



# CITY OF SAN MATEO

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## Agenda Report

Agenda Number: 6

Section Name: {{section.name}}

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**TO:** City Council

**FROM:** Drew Corbett, City Manager

**PREPARED BY:** Finance Department

**MEETING DATE:** December 05, 2022

**SUBJECT:**

Year-end Financial Reports for the Fiscal Year Ended June 30, 2022 - Acceptance

**RECOMMENDATION:**

Formally accept and approve the year-end financial reports for the fiscal year ended June 30, 2022

**BACKGROUND:**

It is the City of San Mateo's long-standing practice to issue its fiscal-year end financial statements within six months after the end of each fiscal year. The City's fiscal year begins on July 1 and ends on June 30. The primary fiscal year-end report is the Annual Comprehensive Financial Report (ACFR), which reflects the cumulative efforts of the year-end process, led by Accounting Division staff, and the completion of the independent audit of the City's financial information. In addition, the Measure S Oversight Committee formally accepted the Independent Accountants' Report on Agreed-Upon Procedures Applied to Schedule of Measure S Revenues and Expenditures for the year ended June 30, 2022 at its meeting on November 15, 2022.

The City's practice is to have the year-end financial reports presented to the Audit Committee, which is comprised of the mayor and deputy mayor, and ask that the Audit Committee recommend that the City Council formally accept and approve the year-end financial reports. However, the Audit Committee meeting that was scheduled for December 2, 2022, was cancelled due to lack of a quorum. In lieu of a formal meeting, Finance Department staff presented the year-end financial reports to Mayor Rick Bonilla, who then recommended that the City Council formally accept and approve the year-end financial reports for the fiscal year ended June 30, 2022.

The purpose of this report is to provide a high level summary of the ACFR, including notable highlights and changes from the prior fiscal year. The City's independent auditor, The Pun Group, a firm of licensed certified public accountants, has rendered an unmodified opinion on the City's basic financial statements for the fiscal year ended June 30, 2022.

## GOVERNMENT-WIDE FINANCIAL STATEMENTS

The government-wide financial statements aggregate the City's financial data into Governmental and Business-Type activities. The latter reflects the City's Sewer Enterprise, and the former accounts for the remainder; most notably, the General Fund.

### *Statement of Net Position*

The Statement of Net Position primarily presents the City's balance sheet-type accounts: assets and deferred outflows of resources (expenditures that apply to a future period), liabilities and deferred inflows of resources (revenues that apply to a future period), and the net of the former and latter categories, reported as net position. The City's total net position for the year ended June 30, 2022 was \$727.9 million, an increase of \$80.6 million or 12.4% compared to the prior fiscal year.

Much of the favorable change in net position reflected the reduction of the City's net pension liability, which decreased from \$247.9 million to \$177.2 million or 28.5%. The \$70.7 million decrease in net pension liability is primarily attributable to the 21.3% investment return by the California Public Employees Retirement System (CalPERS) for the fiscal year ended June 30, 2021. However, the favorable results and the resultant impact on the City's net pension liability will be short lived, as CalPERS' investment return for the fiscal year ended June 30, 2022 was negative 7.5%. The deviations in investment returns from the discount rate for the fiscal year ended June 30, 2021 and June 30, 2022 will be amortized over 20 years, with a five year ramping period, where each year folds in 20% of one year of the amortized value. At its peak, the negative 7.5% investment loss will increase the City's net pension liability by nearly \$100 million.

#### *Statement of Activities*

The Statement of Activities, which reports government-wide revenues and expenses, accounted for \$204.4 million in total expenses, which was a decrease of \$12.8 million or 5.9% compared to the prior fiscal year. The primary driver behind the decrease was the decrease in pension liability due to the favorable deviation of CalPERS' investment returns noted above.

## *FUND FINANCIAL STATEMENTS*

#### *Governmental Funds*

The Fund Financial Statements section of the ACFR presents financial data for the City's major funds, most notably the General Fund. The table below compares the adopted budget, estimate from April 2022, and actual General Fund total revenues and expenditures:

Account Type	2021-22 Adopted	2021-22 April 2022 Estimate	2021-22 Actual	Variance Actual vs. Estimate
<b>Total Revenues</b>	\$144.5	\$160.2	\$159.9	(\$0.3)
<b>Total Expenditures</b>	146.9	146.6	140.4	6.2
<b>Net Gain / (Loss)</b>	<b>(\$2.4)</b>	<b>\$13.6</b>	<b>\$19.5</b>	<b>\$5.9</b>

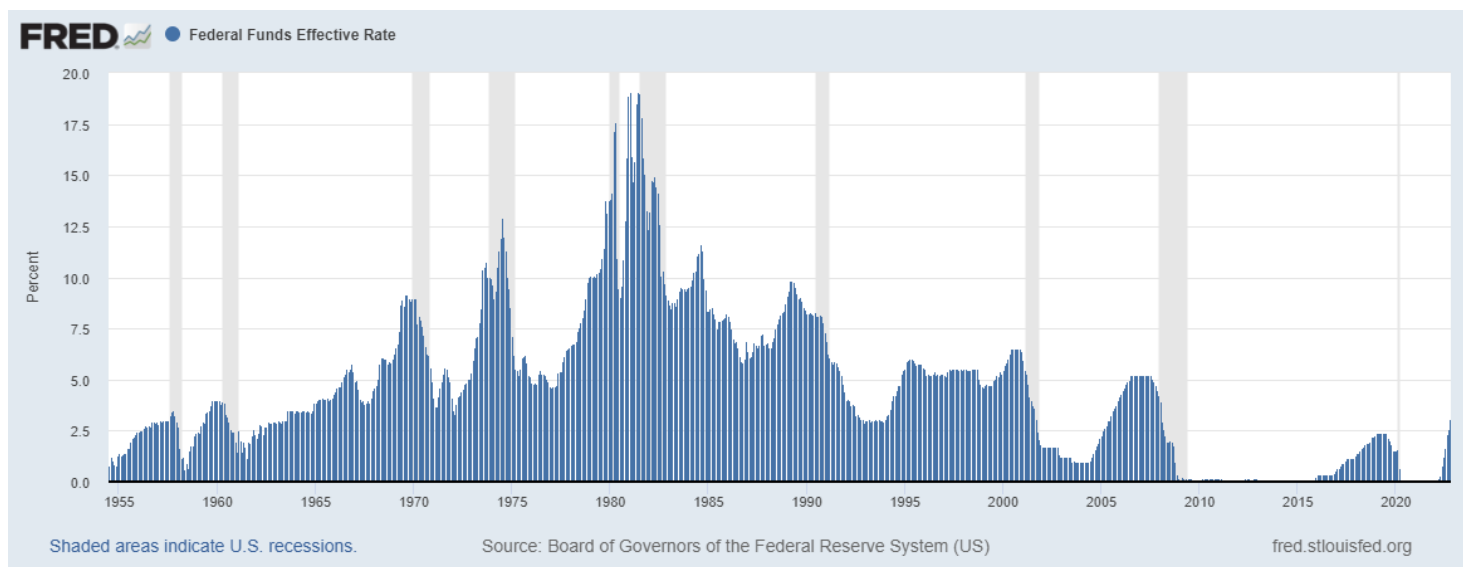
#### **General Fund Revenues**

General Fund total revenues were \$159.9 million, which had a nominal difference of \$0.3 million from the year-end estimate from April 2022.

Property tax revenues accounted for \$2.7 million more than estimated, primarily due to a favorable outcome regarding a dispute between the State Controller's Office (SCO) and the five counties in the State of California that generate Excess Education Revenue Augmentation Fund (ERAF) revenues, which includes San Mateo County. The adopted 2021-22 budget assumed that the funds that were in dispute (and as a result, were withheld by the San Mateo County Controller) would not be distributed. However, resolution with the SCO resulted in the funds being released and Excess ERAF revenues driving the favorable budget variance for property tax revenues. In addition, the property tax in-lieu of vehicle license fees (VLF) shortfall was less than anticipated, so the San Mateo County Controller's Office distributed an additional \$1.4 million in VLF that the City accrued for fiscal year 2021-22.

Sales tax revenues were \$1.2 million more than the April 2022 estimate, affirming the accelerated recovery of the City's sales tax revenues back to the pre-pandemic baseline from fiscal year 2018-19. The recovery was primarily buoyed by the general retail, food products, and transportation sectors. While the recovery of the general retail and food products sectors were driven by a mix of inflation and increasing consumer demand, transportation-related sales tax revenues were predominantly attributable to the escalating cost of gas.

The revenue projections from April 2022 did not factor in the year-end adjusting entry for Governmental Accounting Standards Board (GASB) Statement No. 31, which requires the City to adjust the value of its investment portfolio to fair market value. As a result of the Federal Reserve System's actions to increase the Federal Funds Rate, which is the rate that commercial banks borrow and lend their excess reserves overnight to each other, as shown in the graph below, to address historically high and sustained inflation.



As such, the City accounted for a GASB 31 fair market value adjustment of negative \$11.4 million, of which the General Fund was allocated negative \$4.2 million. If the City sold all its investments as of June 30, 2022, it would recognize the loss. However, the City's investment policy prioritizes, in order, safety, liquidity, and yield. As such, with the high credit quality of its investments, and its practice is to hold most of its investments to maturity, the GASB 31 year-end adjustment is effectively a paper loss and an accounting exercise. The GASB 31 year-end adjustment was not factored into the April 2022 year-end estimate due to the rapidly escalating Federal Funds Rate and the uncertainty as to when it would begin to recede.

### GENERAL FUND EXPENDITURES

Total General Fund expenditures, including transfer out, were \$140.4 million, which is a favorable variance of \$6.2 million compared to the April 2022 year-end estimates. Most of the favorable variance is in transfers out. There were \$1.9 million in transfers out from Measure S to the Capital Improvement Projects (CIP) Fund that did not occur in the fiscal year ended June 30, 2022. In accordance with generally accepted accounting principles, the remaining appropriations, the amount remaining of transfers out have been reserved for CIP in the Measure S sub-fund, and the related budget appropriations have been rolled over to fiscal year 2022-23. This practice is to ensure that fund balance is properly dispositioned between available resources (unassigned) and assigned (reserve for CIP) to avoid overcommitting the fund's available resources.

### OTHER MAJOR FUNDS

The Construction Service Special Revenue Fund, which accounts for revenue and expenditures of activities related to building permits, decreased its total fund balances by \$5.0 million to \$36.3 million, which illustrated the City's efforts to align the cost of services with its fees. Over time, these efforts will gradually reduce reserves down to policy levels, which is 12 months of budgeted operating expenditures.

The General Capital Projects Fund (CIP Fund) accounted for \$32.5 million in expenditures, reflecting the City Council's vision of having well-maintained infrastructure through its investment of \$8.3 million for city-wide street rehabilitation and sidewalk repair, \$5.1 million for downtown parking, and \$9.3 million for North Shoreview flood control improvements. Completion of the flood control capital improvements is expected in 2023, which will remove approximately 1,500 homes from the Federal Emergency Management Agency (FEMA) flood zone. The city-wide street rehabilitation will repair streets that were identified as failed in 2013 and ensure that the City will be able to maintain its Pavement Condition Index score of 70.

### Statement of Revenues, Expenditures, and Changes in Fund Balances

The Statement of Revenues, Expenditures, and Changes in Fund Balances presents revenues by type and expenditures by department for each of the major funds and non-major funds (in aggregate). Total revenues for the General Fund increased from \$137.6 million in the prior fiscal year to \$159.7 million (excluding transfers in) for the year ended June 30,

2022. This \$22.1 million increase in revenues is largely from year-over-year increases in the City's tax revenues – property tax, sales tax, and other taxes.

Property Taxes increased by \$8.2 million compared to the prior fiscal year. The largest drivers were current year secured (\$1.9 million), Excess ERAF (\$1.9 million), and property tax in lieu of vehicle license fees (\$4.8 million). The increase in current year secured property taxes reflected the growth in assessed value, while the increase in Excess ERAF is largely due to the favorable outcome to the dispute between the SCO and the five counties in the state that generate Excess ERAF. In fiscal year 2020-21, the County of San Mateo experienced a property tax in lieu of vehicle license fees (VLF) shortfall of \$96 million. The City's share of the 2020-21 VLF shortfall was \$5.7 million. The County of San Mateo submitted a claim to the State of California for the 2020-21 VLF shortfall in August 2021, which the State considered and appropriated for inclusion in its 2022-23 adopted budget. The VLF shortfall for 2021-22 was \$33 million, or roughly one-third the amount of the shortfall from 2020-21. The City was owed \$13.6 million in VLF in 2021-22 and accounted for \$11.7 million. As such, the City's share of the county-wide VLF shortfall of \$33 million was \$1.9 million. The County submitted the claim for the 2021-22 VLF shortfall to the State for consideration in August 2022.

Sales tax revenues, including the Local 1% (Bradley Burns) and Local 0.25% (Measure S), were \$4.6 million more than the prior fiscal year. As noted earlier, sales tax revenues recovered from the pandemic-driven recession faster than anticipated, and returned to the pre-pandemic baseline from 2018-19, largely buoyed by the general retail, food products, and transportation sectors.

Other tax revenues, including RPTT and TOT, increased by \$6.2 million or 28.2% compared to the prior fiscal year. RPTT represented over 40% of the increase in other taxes, reflecting the continued demand for real estate in San Mateo, though the impact of the trend in escalating interest rates is expected to dampen RPTT revenues in subsequent fiscal years. While TOT revenues have not yet recovered back to the pre-pandemic 2018-19 baseline, they increased from \$0.9 million in the prior fiscal year to \$3.9 million in 2021-22. Staff will continue to monitor the recovery and adjust its long-term assumptions accordingly.

The General Fund accounted for \$135.7 million in total expenditures, which was an increase of \$9.0 million compared to the prior fiscal year. Approximately half of the year-over-year increase was attributable to public safety. Police Department expenditures increased by \$3.7 million, largely due to negotiated increases in employee compensation. The City's operating contribution to the San Mateo Consolidated Fire Department increased by \$1.4 million, also primarily reflecting negotiated increases in employee compensation. Parks and recreation expenditures increased by \$1.9 million, which represented a return of recreational programs and classes that were cancelled in 2020-21 due to the pandemic.

### **Proprietary Funds**

The Sewer Fund's total net position increased from \$228.1 to \$278.6 million, an increase of \$50.5 million or 22.1%, largely driven by the rate payer-approved increase of 13%. The rate increase in 2021-22 was the fourth year of a five year rate plan that began in fiscal year 2018-19. In addition to shifting the rate to be 50% volumetric and 50% fixed cost to provide greater revenue stability, the significant rate increases also provide a critical funding source for the Clean Water Program and ensures that the Sewer Enterprise Fund has the cash position and debt service coverage ratio that is consistent with a viable and sustainable enterprise and commensurate with its high credit rating, as well as compliant with its debt indenture requirements. Cash and investments increased from \$62.7 million to \$103.3 million as a result of the rate increase, while restricted cash and investments increased from \$97.2 million to \$252.6 million reflecting the closing of the 2021 Wastewater Notes Series B, which took advantage of the interest rate spread between the loans from the Environmental Protection Agency's Water Infrastructure Finance and Innovation Act (WIFIA) and interest rates that were available for short-term notes at the time. Total capital assets increased from \$403.7 million to \$552.0 million, a \$148.3 million (36.7%) increase, representing the addition of new capital assets from the Clean Water Program.

### **ADDITIONAL FINANCIAL STATEMENTS**

The other financial statements included as attachments to this report are required for compliance with state law (Gann Limit – Att 2 and Transportation Development Act – Att 5), agreements with the San Mateo County Transportation Authority (Measure A – Att 3 and Measure W – Att 7), San Mateo Municipal Code (Measure S – Att 6), and generally

accepted auditing standards (Auditor's Communication – Att 4). In all the additional financial statements, the independent auditor found the City to be in compliance with the statutory requirements.

**BUDGET IMPACT:**

Excluding transfers in, the amended 2021-22 budget assumed that the City would account for \$141.7 million in General Fund total revenues. Actual total revenues were \$159.7 million; a favorable variance of \$17.9 million or 12.7%.

Excluding transfers out, the amended 2021-22 budget assumed \$141.5 million in General Fund total expenditures. Actual total expenditures were \$135.7 million; a favorable variance of \$5.8 million or 4.1%.

**ENVIRONMENTAL DETERMINATION:**

These year-end financial reports are not a project subject to CEQA, because it is an organizational or administrative activity that will not result in direct or indirect physical changes in the environment. (CEQA Guidelines Section 15378(b)(5).)

**NOTICE PROVIDED**

All meeting noticing requirements were met.

**ATTACHMENTS**

Att 1 - Annual Comprehensive Financial Report for the year ended June 30, 2022

Att 2 – Independent Accountants' Report on Agreed-upon Procedures Applied to Appropriations Limit Schedule For the year ending June 30, 2023

Att 3 – Measure A Fund Schedule of Receipts and Disbursements and Independent Accountants' Report for the year ended June 30, 2022

Att 4 – Auditors' Communication with Those Charged with Governance For the year ended June 30, 2022

Att 5 – Transportation Development Act Financial Statements and Independent Auditors' Reports for the years ended June 30, 2022 and 2021

Att 6 – Measure S Independent Accountant's Report on Agreed-Upon Procedures Applied to Schedule of Measure S Revenues and Expenditures For the year ended June 30, 2022

Att 7 – Measure W Schedule of Receipts and Disbursements and Independent Accountants' Report For the year ended June 30, 2022

**STAFF CONTACT**

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