



CITY OF SAN MATEO

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Agenda Report

Agenda Number: 21

Section Name: {{section.name}}

Account Number: 10-2021

File ID: {{item.tracking_number}}

TO: City Council
FROM: Drew Corbett, City Manager
PREPARED BY: Finance Department
MEETING DATE: June 20, 2022

SUBJECT:

Fiscal Year 2022-23 Operating and Capital Budgets and Gann Appropriations Limit Adoption and Fiscal Years 2022-27 Capital Improvement Program – Approval

RECOMMENDATION:

Adopt Resolutions to approve the fiscal year 2022-23 operating and capital budgets, the 2022-23 position budget, the fiscal year 2022-23 Gann appropriations limit, and the fiscal years 2022-27 Capital Improvement Program.

BACKGROUND:

Prior to Council's adoption of the 2022-23 budget on June 20, 2022, it holds two public hearings to receive public comment on the proposed budget and capital improvement program (CIP). Council was presented with a preview of the General Fund proposed 2022-23 budget on April 18, 2022. The first public hearing was held on June 6, 2022.

Overall, the proposed Citywide budget for 2022-23 is \$284.8 million. This includes an operating budget of \$216.9 million and a capital budget of \$67.9 million. A summary of budget highlights is included in the City Manager's Letter of Budget Transmittal, included as Attachment 4. This agenda report primarily focuses on the General Fund, as it accounts for major tax revenues and funds the City's core services, for which a summary is provided in Attachment 8. Additional narratives are provided for the Construction Services Fund, as it is a perennial major fund of the City's operations, in Attachment 14, and the Sewer Fund in Attachment 26, which is the City's sole enterprise fund and the second largest fund of the City. Fund summaries for all operating funds are provided in Attachments 8 through 26. Internal service funds, which are not formally appropriated by the City Council, as they are solely funded by appropriations in the operating funds, are included in Attachments 24 through 32. The proposed 2022-23 position budget is included in Attachment 1, and CIP summary schedules are provided in Attachments 34 and 35.

General Fund

The General Fund, which is the City's primary operating fund, projects total revenues of \$159.5 million and total expenditures of \$164.2 million, and includes transfers out and all General Fund sub-funds – Measure S, Downtown Services, Recreation Services, and Golf. Budget assumptions for major General Fund tax revenues are discussed in greater detail below.

General Fund Revenues

PROPERTY TAX

The proposed 2022-23 budget anticipates \$80.3 million in property tax revenues, which is over 50% of General Fund total revenues, and as such, is the General Fund's chief revenue source. The primary components of property tax revenues include secured current year (\$46.6 million), Excess ERAF (\$7.9 million), and property tax in lieu of VLF (\$16.1 million).

These primary property tax components accrete based on the change in assessed value, which as of May 2022, is projected to be 7.07%, which includes the change in the California Consumer Price Index (CCPI) or 2%, whichever is less, pursuant to the State constitution. The remainder of the growth in assessed value is attributable to properties that have been sold and the applicable assessed value reset to market value as well as new development that has been added to the City's property tax roll.

The Educational Revenue Augmentation Fund (ERAF), which began in 1992, diverts local property tax revenues due to the State's inability to balance its budget and meet its responsibility to fund public schools in the 1990's. ERAF funds are used by non-basic aid school districts, which do not generate enough property tax to meet their State-determined minimum funding requirement pursuant to Proposition 98. The County of San Mateo is one of five counties in the State of California where there is Excess ERAF, which is the remainder of ERAF funds after funding non-basic aid school districts up to the minimum funding requirement.

Property tax in lieu of vehicle license fees (VLF) began in 2004 after the State agreed to swap the loss of vehicle license fees with property tax. VLF has two funding sources: 1) property taxes from non-basic aid school districts, and 2) ERAF that would otherwise go to non-basic aid school districts. Due to the preponderance of basic aid school districts in the County, there are not enough non-basic aid school districts to backfill the VLF owed to the cities and the County. As such, the County of San Mateo has experienced property tax in lieu of VLF shortfalls over the past couple of years; an issue that is limited to San Mateo County and Alpine County. Napa County is expected to experience VLF shortfalls in the coming fiscal year. The procedure to address the VLF shortfall has been for the County to file a claim with the State at the end of the fiscal year of the VLF shortfall, which is taken into consideration by the State for the subsequent year's budget. The county-wide VLF shortfall from fiscal year (FY) 2020-21 of \$96.1 million is included in the State's proposed FY 2022-23 budget. The City's share of the FY 2020-21 county-wide shortfall is \$7.5 million, which in turn is a part of the \$16.1 million in total VLF revenues from the City's proposed 2022-23 budget.

In the past year, the County of San Mateo and the local cities proposed a legislative amendment to address the VLF shortfall that would have reduced the amount of time that the State backfilled the VLF shortfall from two years to one year. However, the proposal was rebuffed by the State, and the State's counterproposal has been incorporated into their May revise proposed budget for 2022-23. The VLF proposed language from the State would cap Excess ERAF at the FY 2021-22 level and use the subsequent growth in Excess ERAF as a funding source for the VLF shortfall. If the VLF shortfall exceeds what is available from ERAF and property tax from non-basic aid school districts as well as the Excess ERAF above the cap, the State will backfill via an appropriation of its General Fund in the same year of the VLF shortfall.

The primary issues with the State's proposed VLF language are:

1. In 2004, voters approved Proposition 1A, which protects local tax revenues by prohibiting the State from specific actions, including shifting property taxes from cities, counties, and special districts, with certain exceptions as noted in the summary from the Principal Fiscal Policy Advisor for CalCities included as Attachment 5. Principal among them, the State's proposed budget is estimated to have a nearly \$100 billion surplus, so the State **does not** have a severe fiscal hardship. The proposed language in the budget trailer bill would be a takeaway of Excess ERAF property tax dollars by the State, which would be a direct violation of Proposition 1A.
2. In 2010, voters approved Proposition 22, which includes language that "The Legislature may not reallocate, transfer, borrow, appropriate, restrict the use of, or otherwise use the proceeds of any tax imposed or levied by a local government solely for the local government's purposes." (Section 25.5 of Article XIII of the California Constitution).
3. The VLF shortfall currently applies to local cities and the County. The takeaway of Excess ERAF would also impact special districts in the county. Based on preliminary analysis/estimates from the County, **none of the special districts in the county would receive Excess ERAF** and would experience an aggregate loss of \$31.4 million in property tax revenues from the proposed budget trailer bill in FY 2022-23.
4. As assessed value accretes and non-basic aid school districts permanently shift to basic aid status, **the VLF shortfall and the Excess ERAF above the cap will grow exponentially.**
 - a. For FY 2022-23, the VLF amount due to the county and the cities is \$248.1 million. However, the amount of

backfill property tax and ERAF from available from non-basic aid school districts is only \$139.9 million. As such, the VLF shortfall is projected to be \$108.2 million. Based on the language in the budget trailer bill, \$45.9 million of the \$108.2 million in VLF shortfall will come from the Excess ERAF revenue above the FY 2021-22 cap. The remaining \$62.3 million would be backfilled by the State's General Fund. The projected impact to the City of San Mateo's Excess ERAF revenues is projected to be a reduction of \$0.3 million.

- b. By 2031-32, the VLF amount due to the County and the cities is anticipated to be \$452.3 million. The projected amount of backfill property tax and ERAF from available from non-basic aid school districts is projected to be only \$104.9 million. As such, the VLF county-wide shortfall for FY 2031-32 is projected to be \$347.4 million. Based on the language in the budget trailer bill, \$333.2 million of the \$347.4 million in VLF shortfall would be backfilled by Excess ERAF above the FY 2021-22 cap. The remaining \$14.3 million would be backfilled by the State's General Fund. The projected impact to the City of San Mateo's Excess ERAF revenues is a \$6.7 million reduction.

The City's proposed 2022-23 budget does not incorporate the impact of the State's budget trailer bill to Excess ERAF revenues. In concert with the County and cities, the City Manager sent a letter to the respective budget subcommittee chairs of the State Assembly and State Senate to oppose the budget trailer bill's Excess ERAF language. In addition, the Finance Director provided public comment during the recent Assembly Budget Subcommittee meeting to strongly oppose the budget trailer bill. The San Mateo County City Managers' Association and the San Mateo County Finance Officers' Group will continue to monitor this issue closely, keep the City Council and San Mateo community apprised of major developments, and recommend and take actions necessary to protect local property tax dollars. If the county and cities' advocacy efforts are unsuccessful, the Excess ERAF budget will be recommended for adjustment at mid-year.

SALES TAX

The proposed 2022-23 budget assumes Local 1% sales tax revenues (Bradley Burns) of \$22.4 million and local 1/4% sales tax revenues (Measure S) of \$7.0 million, which reflect recovery of sales tax revenues back to pre-pandemic levels. Inflationary pressures and supply chain challenges while the pandemic persists may impact sales tax revenues.

The ongoing shift of consumer habits of purchasing taxable goods online rather than physical stores results in the City receiving a significantly lower share of the Bradley Burns. The State's antiquated revenue and taxation codes have not advance in tandem with modern commerce, as Bradley Burns is not allocated by destination, but rather, point of sale. Sales taxes assessed on online transactions are treated as use tax, which is allocated by each city's proportional share of the Bradley Burns at the county level. On average, the City's proportional share of use tax is approximately 10%. In other words, if a consumer buys an item of clothing for \$100 at a retail location in the City of San Mateo, the City receives \$1 in sales tax revenues via the Bradley Burns. However, if the consumer buys the same item online for \$100, the City receives only 10% of the \$1 in use tax, or \$0.10.

In addition, sales tax rebate agreements between local cities and retailers further dilute the use tax base. The agreements set the point of sale for online transactions for the retailer in the specific city, and in exchange, the local city returns a percentage of the use tax back to the retailer, typically 50%.

By contrast, Measure S, which is a 1/4% transactions and use tax, otherwise known as a district tax, is allocated based on destination. While the Bradley Burns and district tax are based on different tax laws, the disparity between the amount of revenue generated between the two sales tax revenues relative to their rate illustrates the impact of the gradual changes in consumer behavior, the antiquated revenue and taxation codes, and sales tax rebate agreements. If the Bradley Burns were modified to be in alignment with modern technology and current consumer habits by being destination based, Bradley Burns sales tax revenues would be closer to \$28.0 million rather than \$22.4 million.

REAL PROPERTY TRANSFER TAX

Over the past 20 years, the City's real property transfer tax (RPTT) has been impacted by major economic cycles, including the dot com boom/bust (2002-2006), the Great Recession (2007-2012), a period of recovery and growth (2013-2019), and since 2020, the COVID-19 era. The baseline RPTT has been reset to \$11.1 million, based on the average RPTT for the recovery and growth period and COVID-19. However, due to the anticipated trajectory of the Federal Funds rate, mortgage

interest rates have risen significantly, which may dampen the housing market due to the higher cost of borrowing. Local real estate trends and metrics will continue to be monitored as a part of the ongoing analysis of RPTT revenue performance.

TRANSIENT OCCUPANCY TAX (TOT)

While local tourism and the resultant TOT revenues have recovered faster than expected, full recovery back to pre-pandemic levels is not expected until 2031-32. Average occupancy rates have recovered to 60% and are the primary driver for the rebound of TOT, but average room rates have only modestly recovered. TOT revenues for 2022-23 are projected to be \$3.2 million, which reflects ongoing recovery of local tourism, which for San Mateo, is largely dependent on business travel. TOT revenues projections also reflect the return of a hotel that underwent major renovations in the spring of 2023.

General Fund Expenditures

The proposed 2022-23 budget projects \$164.2 in General Fund total expenditures. Notable year-over-year department budget increases, beyond the cost of maintaining core service levels, which include negotiated employee compensation increases most recently reached with the San Mateo Management Association (Management Association), San Mateo City Employees' Association (SMCEA), Service Employees International Union Local 521 Maintenance Unit (SEIU Maintenance), and Department Head/Deputy Directors are discussed in greater detail below:

The City Attorney Office's operating budget of \$1.4 million is an increase of \$0.3 million or 26%, which largely reflects consulting work related to development of a cannabis retail ordinance. This effort stems from the City Council's strategic plan to adopt a retail cannabis ordinance with restrictions around school and significant public benefits, including license fees and safety standards.

The City Clerk Department's operating budget of \$1.1 million is an increase of \$0.3 million or 35%, primarily due to the anticipated costs of the 2022 election.

The Department of Information Technology's operating budget of \$4.6 million is an increase of \$0.7 million or 17%, principally as a result of the addition of the Workday enterprise resource planning (ERP) system, which is a cloud-based solution and on a subscription basis. However, approximately 23% of the annual Workday subscription and training fees as well as the Can Am Technologies system as a service (SaaS) fees will be offset by contributions from the San Mateo Consolidated Fire Department (SMC Fire) based on their proportional share of full service equivalents (FSE).

The Parks and Recreation Department's operating budget of \$21.3 million is an increase of \$2.2 million or 11%, which predominantly reflects the anticipated return of programming that had been impacted by the pandemic.

The Police Department's operating budget of \$55.5 million is an increase of \$4.6 million or 9%. Two police officers are being shifted from patrol to traffic in response to input from the community requesting additional resources for traffic enforcement. This shift adds \$0.1 million in overtime costs and \$0.1 million to purchase two additional motorcycles. Overtime costs for Investigation Services increased by \$0.2 million, reflecting historical trends. The City's two-way radio land mobile radio (LMR) infrastructure is the backbone of communication between the Police Department's Emergency Communications Center, field personnel, and interoperability with allied agencies throughout San Mateo County. It is an essential tool and lifeline for first responders used 24x7. Various components of the radio infrastructure are in dire need of replacement. The total replacement cost of the ECC radio consoles is \$0.4 million, and \$0.2 million has been accumulated in the Equipment Replacement Fund. The remaining \$0.2 million is included in the proposed 2022-23 budget in the Police Department's General Fund operating budget.

The Public Works Department's operating budget of \$11.0 million is an increase of \$1.3 million or 13%. Within the Engineering Services Division, chargebacks for capital improvement projects, planning applications, and site development projects, which reflects staff time charged to these efforts and offset the cost to the operating budget, have been reduced by \$0.7 million based on historical trends.

Transfers out total \$12.9 million, which is an increase of \$4.8 million or 60%, which reflects the need for additional support for the City's CIP – namely, completion of the high voltage LED streetlight project (\$1.6 million), structural improvements for the Marina library (\$1.8 million), and the downtown pedestrian mall (\$0.6 million).

Construction Services Fund

The Construction Services Fund accounts for the revenues and expenditures of the building permit activities. Total 2022-23 revenues are projected to be \$8.8 million, total expenditures are projected to be \$11.8 million, and transfers out are projected to be \$4.5 million. If the proposed budget estimates come to fruition, the Construction Services Fund will result in a planned draw down on its fund balance of \$7.5 million, bringing the fund balance closer to the reserve policy of 12 months of operating expenditures.

Proposed changes to the position budget for 2022-23 include:

Reallocation

- Senior Management Analyst to a Business Manager – net increase of \$6K
- Senior Code Enforcement Officer to an Associate Planner – net decrease of \$17K
- Senior Building Inspector to a Building Inspector II – net decrease of \$28K

New positions

- 1.0 FTE Plan Check Engineer - increase of \$164K
- 1.0 FTE Managing Arborist – increase of \$172K

Sewer Fund

The proposed 2022-23 budget projects \$80.9 million in revenues, principally comprised of sewer service fees of \$75.0 million, which reflect the 12% increase of the final year of the five-year rate plan approved by the City Council. Total expenses are projected to be \$245.8 million, comprised of \$27.0 million in operating expenses, \$202.6 million in CIP, \$14.4 million in debt service, and \$1.7 million in transfers out. The CIP primarily reflects the ongoing commitment to completing the Clean Water Program, a comprehensive plan to update the wastewater collection system and wastewater treatment plant (WWTP).

Based on the study that evaluated the additional staff resources needed to properly operate the new WWTP, the proposed changes to the position budget for 2022-23 include:

New positions

- 3.0 FTE WWTP Mechanic I/II – increase of \$135K each FTE
- 1.0 FTE Mechanic III – increase of \$146K
- 1.0 FTE Facility Maintenance Worker – increase of \$116K
- 1.0 FTE Senior Instrumentation and Control Technician – increase of \$163K
- 1.0 FTE Calibration Technician – increase of \$136K

Eliminated positions

- 2.0 FTE WWTP Supervisor – decrease of \$179K per FTE
- 1.0 WWTP Operator – decrease of \$164K

Gann Limit

In addition to the adoption of the 2022-23 budget and capital improvement program, there will be one other action requested of Council as part of the overall budget adoption process on June 20th. This action is to establish the City's appropriations limit for 2022-23. The appropriations limit, which was originally established in 1979 by Proposition 4, places a maximum limit of the appropriation of tax proceeds that can be made by the State, school districts, and local governments in California. California Government Code requires that the City annually adopt an appropriations limit for

the upcoming fiscal year. As calculated in Attachment 33, the appropriations limit for the City of San Mateo for 2022-23 is \$250,173,878, while the proceeds of taxes subject to the appropriations limit is \$136,080,456. Therefore, the City is well below its appropriations limit for fiscal year 2022-23.

BUDGET IMPACT:

The Citywide Sources of Funding shown in Attachment 6 provides the projected revenues by fund and fund type. The General Fund, including all sub-funds, is projected to have \$149.6 million in total revenues. Special Revenue Funds, which includes the Construction Services Fund, is projected to account for \$32.7 million in total revenues. Debt Service Funds are projected to receive \$5.5 million in total revenues, while Capital Projects Funds are projected to account for \$0.5 million in revenues. Enterprise Funds, which is solely comprised of the Sewer Fund, is projected to receive \$85.2 million in total revenues.

The Operating Budget Summary shown in Attachment 7 provides the proposed appropriations by fund and fund type. The General Fund, including all sub-funds, are projected to have \$151.2 million in total appropriations. Special revenue funds are projected to have \$18.2 million in total appropriations. Debt service funds total appropriations are projected to be \$4.9 million, while capital projects funds total appropriations are projected to be \$0.9 million. Enterprise Funds are expected to account for \$41.7 million in projected appropriations.

The proposed 2022-23 Position Budget as shown in Attachment 1 authorizes 606.24 in total FTE, comprised of 521.51 merit FTE and 84.73 per diem FTE.

ENVIRONMENTAL DETERMINATION:

This budget adoption 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: Fiscal Year 2022-23 Operating and Capital budgets
Att 2 - Proposed Resolution: Fiscal Years 2022-27 Capital Improvement Program
Att 3 - Proposed Resolution: Fiscal Year 2022-23 Gann Appropriations Limit
Att 4 – City Manager’s Letter of Budget Transmittal
Att 5 – Proposition 1A Summary
Att 6 – Citywide Sources of Funding
Att 7 – City Operating Budget by Fund
Att 8 – General Fund Summary
Att 9 – Police Grants and Safety Fund Summary
Att 10 – Solid Waste Fund Summary
Att 11 – HOME Fund Summary
Att 12 – CDBG Fund Summary
Att 13 – Advanced Planning Fund Summary
Att 14 – Construction Services Fund Summary
Att 15 – Gas Tax Fund Summary
Att 16 – City Housing Fund Summary
Att 17 – Low and Moderate Income Housing Asset Fund Summary
Att 18 – Parks & Recreation Fund Summary
Att 19 – Traffic Impact Fee Fund Summary
Att 20 - Commercial Linkage Fee Fund Summary
Att 21 – RMRA Fund Summary
Att 22 – PLHA Fund Summary

Att 23 – Debt Service Funds Summary
Att 24 – 2% Hotel Tax Fund Summary
Att 25 – Capital Improvement Projects Fund Summary
Att 26 – Sewer Fund Summary
Att 27 – Vehicle and Equipment Replacement Fund Summary
Att 28 – Fleet and Building Maintenance Fund Summary
Att 29 – Benefits Fund Summary
Att 30 – Dental Fund Summary
Att 31 – Workers’ Compensation Fund Summary
Att 32 – Comprehensive Liability Fund Summary
Att 33 – Gann Appropriations Limit Calculation
Att 34 – CIP Funded Projects
Att 35 – CIP Program Plan Summary

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