemplated in the Fund's fiscal forecast. Ultimately, utility rates will be required to cover the entirety of the obligation.

During FY 2021, staff will be closely reviewing the costs to operate the system and plan to re-evaluate the rate study to ensure the long-term financial stability of the fund.

An initial summary of the FY 2021 Wastewater Fund budget is included as Attachment D.

Fiscal Impact:

There is no fiscal impact associated with this item at this time.

Recommended Action:

Review the initial FY 2021 budget for the General Fund and Wastewater Fund,
Review the revised General Fund Long Term Financial Forecast, and
Provide guidance to staff regarding budget assumptions.

Attachments:

- A. FY 2021 General Fund Initial Budget Summary
- B. Revised General Fund Long Term Financial Forecast
- C. Cost Reduction Concepts
- D. FY 2021 Wastewater Fund Initial Budget Summary
- E. General Fund Long Term Financial Forecast Assumptions