



Office of the City Manager

Date: April 27, 2020
To: Budget and Finance Policy Committee
From: Dee Williams-Ridley, City Manager
Submitted by: Teresa Berkeley-Simmons, Budget Manager
Subject: FY 2021 Budget Update

The most important problem facing the City at the moment is getting the COVID-19 pandemic under control as quickly as possible. But the consequences, when all is said and done, will extend into other government services, as we manage City services with diminished resources. The City has numerous revenue streams that depend on economic activities and the “Shelter in Place” order practically stopped most economic activity. This has had immediate impact in the current fiscal year, and will continue into FY 2021, as those revenue streams that trail consumer and retail activity feel the brunt of this cessation. Federal direct aid to municipalities for general shortfalls is limited to cities with populations over 500,000, and direct aid to states is not mandated to be distributed to local jurisdictions. There are federal programs to reimburse local jurisdictions for expenditures directly related to addressing COVID-19, but these programs do nothing to offset the loss of revenues caused by the shelter in place order, nor the impacts of a potential general economic downturn.

Legislative Analysts Office

According to the Legislative Analysts Office (LAO), we are facing several immediate challenges. The pace of job losses makes it clear that the economy is in a recession. In California, 12%-15% have lost their jobs. Most impacted are those working in brick and mortar stores like restaurants, bars, leisure services, and retail shops. There are two plausible pathways: a) sharp downturn is followed by a pronounced rebound of economic activity late this year or early next b) recovery is slow with economic output depressed for much longer due to an extended virus or a second virus wave. The economic outcome is largely dependent on the development of the virus itself.

In addition, the LAO indicated that the demand and financing for construction projects will likely also suffer during this economic period. As mentioned earlier, more funding for discretionary aid is needed from the Feds to go through the State out to local governments. The State is also suffering as the outlook points to a \$35 billion State revenue shortfall in the first year, and an additional \$85 billion in subsequent years. The LAO recommends preliminary spending with the idea of a baseline budget in mind, focusing only on existing safety-net programs, necessary additions surrounding COVID-19, and inflation.

Cities such as Santa Monica are already projecting to use up economic stability reserves *in the current fiscal year*, and are looking to reductions in payroll costs to make ends meet. El Cerrito is already planning to cut services by 10% to avoid bankruptcy. While Berkeley's careful planning and fiscal restraint has given us some flexibility to react to the current pandemic, the loss of revenue will still be challenging.

General Fund Revenues

Beyond the short-term impacts of reduced economic activity mandated by the shelter in place order, the City's medium-term finances will be affected by the overall impact of the pandemic on the broader economy. While the length and depth of any recessionary trends due to COVID-19 are unknown at this time, we should prepare for decreased revenues beyond the immediate crisis. We do not know how many jobs will return once movement restrictions are ultimately lifted, but the effects on City revenues could last years. Federal programs to aid small businesses have already been exhausted, and there is still no sure date for when economic activity will return to normal.

As of the close of March, the City collected \$162.5M, or 81% of budgeted revenues for FY 2020. We are projecting total General Fund revenues of \$198.9M for the full fiscal year ending June 30, 2020. This is a 1.3% shortfall from the budgeted amount. While this is a relatively minor adjustment to our original projections, it is important for a couple of reasons not to extrapolate similar effects on future fiscal years.

First, some receipts of revenue by the City lag behind the actual economic activity on which they are based. Since the City accounts for its General Fund revenues on a budgetary basis, Finance doesn't record them until the funds are deposited. For Sales and Soda Taxes, the actual retail economic activity responsible for those revenues precedes our receipt by several months, so the impact on City revenues of any disruptions will be delayed by this same timeframe. Second, certain revenue sources were already outpacing our original projections at mid-year, and so are masking the impacts of the COVID-19.

Details of the General Fund revenues before and after COVID-19 can be found in Attachment A. Below is the FY 2021 General Fund Budget Update. In FY 2021 the General Fund is facing a \$25.5 million shortfall.

**FY 2021
 General Fund Budget Update**
(dollars in millions)

FY 2021 Adopted		FY 2021 Updated (COVID-19)	
Revenues	Expenditures	Revenues	Expenditures
\$201.7	\$201.7	\$177.1	\$202.6 ¹

Property Taxes

The greatest share of the City’s general revenues comes from Property Taxes, which account for 30% of the total General Fund revenue stream. Ongoing recessionary trends in the overall economy could ultimately lead to reduced assessed values upon which Real Property Tax and Vehicle License Fee Tax is based. There are potential near-term impacts on property tax revenues, due to the inability of property owners to make their April payments and potentially the first payment due in FY 2021. We are revising our standard 5% reserve for uncollectable accounts to 10% to account for this eventuality. In the longer term, the larger economic situation could lead to decreased valuations and a drop in sales that allow valuations to be brought to current market values.

For the same reason, we can expect a decrease in revenues from Property Transfer Taxes. While the real estate market has been immediately impacted by movement restrictions and uncertainty regarding future economic conditions, a recession could see sales reduced from previous expectations for the foreseeable future, both in quantity of sale transactions and in the sale prices for those transactions that do proceed.

Sales Taxes

Sales Taxes, for which City receipts trail the underlying consumer economic activity by 3 months, will only have minor impact on revenues in the current fiscal year. FY 2021 will be severely impacted, as the full year’s projections may have to be revised down by 15% or more, due to the shelter in place order alone. Any extended impact on the overall economy will also reduce retail sales of goods, including restaurants, and could further impact this revenue stream next year and beyond. Potential action by the State to grant some form of sales tax remittance deferment could decrease revenues even further.

¹ Includes funding allocations for the following: Solano Avenue Revitalization \$300,000, Wildfire Mitigation (Fire) \$334,000, and Community Service Specialist II (CMO – Communications) \$160,000. In FY 2020 these appropriations were redirected to the EOC for the immediate response to COVID-19.

Business License Tax

Business License Tax is another large component of the City's general revenue stream that will be affected by the pandemic, as they are assessed based on the gross receipts of City's businesses. The current required closure of many businesses, as well as the reduction of business activities or complete cessation resulting from current movement restrictions, will certainly reduce their gross receipts for the current fiscal year, and may cause many businesses to close permanently. Many businesses may be facing pressure just to meet payroll and other costs, and those that have not yet paid current taxes may not make them in the near term. Their future business will also be affected by any negative economic conditions, which will affect City revenues for FY 2021 and potentially future years as well.

Transient Occupancy Tax

The travel and movement restrictions put in place have had an immediate and massive effect on hotel and short-term rental occupancies, which drive the Transient Occupancy Tax (Hotel Tax) collected by the City. These tax payments lag one to two months from the collection by the hotels or STRs from guests, so the direct impacts of COVID-19 restrictions will be felt in the current fiscal year. These impacts, however, may outlast the specific timeframes of travel prohibitions, as legal restrictions may be replaced with lingering consumer anxiety about the safety of travel. Future economic conditions may also lead to a decrease in leisure and business travel as consumers and businesses pursue cost-saving measures, further impacting City revenues.

Other General Fund Revenue Streams

Revenues from the base Transfer Tax, Measure P Transfer Tax, and the U1 Supplemental Business License Tax have contributed surpluses in FY 2020 to offset shortfalls in other taxes. Those surpluses cannot be assured in future years, especially if broader economic conditions worsen. We should be conservative in our outlook, so that we can continue to provide essential services to citizens, no matter what economic conditions we face.

FY 2021 Target Deferrals

The City must adopt a balanced budget. As a result of whirlwind declines in the City's General Fund revenue streams, again, we are facing a \$25.5M shortfall in FY 2021. In order to immediately resolve this General Fund shortfall, we are requiring departments to provide tiered General Fund expenditure deferrals or 1-time reductions of 10%, 12% and 15%. The chart below translates the target deferrals into dollars.

Department	FY 2021 Revised Baseline Budget	FY 2021 Internal Service Costs	FY 2021 Adjusted Budget*	10% Deferral	12% Deferral	15% Deferral
City Auditor	2,657,863	227,099	2,430,764	243,076	291,692	364,615
City Attorney	3,039,583	218,523	2,821,060	282,106	338,527	423,159
City Clerk	2,849,880	182,225	2,667,655	266,766	320,119	400,148
City Manager	7,481,872	605,555	6,876,317	687,632	825,158	1,031,448
Finance	7,172,555	771,001	6,401,554	640,155	768,186	960,233
Fire	35,795,902	2,841,265	32,954,637	3,295,464	3,954,556	4,943,196
Health, Housing, & Community Services	17,701,995	3,013,721	14,688,274	1,468,827	1,762,593	2,203,241
Human Resources	2,635,819	265,070	2,370,749	237,075	284,490	355,612
Information Technology	580,710	-	580,710			
Office of Economic Development	2,959,800	73,306	2,886,494	288,649	346,379	432,974
Parks Rec & Waterfront	6,943,078	851,031	6,092,047	609,205	731,046	913,807
Planning	2,534,191	400,284	2,133,907	213,391	256,069	320,086
Police	73,986,482	4,135,383	69,851,099	6,985,110	8,382,132	10,477,665
PRC	788,001	161,898	626,103	62,610	75,132	93,915
Public Works	4,408,589	890,461	3,518,128	351,813	422,175	527,719
TOTAL	171,536,320	14,636,822	156,899,498	15,631,879	18,758,255	23,447,818
**FY 2021 Adjusted Budget = FY 2021 Revised Budget - FY 2021 Internal Services						
Internal Service Costs include the following:						
Facilities Maintenance						
IT Cost Allocation						
Mail Services						
Vehicle Maintenance						
Vehicle Replacement						

Not included in the proposed deferrals are reductions to internal services funds, transfers supporting special funds, and allocations to community agencies. These items will be reviewed individually based on funding needs. We ask that departments provide their proposed deferrals by **Thursday, April 30, 2020**. All proposals will be reviewed by the City Manager. We understand that this is a difficult task requiring a rapid turn-around.

Budget Strategies Principles

It is important departments develop thoughtful ideas for deferrals that are realistic and result in minimum negative impact to services and operations. Below are the Budget Strategies Principles that staff is using to guide us as we right size the FY 2021 Budget.

1. *Continue serving the community.* Public health and safety functions, as well as essential municipal services will be preserved to the maximum extent possible. In so doing, the City will make every effort to avoid service and workforce reductions.

2. *Live within our means.* Strive for long-term sustainability that aligns available resources with needs and the City's values that embrace a commitment to advancing racial and social equity, serving those who are most in need, and environmental sustainability.
3. *Identify expenditures that can be deferred.* Take a deferment first approach by thoroughly assessing expenditures with a special emphasis on large capital projects, equipment purchases, and new projects.
4. *Pursue other revenue and assistance.* Vigorously pursue cost recovery efforts, secure alternative sources of revenue, and be positioned to capitalize on federal and state assistance.
5. *Manage use of, and replenish, reserves.* In drawing on reserves, the City will adopt a long-term orientation to ensure that funds are available for the duration of the economic downturn. The City will look to its existing policies to ensure that any reserves that are utilized are restored when the economy improves.
6. *Be data-driven and transparent.* Budget decisions will be informed by data and be transparent. Staff will work collaboratively with the Budget and Finance Committee with on-going communication and updates provided to the entire City Council.

In addition, on February 27, 2020, the Budget & Finance Policy Committee (Policy Committee) discussed, reviewed, and approved the following two budget fiscal policies.

1. Funding the 115 Pension Trust
 - a. Raise the Property Transfer Tax baseline from \$12.5 million to \$15 million. The additional \$2.5 million will be allocated to the 115 Pension Trust.
 - b. Property Transfer Tax in excess of \$15 million will be treated as one-time revenue to be used for the City's capital infrastructure needs. However, revenue generated from Measure P is excluded (exempt) from this transfer.
 - c. Savings generated by pre-funding CalPERS will be contributed to the 115 Pension Trust. On an annual basis, staff will analyze the impact of pre-funding CalPERS. If the analysis determines that pre-funding CalPERS will result in budgetary savings, the net savings will be contributed to the 115 Pension Trust.
 - d. Refer to the City Manager to explore including interest above the baseline budget as an additional revenue source.

2. Short-Term Rental General Fund Revenue

The Committee discussed and approved for the Council's consideration the following priorities for the short-term rental revenue as part of the budget process.

- a. Sufficiently fund the implementation and enforcement of the short-term rental program;
- b. Keep the \$500,000 baseline for the arts grants program.

Both of these fiscal policies were approved by the Policy Committee prior to the COVID-19 pandemic. Now that the fiscal impacts of the pandemic are being revealed the Policy Committee might want to reconsider submitting one or both of these policies to the Council for approval and immediate implementation in FY 2021. The Policy Committee should note that the \$500,000 allocation to the arts grants program is included in the FY 2021 General Fund baseline budget of \$202.6 million.

Hiring Freeze

As a cost-savings measure to efficiently utilize organizational resources, there is a freeze on citywide hiring, effective immediately. During this period, Department Heads are asked to suspend any and all hiring activities. As we begin to assess the pandemic's impact on our community, strategic steps are being made to manage our resources. Recognizing the magnitude of challenges ahead, including the great stress on our limited resources, the City's focus is the continuity of essential functions.

The City recognizes this hiring freeze policy will create hardships across the organization. To minimize this impact, Department Heads may request exceptions, which will be considered on a case-by-case basis by the City Manager. The limited exceptions will focus on preserving critical organizational functions to protect the general welfare and safety of our constituents and employees, remain compliant, and minimize risk exposure. Additional details of the hiring freeze including frequently asked questions can be found in Attachment B: Guidelines for Citywide Hiring Freeze.

We must ensure that we have adequate flexibility to continue to effectively respond to the COVID-19 pandemic, which includes challenges that were unplanned but will continue to be revealed as we move through FY 2021.

General Fund Reserves

The General Fund Reserve is distinctly separate from the General Fund Balance (Excess Equity). On January 24, 2017, the City Council established [Resolution No. 67,821](#) – N.S., a policy for the General Fund Reserves (Attachment C).² The General Fund reserves are comprised of two elements: a Stability Reserve and a Catastrophic Reserve.

² <https://www.cityofberkeley.info/recordsonline/export/17153922.pdf>

The Stability Reserve was established to mitigate the loss of service delivery and financial risks associated with unexpected revenue shortfalls during a single fiscal year or during a prolonged recessionary period. The purpose of the Stability Reserve is to provide fiscal stability in response to unexpected downturns or revenue shortfalls. Fifty-five percent of the General Fund Reserve is allocated to the Stability Reserve.

The Catastrophic Reserve was established to sustain the General Fund operations in the case of a public emergency such as a natural disaster or other catastrophic event. The Catastrophic Reserve may be used to respond to extreme onetime events, such as earthquakes, fires, floods, civil unrest, and terrorist attacks. Forty-five percent of the General Fund Reserve is allocated to the Catastrophic Reserve.

When the Council adopted the General Fund Reserve Policy the target level established for the Reserve was a minimum of 13.8% of Adopted General Fund Revenues with an intermediate goal of a minimum of 16.7% by the end of Fiscal Year 2020, if financially feasible. In addition, the Council adopted a long-term goal of 30% of General Fund revenues, to be achieved within no more than 10 years (FY2027). The Council demonstrated their commitment to these goals in the policy by assigning 50% of the General Fund Excess Equity above the first \$1 million to be allocated to the General Fund Reserves. Additional Excess Equity may be allocated to the General Fund Reserves by a majority vote of the Council. The chart below illustrates the FY 2019 allocation of the \$1.16 million distributed to the General Fund Reserves, resulting in a total General Fund Reserves level of 17.43%³.

General Fund Reserves	Stability Reserve	Catastrophic Reserve	Reserve %
Beginning Cash Balance - Reserves	\$ 20.25	\$ 16.39	
FY 2019 Allocation to Reserves	\$ 0.64	\$ 0.52	
% Allocation	55%	45%	
Reserve Balance	\$ 20.89	\$ 16.91	
Reserved for Camps Fund - Tuolumne Carr	-	\$ (3.30)	
Ending Cash Balance - Reserves	\$ 20.89	\$ 13.61	17.43%

We do not know what long-term impacts of the loss of jobs and reduction in property sales and other business activity will have on the City, but it will be significant and it will be negative. We must be strategic with our use of the General Fund Reserves. The General Fund Reserves are our safety net that might need to sustain the City for years to come.

³ Based on the FY 2020 Adopted General Fund Revenues of \$197.0 million.

Special Funds

Staff provided projections for the special funds managed in their department. Most of the funds appear to be sustainable through FY 2021. However, there have been fiscal impacts to some of the special funds that are still unknown. For example, the Parking Meter Fund has experienced a significant revenue decline as the meter rates have been reduced to zero, so we are not generating any on-street revenue from parking. The Off-Street Parking Fund also experienced significant revenue declines. Although street garages are open there is not much demand. Parking fines are down as there continues to be limited enforcement. The Zero Waste fund will also be impacted as we work with businesses to either temporarily suspend or reduce solid waste service. With the adoption of the FY 2020 & FY 2021 Biennial Budget, Council approved a \$1.9 million allocation to the Marina Fund from excess equity generated in FY 2020. However, as excess equity might not be actualized this allocation might need to be reconsidered.

Departments are working diligently to determine fiscal impacts to the various special funds. Departments facing financial challenges with their special funds were asked to notify the Budget Office immediately. These challenges along with proposed solutions will be presented to the Policy Committee and the City Council as we move through the FY 2021 budget development process.

FY 2021 Budget Development Process

One of the Budget Strategies Principles noted above is to be data-driven and transparent. Staff will work collaboratively with the Budget & Finance Committee and the City Council with on-going communication and updates. This pandemic thrust us into uncharted fiscal territories. We do not know how long the impacts of this pandemic will last. We do not know if this sharp downturn is followed by an immediate rebound of economic activity late this year or early next or, alternatively, the recovery is slow with economic output depressed for much longer due to an extended virus or a second virus wave. The economy might not get back to normal until a vaccine is developed, and what will the new normal look like?

Our plan is to propose an FY 2021 Updated balanced budget. The proposed budget will focus on the public health and safety functions, as well as preserving essential municipal services to the maximum extent possible. In so doing, the City will make every effort to avoid service and workforce reductions. Council will be challenged to make some very difficult decisions. However, as additional revenue is realized staff will return to the Policy Committee and the City Council regularly to discuss allocating revenues to priorities that were previously deferred in order to balance the FY 2021 budget. The FY 2021 Proposed Budget Update and Budget Hearing #1 will be presented to Council on May 12, 2020. The FY 2021 Updated Budget is scheduled to be adopted by the Council on June 29, 2020.

Conclusion:

The effects of this pandemic are unknown but will likely be felt for years to come. Therefore, as a City, we should be conservative in our outlook and approach. As additional revenues are generated, priority operational needs will be reassessed for funding. Our goal is to ensure that the budget continues to demonstrate our commitment to stewarding the public's resources for their benefit and that of future generations.