



CITY OF SAN MATEO

City Hall
330 W. 20th Avenue
San Mateo CA 94403
www.cityofsanmateo.org

Agenda Report

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TO: City Council
FROM: Drew Corbett, City Manager
PREPARED BY: Finance Department
MEETING DATE: January 19, 2021
SUBJECT:
Mid-Year Budget Update – Supplemental Budget Appropriation

RECOMMENDATION:

Receive the 2020-21 mid-year budget update and adopt a Resolution to appropriate \$0.4 million of reimbursement revenues in the General Fund for the Police Department operating budget, transfer \$0.6 million in Capital Improvement Project project funding for the Central Park Garage Repair Project from the Downtown Parking and Security Fund to the Parking In-Lieu Fund, and approve increasing the permitted funding of the Sewer Lateral Program by \$225,000 using existing Sewer Fund budget appropriations.

BACKGROUND:

The 2020-21 budget was adopted by the City Council on June 15, 2020, which reflected assumptions and estimates for revenues and expenditures based on available information. This report serves to provide an update on the City's current financial condition, and where it is anticipated to end the fiscal year based on the year-to-date results. The primary focus of the report is the General Fund, which is the City's primary fund, as it accounts for nearly all of the City's tax revenues as well as the City's core operations, including public safety, city administration, parks and recreation, and library.

GENERAL FUND REVENUES

The adopted 2020-21 budget assumed \$129.0 million in total General Fund revenues. Based on year-to-date results, General Fund total revenues are projected to end the year at \$126.8 million; \$2.2 million or 1.7% less than expected. The narrative below will review notable revenue categories that constitute much of the variance.

Property Tax

Current Year Secured

The adopted 2020-21 budget projected that the City would receive \$63.5 million in property tax, which represents 49% of total General Fund budgeted revenue, and affirms its status of being the City's primary revenue source. Based on year-to-date property tax revenues, projections from the County of San Mateo, and projections from the City's property tax consultant, total property tax revenues are projected to be \$66.6 million - \$3.1 million more than the adopted 2020-21 budget. Each of the notable property tax types contributing to the favorable budget variance are discussed in detail below.

Current Year Secured

At \$38.8 million, current year secured is the largest component of property tax revenues. Staff projects that current year secured property tax revenues will be \$41.7 million, or \$2.9 million more than the budget assumption, reflecting a greater

increase in assessed value than assumed.

Excess ERAF

In 1992, in order to remedy its budget balancing struggles, the State of California instructed county auditors to shift local property tax revenues from cities, counties, and non-education special districts to the Educational Revenue Augmentation Fund (ERAF) to offset the State's responsibility to fund public schools. In 2004, California Voters passed Proposition 1A, which constitutionally protects major city revenues from being diverted to school districts or the state, but ERAF, (specifically ERAF I and II) was omitted from the protections afforded via Prop 1A.

In 2013, the State of California implemented the Local Control Funding Formula (LCFF), which changed the way in which school districts were allotted funding. School districts that are able to meet their minimum funding requirement through property taxes are categorized as basic aid, while school districts that do not generate sufficient funding from property taxes to meet their minimum funding requirement (and thus meet the minimum by being allocated ERAF funds) are categorized as non-basic aid. In San Mateo County, there are 26 school districts. 20 are projected to be basic aid, and 6 are projected to be non-basic aid. As such, San Mateo County is one of only five counties in the State of California that has Excess ERAF available that is allocated back to taxing entities, as these funds represent property tax that was originally taken from them in order to fund ERAF.

The adopted 2020-21 budget projected \$4.0 million in Excess ERAF revenue, which is notably less than prior years, which largely reflected a dispute between the State of California and the five counties noted earlier that generate Excess ERAF of how ERAF is calculated. As such, \$180 million in Excess ERAF from three prior years had been retained by San Mateo County until the dispute can be resolved and definitive guidance from the State Controller's Office (SCO) is provided to counties. Based on year-to-date revenues and projected remittances to be received this month, the year-end estimate for Excess ERAF is projected to be \$5.8 million, or \$1.8 million more than the adopted budget, which is largely due to the county releasing \$85.4 million of the \$180.0 million that had been retained due to the dispute with the State. Going forward, the impact of the SCO guidance on Excess ERAF is unknown. We will continue to monitor this issue, collaborate with San Mateo County officials through the San Mateo Finance Officers' Group (SAMFOG), keep the City Council apprised of developments, and update projections from the 10-year plan accordingly.

Property Tax In Lieu of Vehicle License Fees

In 2004, as a part of the budget agreement between the state and local governments that resulted in Proposition 1A, the Legislature approved a swap of property tax for vehicle license fees (VLF) that the state had been paring down in prior years. This revenue source can only be funded by property tax from non-basic aid school districts. Given the preponderance of basic aid school districts in San Mateo County, there are not enough non-basic aid school districts to generate enough property tax to backfill the amount owed to local municipalities. County officials are projecting a \$69.5 million shortfall for the current fiscal year, the City's share of which is \$4.1 million. This follows a \$10.1 million shortfall in 2019-20, which the county submitted a claim for consideration in the state's 2021-22 budget. County officials anticipate that over the next six to seven years, every school district in the county will reach basic aid status. As such, absent any legislative change, a scenario of no non-basic aid school districts in the county in six years would result in an approximate property tax in lieu of VLF county-wide shortfall of upwards of \$270 million, with the City's share of the potential shortfall in excess of \$16.0 million. Given the magnitude of this matter, a subcommittee of the San Mateo County City Managers' Group will be taking the lead on working with state representatives to address this issue.

Sales Tax

The adopted 2020-21 budget projected that the City would receive \$18.0 million in local 1% sales tax (pursuant to the Bradley Burns Uniform Sales and Use Tax Law), and \$5.5 million in Measure S, the City's ¼ cent transactions and use tax. The budgeted revenues reflected the estimated impact of COVID-19 on the City's businesses. Based on current projections from the City's sales tax consultant, both the local 1% sales tax and Measure S revenues are projected to be in alignment

with budget assumptions. The City's sales tax consultant projects that the economic recovery from the recession brought on by COVID-19 will take approximately three years to return to pre-pandemic sales tax levels.

Transient Occupancy Tax (TOT)

The adopted 2020-21 budget assumed sustained low occupancy for the first quarter of the fiscal year and would recover to 50% occupancy in the second quarter. However, due to the immediate, severe, and ongoing impact of COVID-19 on tourism, consistent with the trends that were reported to the City Council during the financial update in October 2020, the City's November 2020 year-to-date TOT revenues are approximately 10% in comparison to the same period in the prior year. As such, staff projects austere TOT revenues of \$0.5 million at year end.

Golf Fees

Even in the most restrictive stay-at-home order, fortunately, golf remains a permitted activity. As such, while the adopted 2020-21 budget of \$2.1 million anticipated a considerable impact from COVID-19 on golf operations, revenues from golf fees are estimated to be \$2.9 million. Consistent with the favorable trend reported during the financial update from October 2020, metrics continue to perform well, including the number of rounds played, green fees collected, and range fees collected, which are 12.7%, 21.3%, and 49.5% more than the same period in the prior year, respectively.

Recreation Service Charges

In contrast to the favorable trend in golf operations, the City's ability to offer in-person recreation classes has been significantly limited by the varying degree of restrictions from the accompanying county health orders. While the adopted budget of \$3.9 million reflected an expected reduction of in-person offerings, it did not assume a reduction of the current magnitude. As such, revenues from recreation service charges are projected to be \$1.1 million by year end based on year-to-date revenues and the ongoing impact of the pandemic on the City's ability to offer in-person recreation classes. While the projected \$2.8 million budget variance is significant, the operating budget associated with providing recreation classes is projecting a significant favorable variance.

Permits, Fees, and Fines

In January 2019, the City Council conducted a study session to discuss parking enforcement. Staff provided a history of the challenges associated with staffing this function and described the enforcement level of service at that time, which did not meet a "reactive" (as-needed or complaint-driven) level of service. After evaluating potential service models, the Council provided direction to pursue a hybrid model with a mix of City and contracted enforcement staff to enhance service delivery and enforcement frequency. In November 2019, the City Council approved an agreement with Serco, Inc. for parking enforcement services. Based on the enhanced service level, parking citation activity was expected to be elevated in the initial months, then plateau after the first year. The elevated parking citation activity was projected to increase citation revenues by approximately \$1.1 million, which served as the impetus for the adopted 2020-21 budget assumption of \$2.1 million in parking citation revenues. November 2020 year-to-date revenues of \$0.4 million are representative of the impact of COVID-19 on downtown businesses and likely, a need to revise the City's assumption for the revenue impact of enhanced parking enforcement. As such, the year-end estimate for parking citation revenues is \$1.1 million, and the primary contributor to the unfavorable projected budget variance of \$1.5 million for the permits, fees, and fines revenue category.

Intergovernmental

The adopted 2020-21 budget assumed that the City would account for \$3.2 million in intergovernmental revenues, which includes \$0.5 million in total interagency staffing reimbursements from the San Mateo Unified High School District (SMUHSD) and the San Mateo Foster City School District (SMFCSD) for the school resource officer program. Since March, the School Resource Officers (SROs) funded by the School Districts have not been in the schools performing SRO duties.

The SRO position funded by the City continues to provide service to the schools. It is unknown whether the district-funded positions will resume this fiscal year. Therefore the \$0.5 million in revenue from SMUHSD and SMFCSD will not be realized.

The City was allocated \$1.3 million in CARES Act funding from the federal government through the State of California (as the primary recipient). Allocation of the CARES Act funding for local municipalities was determined as a part of the state's 2020-21 budget adoption in June 2020. These funds were originally accounted for in fiscal year (FY) 2019-20, however, in accordance with generally accepted accounting principles, the funds will be accounted for in FY 2020-21, as the appropriation of the funds at the state level were not available until July 1, 2020.

Accounting for the loss of SRO reimbursements from SMUHSD and SMFCSD and the City's CARES Act allocation, Intergovernmental revenues are projected to end the year at \$3.6 million or \$0.4 million more than the adopted budget.

GENERAL FUND EXPENDITURES

The adopted 2020-21 budget included General Fund total expenditures of \$136.9 million, which incorporated \$4.3 million in reductions in response to the immediate and severe financial impact of COVID-19 - a \$1.3 million across-the-board reduction in the General Fund operating budget, and a \$3.0 million hiring freeze for any positions that were funded directly or indirectly by the General Fund. General Fund total expenditures are projected to end the year at \$133.6 million, or \$4.2 million less than the amended 2020-21 budget.

The projected budget savings is largely manifest in the Library and Parks and Recreation budgets due to cancellation or a shift to virtual offerings of events, programs, and classes as well as closure of public amenities as a result of the pandemic and the restrictions of the accompanying health orders.

From the beginning of fiscal year 2020-21 through December 2020, the Apple Store at the Hillsdale Shopping Center has requested a uniformed police officer to provide a visible safety presence in stores. These shifts have been filled on overtime, with Apple reimbursing the City for the costs. The presence of a uniformed officer is a deterrent for theft, and also serves to enhance response time for other crimes which occur at the Shopping Center. The Police Department is requesting a budget appropriation of \$0.4 million, which is fully offset by reimbursement revenues from Apple to cover the costs incurred to date in 2020-21. Apple has recently closed all of their California stores indefinitely due to the pandemic and current health orders. If the detail at the Apple Store resumes during this fiscal year, then an additional budget appropriation, fully offset by reimbursement revenues, will likely be necessary.

OTHER FUNDS

Construction Services Fund

The Construction Services Fund accounts for building permit revenues and expenditures for activities related to the review of private development projects to achieve high quality and long-term economic growth in the City. The adjusted 2020-21 budget for the Construction Services Fund anticipated \$8.8 million in revenues and \$10.3 million in expenditures. Based on year-to-date actuals, total revenues are projected to be aligned with budget, which primarily reflects 1) the responsiveness of the Community Development Department to set up an online permit portal to sustain service levels; and 2) the continued demand for permit services and robust development in the City. Total expenditures are projected to be \$6.7 million, which accounts for staff vacancy budget savings and professional services that were budgeted for but not used to the degree anticipated, including outside plan check services, as the demand has largely been met using staff resources.

Downtown Parking and Security Fund

The Downtown Parking and Security Fund accounts for parking and other related services in downtown San Mateo, along with parking enforcement services throughout the City. Expenditures in this fund include downtown parking operations,

facilities maintenance, security, planning, and parking enforcement. Revenues in this fund primarily come from parking meters, but also lease revenues from retail tenant spaces located at the City's Main Street and Transit Center Garages. The adjusted 2020-21 budget projected \$5.3 million in revenues and \$4.6 million in expenditures. Based on year-to-date actuals, by year-end, revenues are projected to be \$2.7 million and expenditures are projected to be \$3.7 million. The decline in parking meter revenue is the primary driver for the unfavorable budget variance in revenues, reflecting the impact of the pandemic on downtown parking and local commerce. The \$0.9 million favorable budget variance in expenditures is largely from operating savings due to contractual services that have not been required to the degree anticipated in the budget.

The Downtown Parking and Security Fund ended the prior fiscal year with \$4.1 million in cash and \$3.8 million in fund balance, of which \$1.1 million was reserved for carryover encumbrances and \$2.9 million was reserved for Capital Improvement Project (CIP) projects. The remaining deficit \$0.2 million in unrestricted fund balance, which is the difference between the \$3.8 million in total fund balance and the amounts reserved for encumbrances and CIP, represents the amount that the fund is overcommitted. With a projected ending net reduction in fund balance of \$1.0 million for 2020-21, in order to ensure that the fund is favorably dispositioned in the short term, staff from the Public Works Department and City Manager's Office are reviewing CIP project commitments to determine which can be uncommitted (and have the associated fund balance reclassified as unrestricted) or deferred to a future period.

So far, staff has identified the Central Park Garage Repair Project as one that can release committed fund balance back to the Downtown Parking and Security Fund unrestricted fund balance. The project is budgeted for \$1.6 million, all from the Downtown Parking and Security Fund. The structural improvements included in the project are also eligible for Parking In-Lieu funds. Staff recommends that the City Council approve transferring \$0.6 million of the project funding from the Downtown Parking and Security Fund to the Parking In-Lieu Fund. This, along with approximately \$0.4 million in expected savings from the project, will add approximately \$1.0 million back to the unrestricted fund balance.

Sewer Fund

The Sewer Fund accounts for the sewer collection systems, the Wastewater Treatment Plant (WWTP), and disposal facilities. The adjusted 2020-21 budget projected \$63.5 million in revenues, and year-end revenues are projected to be \$66.2 million. The primary revenue source for the fund are sewer service charges, which represent 87% of total budgeted revenues. Sewer service charges are submitted to the county each year to be collected as a part of the property tax bill. Sewer service charges are considered part of secured property tax with respect to the Teeter Plan, in which a county commits to remitting 100% of secured property taxes, and in exchange, the county gets to keep penalties and interest. As such, sewer service charges are projected to be aligned with the budget.

The adjusted 2020-21 budget projected \$41.3 million in expenses. Based on year-to-date results, Sewer expenses are projected to be \$36.3 million, a favorable variance of \$5.0 million, largely comprised of \$1.2 million in salary and benefits budget savings stemming from vacancies and \$3.3 million in operating budget savings. Staff requests to use a small portion of the projected budget savings to increase the funding for the City's Sewer Lateral Program, which has proven to be quite popular this year, with applications up by about 40% as of November. By mid-November, City staff had begun a waitlist for the program, having already received about 178 applications. City staff has had consistent requests for the program, even prior to the brochure and additional information on the updated Sewer Lateral Ordinance being made available to the public. In order to ensure that we have sufficient funding to support the implementation of the Sewer Lateral Ordinance updates, staff is requesting formal City Council approval to increase permitted funding for the Sewer Lateral Program by \$225,000 this fiscal year.

Based on the year-end estimates for revenues and expenses, the Sewer Fund is expected to generate an increase in net position of \$30.0 million, which will increase net position from \$194.3 million to \$224.3 million, and ensure that the Sewer Enterprise remains in compliance with its debt covenants with respect to the debt service coverage ratio, which measures the relationship between net surplus (revenues [excluding capital contributions from regional customers] less expenses [excluding interest]) and the debt service in a fiscal year. With a projected net surplus of \$37.7 million (as defined above), and total debt service of \$14.9 million in 2020-21, the projected debt service coverage ratio is 253% or 2.53X, which is

above the minimum 1.2X required by the Fund's debt covenants and the 1.55X level for single "A" credit-rating criteria.

BUDGET IMPACT:

The General Fund began fiscal year 2020-21 with \$85.5 million in fund balance. Based on the projected year-end estimate of \$126.8 million in General Fund revenues, and \$133.6 million in total expenditures, the General Fund is anticipated to end the year with a net reduction of \$6.8 million in fund balance. In the event these year-end financial projections come to fruition, the General Fund would have an ending fund balance of \$78.8 million, which would be comprised of \$31.9 million in operating reserve pursuant to the City's reserves policies, \$4.8 million in housing set-aside, and \$42.0 million in budget stabilization reserves.

ENVIRONMENTAL DETERMINATION:

This mid-year budget report 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

Att 1 - Proposed Resolution

STAFF CONTACT

Rich Lee, Director, Finance
rlee@cityofsanmateo.org
(650) 522-7102