



Staff Report

TO: City Council
FROM: Jeff Mohlenkamp, Finance Director
DATE: October 8, 2020
SUBJECT: Discuss and Provide Direction to Staff Regarding FY 2022 Budget

Background and Analysis:

This workshop is designed to provide the City Council with an update regarding the current financial condition of Beaumont, to discuss some recommended budget adjustments and to begin the discussion of long-term financial planning, including future allocation of one-time resources.

This report provides the following sections:

1. Historical Background – highlights General Fund results from recent past years;
2. Estimated General Fund and Wastewater results for FY 2020;
3. Discussion of the Covid-19 pandemic, its results on financials to date and unknowns regarding future impacts;
4. Adjustments to the General Fund long term financial forecast;
5. Estimate of FY 2021 General Fund results and proposed budget adjustments;
6. Estimate of FY 2021 Wastewater Fund results and proposed budget adjustments;
7. Early discussion of FY 2022 budget and beyond; and
8. Discussion of allocating General Fund and CFD Fund unrestricted balances.

Historical Background

At the conclusion of FY 2016, the City had a General Fund deficit in excess of \$4 million. By the end of FY 2018 the General Fund had a reserve balance of \$10.5 million. This was a \$14.5 million turn-around in the City finances over a two-year period of which approximately \$8.1 million of was one-time revenues. The remaining \$6.4 million is the result of operating surpluses through cost saving measures deployed by the City and increases in revenues supporting operations.

At the conclusion of FY 2019 the General Fund had an unassigned balance of \$15.3 million.

Unassigned General Fund Balance (ending balances, including transfers)

FY 2016 - (\$ 4,070,636)

FY 2017 - \$ 5,247,540 – included \$8.1 million in one-time items to the General Fund

FY 2018 - \$10,531,271 – no one-time adjustments

FY 2019 - \$15,284,159 – no one-time adjustments

Projected General Fund Results from FY 2020

The General Fund is projected to have an operating surplus of approximately \$8.5 million from FY 2020. Revenues are projected to be \$39.6 million and expenses \$31.1 million. Of this surplus, fully \$6.3 million is considered one-time in nature. This provides for a true operating surplus of \$2.2 million as follows:

Estimated GF Revenues -	\$39.6 million
Estimated GF Expenses -	<u>\$31.1 million</u>
GF Surplus-	<u>\$ 8.5 million</u>
Less: One-Time Solid Waste Retention Fee -	\$ 5.0 million
Less: One-Time Sales Tax Increase -	\$ 1.2 million
Less: Residual Solid Waste Revenues -	<u>\$.1 million</u>
Total One-Time Revenues	\$ 6.3 million
Surplus From Operations -	<u>\$ 2.2 million</u>
after eliminating one-time items	

After normalizing the impacts of the changes to solid waste FY 2020, revenues were slightly below those for FY 2019. The primary factors were increases in tax revenues that were more than offset by reductions in permitting/inspection revenues. Meanwhile, expenses increased by approximately 4.7%. The primary driver of this was increases in personnel costs.

This resulted in a comparable drop in ongoing operational surplus from over \$4 million in FY 2019 to \$2.3 million in FY 2020.

Projected Wastewater Fund Results for FY 2020

The Wastewater Fund is estimated to have a surplus from operations of \$590,000. This surplus is the result of revenues exceeding those budgeted by approximately \$400,000 and savings in both personnel and operating costs.

Revenues -	\$10.5 million
Personnel Costs -	\$ 1.6 million
Operating Costs -	\$ 3.0 million
Equipment and Capital Maintenance -	\$.8 million
Debt Service -	\$ 3.7 million
Committed to Capital Projects -	<u>\$.8 million</u>
Total Costs/ Commitments	<u>\$ 9.9 million</u>
Estimated Surplus -	<u>\$.6 million</u>

It should be noted that the current budget does not provide a structured approach to infrastructure replacement costs. Further, development impact fees were used to cover \$1 million of the fund's debt service obligation in FY 2020. This has been reduced to less than \$300,000 in FY 2021.

COVID-19 Pandemic Impacts and Unknowns Going Forward

The COVID-19 pandemic has been impacting the City and its finances since March. The impacts of State and Federal restrictions and resulting business interruptions was projected to directly impact sales tax revenues, transient occupancy tax (TOT) collections and to potentially stall development activity. To date the impacts to City finances have been less than expected. Commercial development activity implemented prior to the pandemic has continued; however, single family residential activity is on pace to be about half of what it was in 2019, 250 projected new home permits in 2020 as compared to 513 for 2019. Further, after eliminating one-time receipts, sales tax revenues are in line with the FY 2020 budget and approximately \$165,000 less than those for FY 2019. City staff assumes that Beaumont's relative stability in sales tax revenues experienced thus far may be attributed to the fact that the local retail market is serving the basic needs of the community. Beaumont is not very reliant on tourism or operations that rely on larger social gatherings. While service type businesses took some major hits and gas stations also fared poorly, most of our retailers suffered losses

that were less than expected. Further, some large retail/ wholesale businesses increased sales during the COVID-19 pandemic.

The City's finances are very reliant on property tax and CFD service charges. As a result, while short term impacts to consumer confidence and household income levels can weaken overall results. The primary concern for the City would be a longer term decrease in household income or other factors that weaken the housing market or disrupt the capital needed to fund development activity.

One of the reasons that COVID-19 has had limited impacts on City finances is the Federal stimulus packages. The enhancement to unemployment benefits, direct payments to taxpayers and other stimulus elements have artificially introduced a significant level of cash and liquidity to the market. While it is impossible to fully assess the impacts on consumer spending, it is likely significant.

Unknowns Going Forward

The COVID-19 pandemic is not over and it is unclear how this will unfold over the next 3 to 6 months. There is some evidence of another wave of COVID-19 infections which could very well lead to additional economic impacts and worsening financial performances. Some of the concerns to City finances are as follows:

- Uncertainty of continued Federal stimulus – it is not clear how much additional Federal stimulus will be provided to households and businesses,
- Long term impacts of massive Federal spending and resulting deficits – likelihood of inflation increases,
- Long term impacts of the Federal Reserve Bank keeping interest levels at historic low levels, and
- Likelihood of a structural recession within the next 3 to 4 years – this could have deeper impacts to the real estate market.

While COVID-19 impacts to Beaumont's economy have not been as significant as projected thus far, there is reason for continued caution as the unknowns are significant. This is particularly true given the fact that the Country has been highly reliant on Federal stimulus that cannot continue long-term. Further, economic policy to keep interest rates low and high liquidity in the market cannot continue long term. As a result, a more normal type of recession that is led by capital deficiencies, inflation and interest rate increases remains likely during the next several years.

Long Term Financial Forecast

While the City has enjoyed three years of operating surpluses in the \$2 to \$4 million range, the most recent pattern suggests that expenditure growth will outpace revenue growth leading to operating deficits within the next three to four years. This is especially true if the City seeks to maintain service levels to this growing community.

Even if the City were to hold the line on new positions and risk falling behind on service levels, the trendline and forecast suggests narrowing surpluses and possible deficits within 5 years.

The revised forecast assumes a moderate level recession that impacts the City in FY 2023 with lingering impacts through FY 2025. The impacts are initially felt in sales tax in the first year and to property related revenues in the second year. This model is consistent with the City's historical trends observed since 2000.

Staff also prepared a model that does not include a recession for comparison purposes. It is important to note that even a model that contemplates no recession still demonstrates narrowing surpluses. Those surpluses are consumed when adding any new positions or costs to keep pace with demand for services.

Core Assumptions Used to Build the Forecast Models

Each of the models prepared provides for moderate growth in revenues. The recession model provides for a higher growth profile before and after the contemplated recession, whereas the non-recession model assumes consistent growth.

Revenue Type	Recession Model (Average growth)	Non-Recession Model (Average growth)
Sales Tax	2.8%	4.8%
Property Tax/ VLF	3.3%	5.7%
Other Taxes/ Bus License	3.0%	3.0%
Permits and Fees (development related)	4.0%	4.8%
CFD Transfer	3.7%	4.0%
Charges for Services	3.0%	3.0%
Overall Average	3.1%	4.3%

The two forecasts provide for the same assumptions in estimating personnel costs, operating expenses and vehicle/equipment needs.

Expense Type	Average Growth
Personnel Expenses	
Salaries	4.0%
Pensions	7.5%
Health Insurance	5.4%
Other personnel	4.0%
Operating	
Contractual Services	5.0%
Utilities	3.5%
Insurance	4.0%
Repairs and Maintenance	2.5%
Other operating costs	2.5%
Vehicles and Equipment	3.0%
Overall Average	4.8%

As demonstrated above the forecast, with base level expenditures that does not include new positions or costs to maintain services provides for narrowing surpluses or deficits (Recession Model) as expenditure growth is likely to outpace revenue growth.

The costs to maintain services that includes adding positions and costs to maintain infrastructure provides for likely budget deficits in future years under both models.

The following table summarizes the results of the two forecast models, if positions and operating costs are added to maintain service levels:

FY	LTFF- Recession Model	LTFF – NO Recession (Moderate Growth)
2022	\$ 1,813,879	\$ 1,734,659
2023	(\$ 255,087)	\$ 212,056
2024	(\$ 3,586,818)	(\$ 376,596)
2025	(\$ 4,924,764)	(\$ 933,007)
2026	(\$ 5,230,058)	(\$ 1,560,808)
2027	(\$ 6,066,558))	(\$ 2,200,900)
2028	(\$ 6,957,913))	(\$ 2,918,089)

2029	(\$ 7,907,018)	(\$ 3,651,548)
2030	(\$ 8,906,717)	(\$ 4,457,725)
Cumulative - Surplus/(Deficit)	(\$42,021,084)	(\$14,152,047)

Attachment A provides the long-term financial forecast that includes a recession. Attachment B provides the model with no recession. Attachment C provides the assumptions for both models.

FY 2021 General Fund Initial Estimate

As the City was completing its budget for FY 2021, the COVID-19 pandemic was in its earliest stages. The level of uncertainty resulted in the City Council adopting a very conservative budget. The budget included significant reductions to revenue estimates and expenses.

At this time, City staff projects that FY 2021 revenues will exceed budget estimates by \$2.2 million. General Fund revenue trends are continuously monitored and adjustments will be made as is deemed prudent. The revised revenue estimates are based upon the following assumptions:

- **Sales Tax** - \$1,700,000 (the budget is \$4 million – projected to receive revenues of \$5.7 million),
- **Property Tax** - \$300,000 (the FY 2021 budget of \$6.1 million was already achieved in FY 2020, moderate growth provides for an increase of \$300,000,
- **Other taxes** - \$100,000 (utility users tax and franchise fees were estimated very low and the City is highly likely to exceed these targets as growth in the City continues at higher levels), and
- **Business license** - \$100,000 (revenues came in higher than expected in FY 2020 as new businesses more than offset any business closures, Staff do not see this trend changing in the near term as additional businesses have opened or are scheduled to open during FY 2021.)

Totals - \$2,200,000

Worsening economic conditions related to the COVID-19 pandemic would likely negatively impact these projections.

City staff is preparing budget adjustments for City Council consideration that would allocate approximately \$600,000 of this projected surplus. This includes the following key elements:

- Unfreezing 1 of 4 frozen Police Officer positions – December 2020,
- Authorize an overfill of two Police Officer positions due to additional vacancies – December 2020,
- Unfreeze a Streets Maintenance Worker position – December 2020,
- Unfreezing some Recreation Specialist positions beginning in March 2021,
- Add a Payroll Technician position to support inhouse payroll management – December 2020, and
- Targeted operational cost addbacks from cuts made in the budget – to support inspections and plan checks due to continued development activity.

Since these are ongoing costs, the full year costs for FY 2022 would be approximately \$1.0 million, which will increase incrementally in FY 2023 and beyond.

A summary of the proposed budget adjustments is included as Attachment D.

FY 2021 Wastewater Fund Initial Estimates

Revenues in FY 2020 have exceeded projections and expenses, provided operational savings implemented for the fiscal year. City staff is projecting that FY 2021 will realize retained revenues from \$300,000 to \$400,000.

Wastewater treatment plant management have identified critical needs in running the new sewer system to ensure operational integrity and to meet new regulatory requirements. City staff is proposing to add three positions to support operational needs as follows:

- Compliance Manager – this position would be responsible for monitoring and reporting on all of the required elements that are to be established by the Regional Water Quality Board through its issuance of Beaumont's new discharge permit;
- 2 Collections Maintenance Workers – these positions will provide maintenance services on the brine line and plant collection infrastructure to reduce wear and tear on the system. Two employees currently have responsibility to maintain 199 miles of sewer lines and soon to be 12 lift stations. Additional staffing will be

required to ensure proper functioning and reduce the risk of backup or overflow;
and

- Contract Costs – the wastewater plant is highly automated and will require external expertise to monitor and adjust the system. This will include extensive support over the next 6 to 9 months while configurations are being set and adjustments are critical.

The estimated cost for these added positions in FY 2021 assuming a start date of December 1, 2020, is approximately \$312,000. The full year estimate is \$ 460,000. See Attachment E for additional details.

FY 2022 Budget and Beyond

As evidenced from the long-term financial forecast, even the more optimistic models demonstrate financial challenges for the City in future years. This is especially true when considering the following key areas:

- The growth in population and commercial activity will demand additional police officers and related support services in future years;
- The City continues to add street miles and parks that will require maintenance and additional contracting and/or staffing resources in future years;
- Measure A funds to the City are set to decline pursuant to the settlement agreement with WRCOG, reducing funds to maintain our streets and roadways;
- The City is scheduled to begin construction on a new fire station in FY 2021 and will need to staff the station by early FY 2023;
- City facilities are aging and continue to require more maintenance than the current budget allows. A failure to maintain would likely result in higher long-term costs; and
- Information technology is of growing importance for the City and will require more investment to protect the information we manage and to provide continuity of services. This was made even more clear during the COVID-19 pandemic as the City has been highly reliant on technology to continue service levels to the community. Additionally, technological enhancements will likely be key to keeping pace with service demands in a more cost-effective manner.

While these needs and the absence of ongoing revenues to meet them is daunting, Beaumont is well positioned to address these issues in a structured and coordinated manner. To do so will require a clear look at what services the City needs to perform and to prioritize expenditures to make best use of resources.

It is likely that needs will outpace resources. In this event, the City will need to consider other sources of revenues.

Allocation of One-Time Funds

With the estimated results from FY 2020, the City has approximately \$18.5 million in unrestricted General Funds and \$7.5 million in unallocated CFD funds. If the City maintains a fund balance reserve threshold of 25% to 35% reserve in unrestricted General Funds, this would leave \$11 million in unrestricted reserves and allow the allocation of \$7.5 million to one-time projects. For the CFD unallocated funds, City staff is proposing the allocation of \$6.5 million, leaving \$1 million in unallocated CFD admin reserves.

Due to the long-term financial picture discussed above, City staff is proposing that a portion of these funds be placed into reserves designed for specific purposes. The remainder is recommended to be allocated to specific identified needs and to capital projects. Attachment F provides concepts of proposed allocations for City Council discussion.

Fiscal Impact:

There is no fiscal impact as this time.

Recommended Action:

Review the financial condition of the City and provide direction to staff regarding future budget decisions and allocation of one-time resources.

Attachments:

- A. General Fund Long Term Financial Forecast 2021-30 – Recession Model
- B. General Fund Long Term Financial Forecast 2021-30 – No Recession Model
- C. Long Term Forecast Assumptions
- D. Proposed General Fund Adjustments for FY 2021
- E. Proposed Wastewater Fund Adjustment for FY 2021
- F. Proposed Allocation of One-Time General Fund and CFD Unassigned Funds