



STAFF REPORT

June 22, 2022
File Number 0430-30

SUBJECT

FISCAL YEAR 2022/23 OPERATING BUDGET ADOPTION

DEPARTMENT

Finance

RECOMMENDATION

Request the City Council adopt Resolution No. 2022-69 approving the Fiscal Year 2022/23 Annual Operating Budget; and adopt Resolution No. 2022-70 approving the Appropriations Limit (Gann Limit) for Fiscal Year 2022/23.

Staff Recommendation: Approval (Finance: Christina Holmes, Director of Finance)

Presenter: Christina Holmes, Director of Finance

ANALYSIS

The proposed FY2022/23 Annual Operating Budget document can be viewed on the City's website at: <https://www.escondido.org/annual-operating-budget>.

On May 11, 2022, City Council was presented with an update on the annual budget process, General Fund Multi-Year Financial Forecast, and the Preliminary Operating Budget for FY2022/23. Operating revenue has not kept pace with the growing costs of providing City services, and as a result the General Fund long-term financial plan has projected annual deficits creating a structural budget deficit. To address this projected shortfall, the City has maintained a hardline on expenditures and staff are continuously seeking measures that ensure efficiency, while enhancing basic operations. Despite all of these measures, and the City's efforts to fund projects with grants and other sources of one-time funds, it has not been enough to meet growing costs and demand for services, the General Fund operating budget projected a net operating deficit of \$8.5 million. The City Council direction to Staff during the Preliminary Budget Workshop was to prepare a General Fund Operating Budget that closed the \$8.5 million deficit, without impacting the Public Safety departments and services, including Police, Fire, and Public Works.

In order to address the \$8.5 million General Fund deficit, Staff evaluated both projected operating revenue and the proposed operating expenses for FY2022/23. A detailed report of the proposed amendments and reductions is included at the conclusion of this staff report. Due to updated information received subsequent to the May 11, 2022 budget workshop, Sales Tax revenue was increased by



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\$1,000,000 and property tax revenue was increased by \$430,000. General Fund operating expense reductions of \$7,068,910 were recommended, summarized below.

	<u>Total Budget Reduction</u>
Fleet Services Vehicle Replacement Funds	(2,278,970)
Roof Repair of City Buildings	(550,000)
Cost Savings Budget Reduction	(1,000,000)
California Center for the Arts	(1,935,949)
Public Works Reduced Maintenance Positions	(427,500)
Items Removed & Reclassified	(1,317,491)
Total Budget Reductions	(\$7,068,910)

The proposed reductions and modifications to City services were sufficient to close the FY2022/23 budget gap. The following is a summary of the proposed sources and uses in the preliminary Operating Budget presented on May 11, 2022, the amendments to the preliminary budget, and the updated sources and uses presented on June 8, 2022:

	May 11, 2022 Preliminary Budget	Amendments	June 8, 2022 Proposed Budget
<u>Sources of Funds:</u>			
Operating Revenue	\$118,257,230	\$1,430,000	\$119,687,230
Deposit – PEG Fees	11,700		11,700
Transfer from Gas Tax Fund	2,055,000		2,055,000
Transfer from CFD No. 2020-1 (The Services)	285,000		285,000
TOTAL, Sources	\$120,608,930	\$1,430,000	\$122,038,930

<u>Uses of Funds:</u>			
Operating Budget	\$128,520,810	(\$7,068,910)	\$121,451,900
Transfer to Building Maintenance	86,880		86,880
Transfer to Reidy Creek Golf Course – Debt Service	362,750		362,750
Transfer to Successor Agency – Housing	25,000		25,000
Transfer to Vehicle Parking District	112,400		112,400
TOTAL, Uses	\$129,107,840	(\$7,068,910)	\$122,038,930

FY2022/23 General Fund Net Operating Deficit	(\$8,498,910)		\$0
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JUNE 8 BUDGET DIRECTION RECEIVED FROM CITY COUNCIL

After discussion and consideration of the recommended budget reductions, City Council directed Staff to modify the proposed FY2022/23 operating budget and offset some of the budgetary cuts recommended with the use of no more than \$5,000,000 in one-time funds from the American Rescue Plan Act (ARPA) funds and the Section 115 Pension Trust fund.

With the direction from City Council, Staff have evaluated the list of operating budget cuts and are recommending adding back the following items to the FY2022/23 operating budget, resulting in the use of one-time funds of \$3,735,030.

Fleet Services Fund – FY2022/23 Proposed Budget Reduction = \$2,278,970

Add Back Funding of \$1,214,500

To help alleviate budget shortages, available resources in the Fleet Fund have been used to balance prior year budgets. Since the Great Recession that began in FY2009/10, the Fleet Services Fund has minimized budgetary impacts to the General Fund by deferring purchases, reducing allocations, and using reserve balances.

In the preliminary FY2022/23 budget, the allocation from the General Fund to the Fleet Services Fund was increased by \$2.2 million to partially fund upcoming Police, Fire, and Street Maintenance vehicle purchases. One of the steps staff took to close the FY2022/23 General Fund deficit was to reduce this allocation to the Fleet Service Fund by the \$2.2 million and to instead utilize \$1.2 million from the Fleet Fund reserves in order to replace 20 police cars, 4 police motorcycles, 11 trucks, and 5 other pieces of equipment all of which are past their useful life.

Staff are proposing to increase the funding to the Fleet Services Fund to move forward with these purchases without the use of reserves of \$1,214,500.

Roof Repair of City Buildings – FY2022/23 Proposed Budget Reduction = \$550,000

Add Back Funding of \$550,000

The roofs of many City buildings are at the end of their useful life resulting in deterioration, leaks, and potential mold. In order to address the deferred maintenance of more than \$1 million in roof repairs, the FY2022/23 preliminary operating budget includes \$550,000 to address urgent repairs needed to prevent further damage.



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Historical Cost Savings Target – FY2022/23 Proposed Budget Reduction = \$1,000,000

Add Back Funding of \$400,000

Historically the City's practice has been to budget for the full cost of operating expenses. Items such as employee service savings resulting from vacant positions are not assumed in the operating budget or financial forecast with the goal of developing a conservative budget. The preliminary FY2022/23 Operating Budget presented in May used this same methodology.

To account for the annual expenditures savings, the preliminary operating budget presented on June 8 included a cost savings rate, or budget reduction, in recognition of these annual savings. The proposed FY2022/23 cost savings budget reduction is \$1 million, which excludes the Public Safety departments and services. Based on an analysis of the previous 5 fiscal years of savings, a Cost Savings Reduction line item has been added to individual departments in the General Fund.

Many municipal agencies utilize this budgetary practice of setting a target based on historical spending trends, but this represents a significant change in way the City does business. Therefore, Staff are recommending to include an offsetting Cost Savings Contingency amount of \$400,000 in the non-departmental section of the budget to give some flexibility in managing available resources to be used throughout the fiscal year under the direction of the City Manager.

California Center for the Arts, Escondido (CCAЕ) – FY2022/23 Proposed Budget Reduction up to \$1,900,000

Add Back Funding of \$1,570,530

The CCAE facility is owned by the City of Escondido and operated by the California Center for the Arts, Escondido, Foundation, Inc. (the "Foundation") under a Management Agreement. Financial support is provided to the Foundation from the City for various items, including a management fee paid to the Foundation for the operation of the Center, all gas and electric utility bills for the campus, and support from Building Maintenance and Network Administration, either through direct payments of operational costs or employee staff time. The following is a summary of those financial support items that were included in the preliminary FY2022/23 operating budget:

- Management Fee: \$788,370
- Gas & Electric Utilities expenses: \$810,000
- Building Maintenance Services: \$829,800
- Network Support Services: \$102,090

To address the General Fund deficit for FY2022/23, Staff proposed amending the management agreement with the Foundation to eliminate the management fee of \$788,370, transfer the responsibility of all gas & electric utility costs to the Foundation, as well as the direct maintenance expenses of approximately \$337,579 that are currently paid for by the City resulting in General Fund savings of approximately \$1,935,949.



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To allow time to work with the Foundation on a long-term solution to the operating and financial impacts to the City, all financial support items for the CCAE were added back to the General Fund operating budget. In addition, the Foundation has proposed an initial reduction in the annual management fee of \$133,000; from the Preliminary FY2022/23 budget amount of \$788,370 to \$655,370. The management fee will be disbursed to the Foundation in two installments, the first in July 2022 for half of the original proposed management fee (\$394,185) and the balanced of the reduced amount (\$261,185) in January 2023. Before the second disbursement of funds, the City and Foundation will negotiate a new management agreement to reflect these changes and also update the agreement on related matters.

The following is a summary of the financial support items to the Foundation that are now included in the proposed FY2022/23 operating budget:

- Reduced Management Fee: \$655,370
- Gas & Electric Utilities expenses: \$810,000
- Building Maintenance Services: \$713,270 (*modified number reflects updated Citywide allocations in the final proposed budget*)
- Network Support Services: \$102,090

FY2022/23 OPERATING BUDGET UNDER CONSIDERATION FOR ADOPTION

As detailed above, the following is a summary of the budgetary reductions that Staff have proposed adding back to the General Fund Operating Budget:

	Added Back
Fleet Services Vehicle Replacement Funds	\$1,214,500
Roof Repair of City Buildings	550,000
Cost Savings Budget Reduction	400,000
California Center for the Arts	1,570,530
Total Added Back to Budget	\$3,735,030

The staff recommendation is to utilize funds from the Revenue Loss provision of the American Rescue Plan Act to close the General Fund operating budget deficit in FY2022/23. The American Rescue Plan Act will provide the City one-time funding of \$38,808,509 to cover expenses in response to the COVID-19 pandemic, make up for lost revenue, and ease the overall economic impact from the pandemic. Funds may only be used for project costs initiated on or after March 3, 2021, and must qualify within one of the eligible expenditure categories described below. All funds must be fully spent by December 31, 2026.

The American Rescue Plan Act defines four broad use categories for the State and Local Fiscal Recovery Fund program: response to the public health emergency or its negative economic consequences; provision of premium pay to eligible workers; revenue replacement; and investments in water, sewer and broadband infrastructure. In September 2021, the City Council approved a spending plan of \$22,808,509



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and identified \$6,000,000 of funds to be used under the loss revenue category based on a calculation required by the Treasury Department, summarized in the table below.

Summary of American Rescue Plan Act Funds	
American Rescue Plan Act Allocation	\$38,808,509
Spending Plan Adopted September 2021	(22,808,509)
Earmarked for Loss Revenue	(6,000,000)
Remaining ARPA Funds Not Yet Allocated	\$10,000,000

Based on updated guidance from Treasury released in January 2022, a standard allowance can be elected by all recipients which permits the amount claimed under revenue loss to increase to \$10,000,000. The amount claimed under revenue loss can be used for “general government services,” which provides significant flexibility for municipalities. “General government services” includes any service traditionally provided by a government, other than a few exceptions explicitly identified by the Treasury. The Final Rule lists some common examples of “general government services,” including road building and maintenance and other infrastructure, health services, general government administration, staff and administrative facilities, environmental remediation, and provision of police, fire and other public safety services (including purchase of fire and police vehicles).

An update on the American Rescue Plan Act was presented to City Council on April 20, 2022. In August, Staff will return to City Council to give feedback and additional details on the requested direction to research funding programs or capital projects. In addition, Council will be asked to vote to finalize the calculation on revenue recovery options based on the January 7, 2022 Final Rule guidelines.

With the use of American Rescue Plan Act Funds of \$3,735,030, the updated FY 2022/23 Operating Budget Sources and Uses are as follows:

	June 8, 2022 Proposed Budget	Amendments	FY2022/23 Proposed Budget
<u>Sources of Funds:</u>			
Operating Revenue	\$119,687,230		\$119,687,230
Deposit – PEG Fees	11,700		11,700
<i>Transfer from American Rescue Plan Act</i>	-	\$3,735,030	\$3,735,030
Transfer from Gas Tax Fund	2,055,000		2,055,000
Transfer from CFD No. 2020-1 (The Services)	285,000		285,000
TOTAL, Sources	\$122,038,930	\$3,735,030	\$125,773,960



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Uses of Funds:			
Operating Budget	\$121,451,900	\$3,735,030	\$125,186,930
Transfer to Building Maintenance	86,880		86,880
Transfer to Reidy Creek Golf Course – Debt Service	362,750		362,750
Transfer to Successor Agency – Housing	25,000		25,000
Transfer to Vehicle Parking District	112,400		112,400
TOTAL, Uses	\$122,038,930	\$3,735,030	\$125,773,960

Until revenue is increased on an ongoing and structural basis, the City must continue to rely on short-term, one-time resources to continue operations and avoid drastic cuts to City services. To maintain a balanced budget and yet continue an appropriate level of service and address City priorities, the Fiscal Year 2022/23 budget utilizes funds from the American Rescue Plan Act, a short-term, one-time source of funds. There are also many much-needed items that are not included in the FY2022/23 proposed budget:

- critical infrastructure, equipment and vehicle, and repair needs
- deferred maintenance of current facilities and parks
- ongoing maintenance of new assets being added to the community
- underfunding reserve accounts
- ability to continue supporting community organizations and events
- addressing organizational capacity issues

In addition to the above, high priorities from the community are not being addressed. The City continues to strive to provide the level of service residents expect and deserve, but given the structural General Fund deficit, it is increasingly becoming more difficult to do so.

In keeping with our commitment to long-term planning, staff will continue to provide financial recommendations based on realistic revenue projections, risk assessments, and prudent spending to ensure a stable financial position. The community engagement and outreach regarding the City's budget and projected operating deficit will continue after this fiscal year's budget is adopted. The City Manager has set aside funds in the budget to enhance the dialogue with the community, evaluate the services the City provides, and determine the right size of the organization to continue to provide those critical City services while addressing the high priorities of the community.

Summary of Amendments and Budget Reductions Proposed on June 8, 2022

Sales Tax Revenue Forecast – FY2022/23 Budget Revenue Increase = \$1,000,000

During the FY2022/23 preliminary budget workshop, City staff reviewed the assumptions and analysis used for forecasting sales tax revenue. Sales Tax, which makes up 42% of total FY2022/23 projected General Fund operating revenue, is highly sensitive to economic conditions, making this revenue



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particularly challenging to forecast. To assist with this analysis, the City works closely with its sales tax consultant, Avenulnsights, in projecting sales tax revenue.

Avenulnsights prepares three levels in their forecast for projected sales tax revenue – Conservative, Most-Likely, and Optimistic. These assumption and numbers are updated each quarter based on current economic conditions and actual revenue collected for the City. The preliminary FY2022/23 budget proposed using the conservative forecast assumption of \$50 million. This level was proposed after discussion with the consultants, and an analysis of possible economic conditions this upcoming fiscal year.

There are indicators that the economy could slow once more which would impact the forecasted revenue. The fiscal support through Federal programs, which assisted in pushing up demand in 2020 and 2021 through stimulus spending, has expired. Although wages have been increasing nationwide, inflation has been rising faster, leading to a decrease in purchasing power which could hurt consumer demand. On the other hand, the combination of Federal stimulus programs and limitations on household spending for certain items, such as travel, have enabled consumers to save, which could prop up spending leading to continued sales tax growth in the next fiscal year. Despite the unknowns, sales tax revenue continues to grow and is trending above the amount projected in the current fiscal year, 2021/22. Therefore, staff have increased the FY2022/23 projected sales tax revenue by an additional \$1 million, or 10% from the prior fiscal year:

Revenue	FY2021/22 Amended	FY2022/23 Projected	Change	%
Sales Tax	\$46,347,300	\$51,012,200	\$4,664,900	10%

City staff will continue to monitor economic indicators and sales tax revenue closely and return to Council with updates during the fiscal year.

Property Tax Revenue Forecast – FY2022/23 Budget Revenue Increase = \$430,000

Projected property tax revenue is based on growth in prior fiscal years, while also accounting for the annual inflation adjustment which is capped at 2% under Proposition 13. Changes in the assessed value in property, and subsequent property tax revenue the City receives above the 2% limit, can be largely attributed to property value reassessments that occurred as the result of changes in ownership and new construction in the City. Shortly after the May 11 City Council meeting, the County Assessor provided their preliminary property assessed values for the City for the upcoming fiscal year. The total combined assessed values are estimated to grow by \$1,206,124,087, a 6.7% increase from the prior year, slightly above the amount currently forecasted in the City's budget. Based on the additional information received from the County Assessor and an evaluation of historical results, staff increased the FY2022/23 projected property tax revenue by \$430,000, or 6% from the prior fiscal year.



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	FY2021/22 Budget	AMENDED FY2022/23 Projected	Change	%
Revenue				
Property Tax	\$30,925,000	\$32,780,100	\$1,855,100	6%

Items Reclassified and Removed – FY2022/23 Budget Reduction = \$1,352,540

The following is a summary of the additional budget items that have been eliminated or modified, as described below, from the FY2022/23 proposed operating budget that further closed the budget gap:

	Description	Budget Amount
1	Staff Position – Grant Writer Management Analyst	\$112,800
2	Staff Position – Human Resources Analyst	76,000
3	Staff Position – Digital Media Technician	77,240
4	Fire Department Equipment	109,000
5	Planning Division Budget	550,000
6	Reduction in Public Works Municipal Services	427,500
Total Budget Items Reclassified		\$1,352,540

- 1) Grant Writer Management Analyst – Reclassified a Vacant Position: The City is heavily reliant upon grant funding in many areas of operations. To prioritize the CityWide effort to continue to seek grant opportunities, the Finance Department has reclassified a vacant Customer Service Representative position to the Grant Writer Management Analyst position which will be no financial impact to the General Fund.
- 2) Human Resources Analyst – Allocated to Utility Funds: To address a reduction in staff resources and increased workload, City staff are recommending adding the Human Resource Analyst position to the FY2022/23 budget; however, there will be no financial impact to the General Fund. The position is recommended to assist with recruitment efforts resulting from increased turnover and to properly support all departments with Human Resources needs. The position is allocated to the Water and Wastewater Funds. In addition, due to the additional responsibilities the Human Resources department has assumed to comply with the mandated COVID-19 protocols, staff costs in the department will be reimbursed from the administrative expenses set aside in the American Rescue Plan Act funds.
- 3) Digital Media Technician Removed from FY2022/23 Budget: The Digital Media Technician position was added at the request of the City Council Boards and Commissions subcommittee in order to expand services to broadcast Planning Commission and other Board and Commission meetings. Without this position, those additional services cannot be provided.



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- 4) Fire Department Equipment – An alternative funding source was identified for Fire Department equipment of \$109,000. At the end of FY2020/21, City Council approved the use of yearend net surplus funds of \$475,000 for the purchase of EKG monitors. The total cost of the purchase is estimated to be under the amount budgeted due to negotiating a much more favorable trade in value for the older equipment. City staff are recommending the remaining funds budgeted for the EKG monitors be reallocated to purchase the Fire equipment proposed in the preliminary FY2022/23 operating budget.
- 5) Planning Division Reclassification of Consulting Services: The Planning Division budget provided for \$500,000 in contract consultant services, which are offset by fees paid for by the project applicant. Expenses are incurred as development projects moved forward; however, over the previous five fiscal years the activity has been minimal. To better reflect anticipated General Fund operating expenses, the activity has been reclassified and will be accounted for outside of the Planning Department budget. This resulted in a decrease of \$500,000. The preliminary FY2022/23 Planning Department budget also contained \$50,000 for a clean energy study, which is no longer needed since the City joined the Clean Energy Alliance. The total reduction in expenses for this department is \$550,000.
- 6) Reduction in Public Works Municipal Services – Removed from FY2022/23 Budget. During the Great Recession, Public Works pivoted to outsourcing municipal services as a cost saving measure. Although outsourcing services provided savings, recent case law has determined that for General Law cities like Escondido, outsourcing non-special municipal services is prohibited by state law.

As a result, six new positions were added to the Building Maintenance Fund's preliminary FY2022/23 budget to perform plumbing, electrical, and structural repairs at City facilities. Without these positions, there will be longer lead times on plumbing repairs which will result in shutting down restrooms, long-term continued deferred maintenance, and potential loss of power at City facilities. All city facilities will be impacted without these services.

To reduce the increase to the General Fund budget, Building Maintenance has reduced the number of new positions to two plumber staff positions and eliminated the new equipment of \$330,000. This will result in budgetary savings from the preliminary proposed budget of approximately \$427,500.

RESOLUTIONS

- A. Resolution No. 2022-69 approving the Fiscal Year 2022/23 Annual Operating Budget
- B. Resolution No. 2022-70 approving the Appropriations Limit (Gann Limit) for Fiscal Year 2022/23



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- C. Resolution No. 2022-70 – Exhibit A - GANN Calculation
- D. Resolution No. 2022-70 – Exhibit B - GANN Limit Calculation