



# CITY OF SAN MATEO

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## Agenda Report

Agenda Number: 14

Section Name: {{section.name}}

Account Number: 10-2031

File ID: {{item.tracking\_number}}

**TO:** City Council  
**FROM:** Alex Khojikian, City Manager  
**PREPARED BY:** Finance Department  
**MEETING DATE:** February 20, 2024  
**SUBJECT:**  
2023-24 Mid-Year Budget Update

**RECOMMENDATION:**  
Receive the 2023-24 Mid-Year Budget Update

### BACKGROUND:

This agenda report provides a financial update on the City's major funds: the General Fund, the Construction Services Fund, and the Sewer Fund. It summarizes the City's mid-year fiscal status by analyzing anticipated revenues and expenditures based on data through December 2023, comparing the projections to the current budget for the 2023-24 fiscal year. The mid-year projections incorporate the final 2022-23 fiscal year results, year-to-date actuals, and other data points that were not available when the budget was originally developed. The primary focus of this analysis is on the General Fund, the City's primary operating fund, accounting for many tax revenues and funding essential city services.

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### *General Fund*

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#### ***General Fund Revenues***

The City's 2023-24 budget anticipated a moderate pace of continued economic growth. With over half of the fiscal year's actual transactions analyzed, the City's General Fund revenues are now projected to exceed the 2023-24 budget by \$2.2 million.

The amended 2023-24 budget assumes total revenues of \$159.3 million. Based on year-to-date results through December 2023, the total revenues are projected to be \$161.5 million. Many of the increases came from better-than-expected revenues from fees and charges for services, which offset the downward adjustments in sales tax, property transfer tax, and transient occupancy tax.

The detailed analysis below provides insight into the primary contributing factors to the overall favorable budget variance.

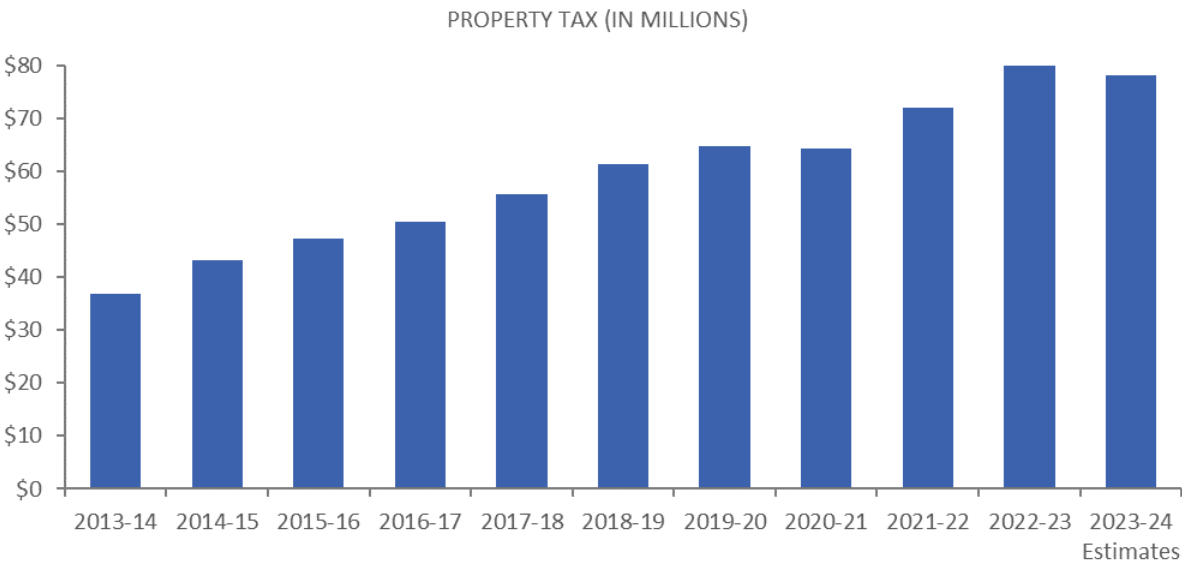
#### **PROPERTY TAX - \$78.0M ADOPTED | \$78.4M PROJECTED**

Property tax remains the largest and most stable revenue source for the General Fund. The projected property tax revenue for 2023-24 is \$78.4 million, based on the latest information from the County of San Mateo, resulting in a favorable budget variance of \$0.4 million.

Two major uncertainties for this revenue source are the recent slowdown in the real estate market and the property tax in lieu of vehicle license fees (VLF) shortfall.

Over the past 12 years, the City’s real property assessed values (AV) have consistently grown, averaging 6.9% annually. The projected AV growth for 2023-24 is 5.5%, indicating a slowdown attributed to rising interest rates. Though the housing market may further cool in the upcoming fiscal year, the property tax base in San Mateo is expected to remain stable, with a projected growth of 3% for fiscal year 2024-25.

Another challenge to the city is the VLF shortfall. As more school districts shift from non-basic-aid to basic-aid status, the County of San Mateo’s VLF shortfall continues to grow. Currently, the only way to backfill the VLF shortfall is for the County of San Mateo (County), on behalf of itself and all the municipalities within the county, to file a claim with the State of California (State) in August each year to backfill the prior fiscal year’s VLF shortfall, resulting in a two-year delay in VLF payments. For instance, the City’s share of the 2020-21 VLF shortfall (\$5.7 million) was received in fiscal year 2022-23, and the 2021-22 VLF shortfall (\$1.9 million) was received in fiscal year 2023-24. However, payment delay is not the sole challenge; due to State budget deficits, the State may decline to utilize its General Fund to backfill the VLF shortfall. It is anticipated that the City’s share of the countywide VLF shortfall will be \$4.1 million and \$6.6 million, respectively, for fiscal years 2022-23 and 2023-24. Currently, there is a task force, including City Managers from cities in the County, to review options to permanently address this issue with the State. Staff will continue to monitor the VLF shortfall status and adjust our budget strategy as we develop the new fiscal year budget.

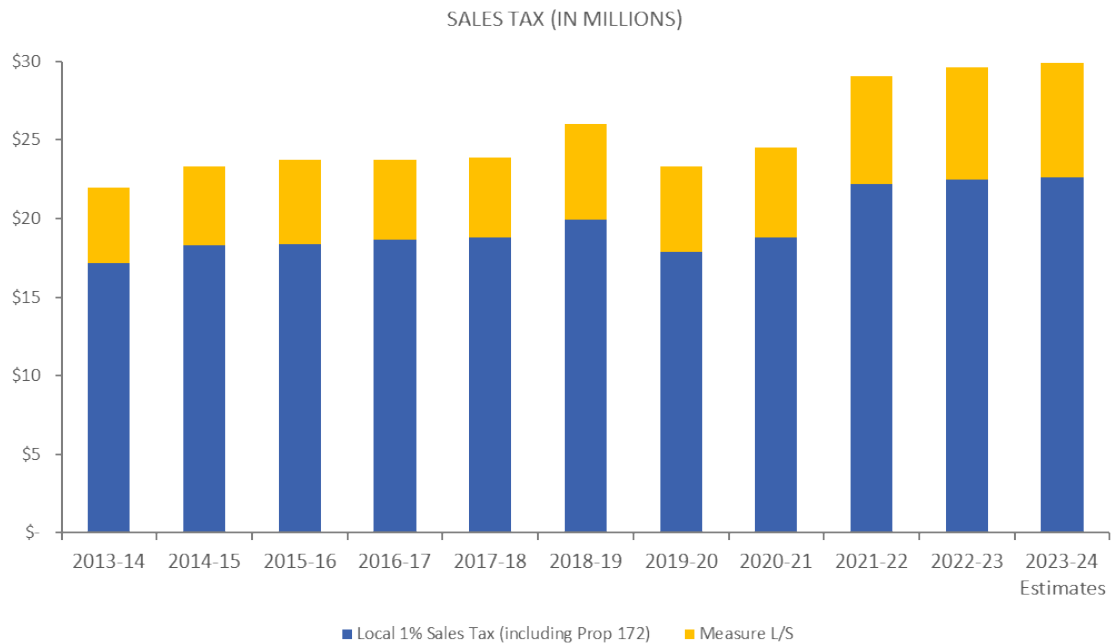


**SALES TAX - \$31.2M ADOPTED | \$29.9M PROJECTED**

Sales tax revenue is currently the second largest single revenue source of the General Fund and is particularly susceptible to economic cycles. At mid-year, the City’s projected sales tax for 2023-24 is \$29.9 million, \$1.3 million below the budgeted amount.

As illustrated in the chart below, sales tax revenue experienced revenue loss during the pandemic but rebounded in 2021-22 following the removal of pandemic restrictions and benefited from high inflation. As supply chain issues eased and inflation gradually receded to 3%, sales tax revenue stabilized.

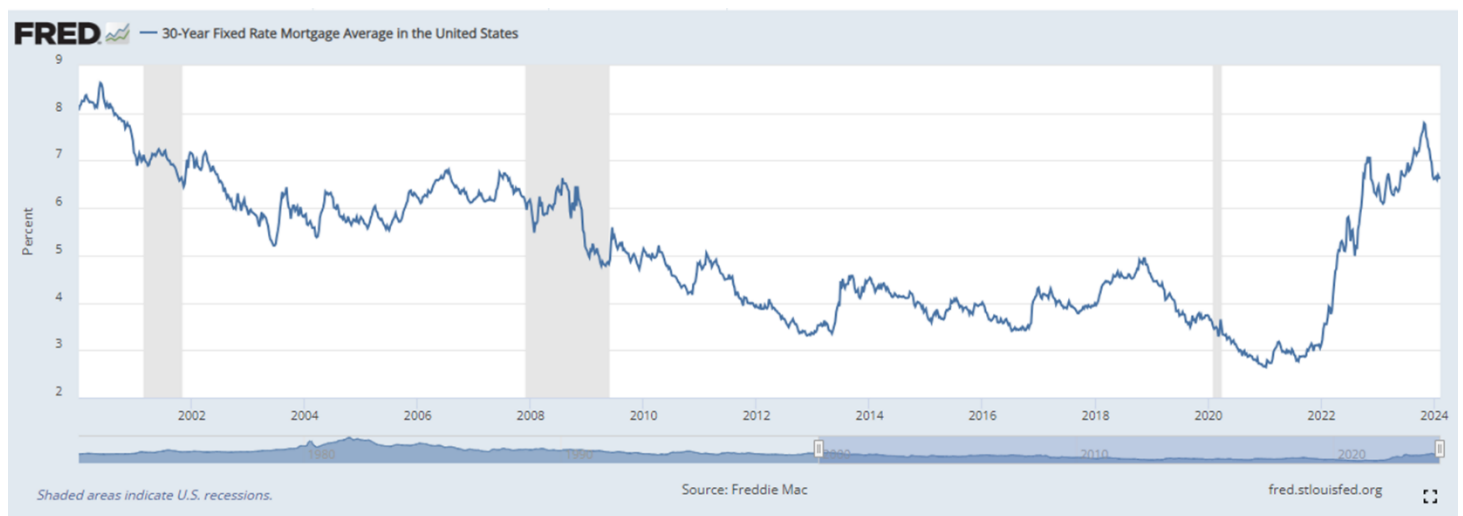
If we use the 2018-19 sales tax level (pre-pandemic) as the baseline and apply a 2% annual growth rate, the projected 2023-24 sales tax would have been \$28.8 million. Therefore, while our mid-year sales tax projection of \$29.9 million falls short of the budget projection, it exceeds the 2% baseline growth projection.



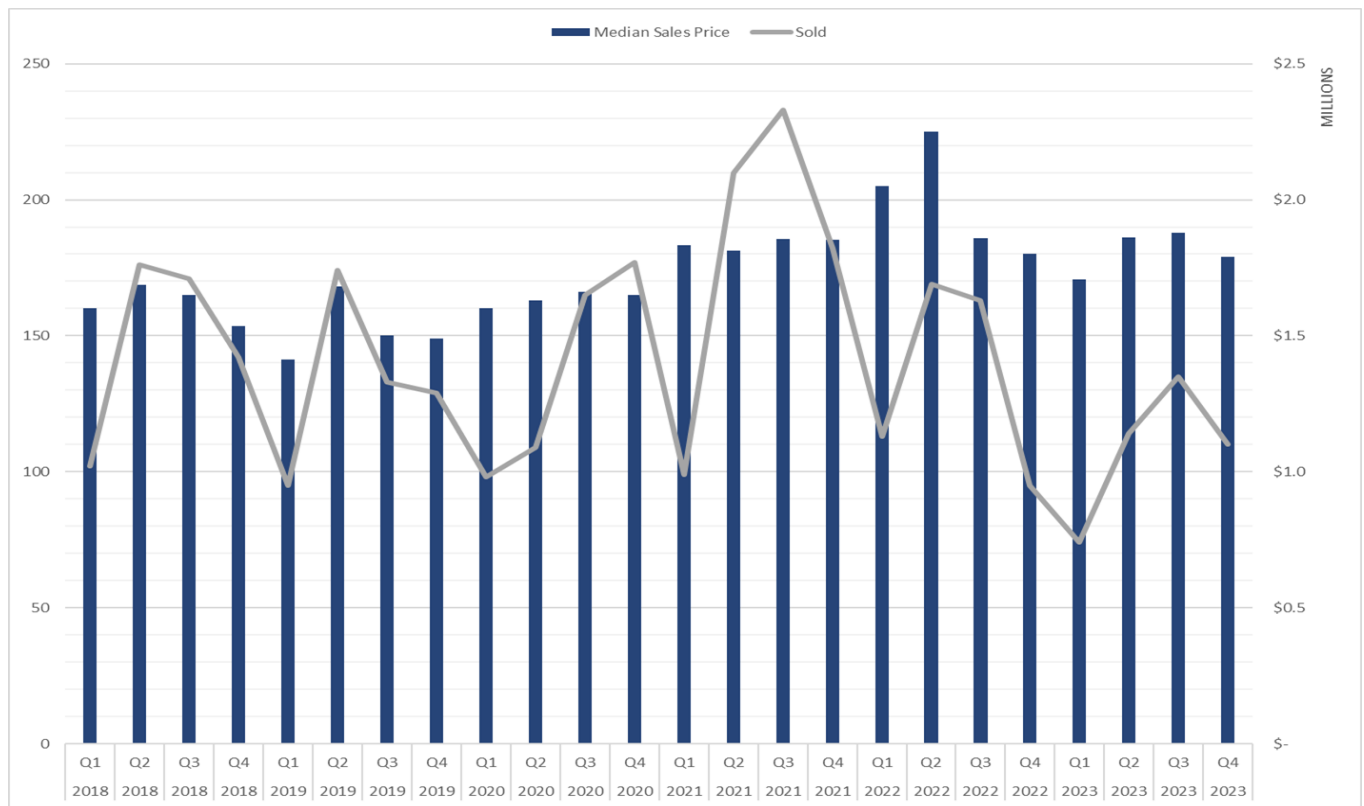
### REAL PROPERTY TRANSFER TAX - \$8.0M ADOPTED | \$7.0M PROJECTED

The City collects a real property transfer tax (RPTT) upon the sale or transfer of any property within the City boundaries. As a charter city, San Mateo voters approved a 0.5% RPTT rate. Furthermore, in the November 2022 election, San Mateo voters approved Measure CC that increased the RPTT rate to 1.5% for properties sold or transferred with a value of \$10 million or more.

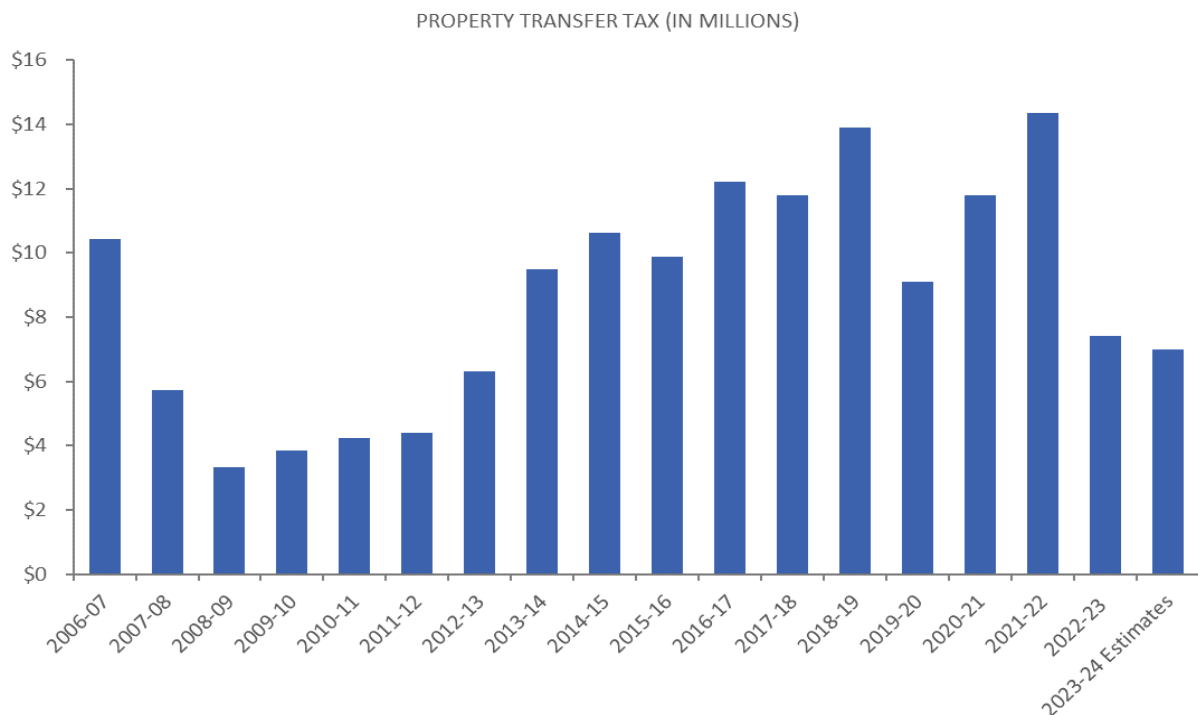
Over the past two years, in response to high inflation, the Federal Reserve (Fed) has tightened monetary policy by increasing the Federal Funds Rate, which is the interest rate that banks charge each other to borrow or lend excess reserves overnight. As a result of the precipitous rise in the Federal Funds Rate, the average 30-year mortgage rate has increased significantly as shown in the graph below.



The surge in mortgage rates has had a dampening effect on home sales. The number of single-family homes sold decreased over 25% in calendar year 2022, and it experienced an additional 20% decline in calendar year 2023. However, due to persistent high demand in the housing market and the stabilization of the mortgage rates, the average median sales price remains strong. After dropping for three consecutive quarters in 2022, the median home price has returned to the \$1.8 ~ \$1.9 million range in 2023.



RPTT revenue is highly volatile since it is influenced by both property values and transaction volume. When both home sales and prices drop, the impact on RPTT revenue is significant. As shown in the chart below, at the close of fiscal year 2022-23, RPTT revenue decreased to \$7.4 million from its record high of \$14.3 million in the prior year. And for fiscal year 2023-24, RPTT revenue is anticipated to remain at the \$7 million level.



## TRANSIENT OCCUPANCY TAX - \$6.0M ADOPTED | \$5.3M PROJECTED

The City's Transient Occupancy Tax (TOT) revenue is primarily driven by business travel and typically generated \$7 million pre-pandemic. As we all know, TOT has experienced significant revenue loss during the pandemic and has been slow to recover since. At the close of fiscal year 2022-23, TOT has reached \$6 million and was originally projected to recover to the \$7 million baseline by 2024-25. However, due to a hotel potentially ceasing operations in May 2024, revenue projections have been adjusted downward to \$5.3 million for fiscal year 2023-24 to reflect the potential fiscal impact. TOT is the only General Fund tax revenue that has not recovered back to the pre-pandemic baseline. It is uncertain when that will occur, if at all. Staff will continue to monitor changes in hotel operations, incorporate new information into the budget development for the next fiscal year, and adjust long-term assumptions as necessary.

## OTHER GENERAL FUND REVENUES

Other General Fund revenues are on track to stay within budget, except for business license tax, golf fees, recreation service charges, and permits, fees, and fines revenues, which are expected to outperform the budget projection:

	2021-22 ACTUALS	2022-23 ACTUALS	2023-24 ADOPTED BUDGET	2023-24 MID-YEAR PROJECTION	BUDGET VARIANCE
Business License Tax	6,686,853	8,797,963	6,302,889	6,902,889	600,000
Golf Fees	3,465,658	3,199,468	3,174,250	3,300,250	126,000
Recreation Service Charges	2,916,078	3,653,413	3,567,724	4,367,724	800,000
Permits, Fees, and Fines	5,723,723	8,018,782	4,632,500	7,932,500	3,300,000

- Business license tax is anticipated to reach \$6.9 million in 2023-24.
- Golf fees are expected to mirror the performance of the last two years, bringing in approximately \$3.3 million.
- Recreation service charges are projected to further recover to \$4.3 million.
- Permits, fees, and fines revenue will approximate \$7.9 million, outperforming the original budget projection, resulting in a favorable budget variance of \$3.3 million. The increase is primarily attributed to better-than-expected parking revenues and public works permit revenues.

In summary, while certain revenue streams face challenges, the City's General Fund revenues exhibit resilience and are positioned for continued growth. Staff will continue to monitor areas of uncertainty, such as VLF shortfall and TOT, and make necessary budget adjustments in response to changing economic conditions and potential operational impacts.

## General Fund Expenditures

The amended 2023-24 budget assumes \$176.5 million in General Fund total expenditures. Based on December 2023 year-to-date transactions, total expenditures are projected to be \$169.5 million, a favorable budget variance of \$7.1 million or 4.0%. The majority of the favorable budget variance stems from vacancy savings, which is spread throughout all departments. There are many open merit and per diem staff positions that the City is targeting to fill within the next few months. Many executive level vacancies have contributed to the savings, as well as the per diem staff savings which largely offsets vacant staff positions and fluctuates based on seasonal requirements/expectations.

## General Fund Balance

As shown in the tables below, the preliminary 2022-23 financial statements reveal a positive outcome for the General Fund, with an operating surplus of \$6.4 million as total revenues exceeded the funds' total expenditures. The fund concluded the fiscal year with a fund balance of \$117.9 million.

The adopted 2023-24 budget initially indicates a deficit of \$12.6 million, which has increased to \$17.2 million due to supplemental budget appropriations approved since July, totaling \$4.6 million. Of this amount, \$3 million is designated for

storm improvement projects and wet weather preparedness. However, the mid-year update presents a more favorable outlook, with total revenue projected at \$161.5 million and total expenditures at \$169.5 million, resulting in a reduced deficit of \$8.0 million. It is anticipated that the General Fund will conclude the current fiscal year 2023-24 with a fund balance of \$109.9 million.

Change to Fund Balance:

GENERAL FUND	2022-23 ACTUALS*	2023-24 AMENDED BUDGET	2023-24 MID-YEAR PROJECTION	BUDGET VARIANCE
Beginning Fund Balance	\$ 111.5	\$ 117.9	\$ 117.9	\$ -
Total Revenues	165.9	159.3	161.5	2.2
Total Expenditures	159.5	176.5	169.5	(7.1)
Resources Over / (Under) Requirements	6.4	(17.2)	(8.0)	9.3
Ending Fund Balance	\$ 117.9	\$ 100.6	\$ 109.9	\$ 9.3

\*preliminary

General Fund Ending Balance:

GENERAL FUND	2022-23 ACTUALS*	2023-24 MID-YEAR PROJECTION	Up (Down) \$
25% Operating Reserve	\$ 36.8	\$ 39.4	\$ 2.6
Housing Reserve	4.8	5.9	1.0
Committed to CIP	8.3	8.3	-
Rainy Day Reserve	68.0	56.3	(11.6)
Ending Fund Balance	\$ 117.9	\$ 109.9	\$ (8.0)

\*preliminary

Of the \$109.9 million General Fund balance, \$39.4 million was set aside as an operating reserve, maintaining an amount equal to at least three months of the annual General Fund operating expenditure budget. The housing reserve was approved by the City Council in previous years to support the ongoing development of new affordable housing. The Housing Element requires the allocation of 20% of the General Fund property tax revenues from former Redevelopment Area (RDA) sites for affordable housing. Accordingly, starting in fiscal year 2023-24, an additional \$1 million will be added to the housing reserve, bringing the balance to \$5.9 million. Additionally, \$8.3 million of the General Fund balance has been committed to capital improvement projects (CIP) and is not available for discretionary use. The remainder of the fund balance constitutes the General Fund's rainy day reserve, expected to decrease to \$56.3 million (from \$68 million) by 2023-24.

In the upcoming 2024-26 budget study session in April, staff will present options for Council consideration and seek Council direction regarding the reallocation of funds from the rainy day reserve. The primary objective is to optimize allocation of city resources to address pressing issues, such as infrastructure maintenance and repair, emergency preparedness and challenges from rising pension costs. It is important to balance the immediate needs with the city's overall financial health, and make strategic financial plans with a long-term perspective.

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*Construction Services Fund*

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The amended 2023-24 budget assumes \$8.8 million in total revenues, \$12.5 million in total expenditures, and \$5.5 million in transfers out. Based on year-to-date trends, total revenues are projected to be \$9.2 million, total expenditures are projected to be \$11.7 million, and transfers out are expected to be \$5.5 million, consistent with the budget. Projected

revenues reflect a strong demand for development-related services, with very high permit volumes for single-family projects and accessory dwelling units, and continued construction activity related to previously entitled commercial/multi-family projects. Projected expenditures reflect a continued need for consultant support for development services, in particular plan checking and building inspections. If the projections come to fruition, the Construction Services Fund would end the fiscal year with a drawdown of \$8.0 million in fund balance.

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### *Sewer Fund*

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The amended 2023-24 budget assumes \$86.2 million in total revenues, \$56.9 million in total expenses, and \$55.8 million in transfers out, primarily for capital improvement projects. Sewer Fund revenues are expected to be within budget assumptions.

Sewer Fund total revenues are projected to be \$88.2 million, total expenses estimated at \$52.5 million and transfer out will approximate the budget amount. Compared to the amended 2023-24 budget, if it comes to fruition, the Sewer Fund would end the fiscal year with a drawdown of \$20.1 million. The primary drivers of the unfavorable budget variance are the increasing transfers out for capital improvement projects. Though it is unlikely that all appropriations for transfers out to support capital projects will be completed by fiscal year end, the remainder will be committed and rolled over to the subsequent fiscal year.

#### **BUDGET IMPACT:**

There is no budgetary impact resulting from this report. The financial status of the General Fund for the current year, as well all other City funds, will continue to be monitored, with updated final estimates incorporated into the recommended 2024-26 Budget.

#### **ENVIRONMENTAL DETERMINATION:**

This mid-year budget update is not a project subject to CEQA, because it is a government fiscal activity which does not involve any commitment to any specific project which may result in a potentially significant physical impact on the environment. (CEQA Guidelines Section 15378(b)(4).)

#### **NOTICE PROVIDED**

All meeting noticing requirements were met.

#### **ATTACHMENTS**

None

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