



# City Council Agenda Report

**FROM:** Lauren Lai, CPA, Finance Director

**SUBJECT:** FY20/21 Financial Report on Structural Deficit and Coronavirus (COVID-19) Deficit on the City General Fund and Proposed Budget Reductions and Revenue Enhancements (Not a Project under CEQA Article 20, Section 15378 and under General Rule Article 5, Section 15061)

## **RECOMMENDATION:**

City Council receive Financial Report on Coronavirus (COVID-19) Impact on City General Fund Fiscal Year 2020/2021 and Various Proposed Budget Reductions and Revenue Enhancements.

## **POLICY IMPLICATIONS:**

Monterey City Charter section 6.6(e) provides: “[i]f there are insufficient funds available to provide for the ordinary and necessary services in any budget year, they may, by an affirmative vote of four (4) members of the City Council, reduce the amount to be appropriated for Neighborhood and Community Improvements.”

## **FISCAL IMPLICATIONS:**

Staff estimates that the effects of COVID-19 pandemic will devastate the City’s General Fund revenues for FY19/20 and FY20/21(2 years) by approximately \$31 million.

The loss is now \$13 million (or 16.2%) through the remainder of fiscal year FY 19/20 (mid-March through June 2020), which is \$3 million higher than originally estimated in April 2020.

For fiscal year FY 20/21, the current estimates project a revenue loss of \$18 million (21.7%) of an \$83 million budget. Additionally, the pandemic created significant financial losses in other funds such as Tidelands, Parking, Measure P & S, etc. The Monterey County Convention and Visitors Bureau (MCCVB) has adjusted the City of Monterey’s revenue loss assumptions for Transient Occupancy Tax (TOT) from \$10M to \$13M. Council resolved \$10M of the \$13M FY20 COVID-19 deficit in April, so the balance of \$3M should be resolved in FY21.

The FY21 proposed solutions need to address \$21M, comprising \$3M FY20 COVID-19 deficit balance and \$18M FY21 COVID-19 deficit. Moreover, the FY21 budget had a structural deficit of \$2.8M which will increase to \$3.2M due to various program and/or insurance updates, however we anticipate this deficit of \$3.2M will be resolved with the new voter-approved Measure G (½ cent per dollar sales tax).

## **ENVIRONMENTAL DETERMINATION:**

The City of Monterey determined that the proposed action is not a project as defined by the California Environmental Quality Act (CEQA)(CCR, Title 14, Chapter 3 (“CEQA Guidelines”), Article 20, Section 15378). In addition, CEQA Guidelines Section 15061 includes the general

rule that CEQA applies only to activities which have the potential for causing a significant effect on the environment. Where it can be seen with certainty that there is no possibility that the activity in question may have a significant effect on the environment, the activity is not subject to CEQA. Because the proposed action and this matter have no potential to cause any effect on the environment, or because it falls within a category of activities excluded as projects pursuant to CEQA Guidelines section 15378, this matter is not a project. Because the matter does not cause a direct or any reasonably foreseeable indirect physical change on or in the environment, this matter is not a project. Any subsequent discretionary projects resulting from this action will be assessed for CEQA applicability.

**ALTERNATIVES:** N/A

### **DISCUSSION:**

On April 7 and 21, Council was briefed on the Novel Coronavirus (COVID-19) pandemic and its unprecedented and unpredictable nature and its effects on the City's budget, expenditures and service levels.

Monterey's hospitality industry has nearly grinded to a halt, with dire consequences for the City of Monterey's budget. The City's revenues are dependent on tourism, which accounts for approximately 35% of the City's General Fund, 62% of Measure P and S, and almost 100% of Neighborhood Community Improvement Program (NCIP) and Parking Funds.

The mission of the City of Monterey during this pandemic has been to remain focused on

- maintaining public safety as the top priority,
- keeping the core functions of our local government operational, and
- to encourage a speedy recovery of our economic engines with a focus on our hospitality industry.

With that in mind, our City needs to be prepared to brace for a wide range of fiscal and economic damages, which are occurring and still unfolding. As staff has shared previously, temporarily shuttered facilities such as the library, museums, recreation / park centers, conference center, and sports center must reopen in a safe manner under approved social distancing measures, and in a manner that is fiscally prudent. This report presents short-, mid- and long-term considerations and solutions. The COVID-19 pandemic is causing a significant paradigm shift forcing the City Council to consider revenue, expenditures, and service levels in a compressed timeline. Staff will present a summary of this information and request Council and general public feedback.

This report should be taken in light of prior years of fiscal reform and reductions. Major prior year considerations include: (1) Fiscal Health Response Plan (FHRP) - addressing structural deficit; (2) pre-existing pension obligations; (3) pre-existing unfunded facility repairs; and (4) multiple departments made significant cuts to balance the budget, and it's imperative to consider the reduced staffing and service levels of these departments going into the deeper cuts identified in this COVID-19 report.

This report includes four major sections: (1) Fiscal Overview; (2) Big Picture Strategy / Policy; (3) Broad Service Reductions; and (4) Paradigm Shift Ideas. In terms of timeline, Staff

anticipates additional COVID-19 and budget discussions on June 2 and June 16. The goal is for the Council to adopt budget amendments on June 16th, which will be effective July 1, 2020.

The presented data and proposed solutions are made to correct the short-term budgetary shortfalls. The City of Monterey has provided continuously high service levels to our residents and businesses. It is the intent of the proposed solutions to return to these service levels as soon as it is fiscally responsible.

### ***Labor Contracts:***

The City is currently in closed contracts with all of the labor groups. Six of the labor groups have contracts expiring June 30, 2021 and one labor group (Fire) has a contract expiring in June 30, 2022, but may be reopened for negotiations on station staffing and salary in 2021. Therefore, other than layoffs, the City cannot require or impose concessions to achieve reductions in expenditures. All executives (making up a total of 12 employees) have offered and the City has implemented concessions. At this time, these savings will fund a \$1,000 severance to the 81 employees temporarily laid off. Police management and Fire management (making up a total of eight employees) have volunteered concessions.

The City must continue to engage in discussions with the other labor groups to request concessions to salary, salary-based premiums, and benefits. The City does not want to impact the ability to recruit and retain talent. But given that approximately 78% of the general fund expenditures are related to personnel (salary/benefits), the reality is that without across-the-board concessions provided by labor groups the City will need to implement additional layoffs and cuts to city services and programs, including public safety.

### ***Fiscal Overview: Devastation of City General Fund FY 21:***

#### Deficit Summary:

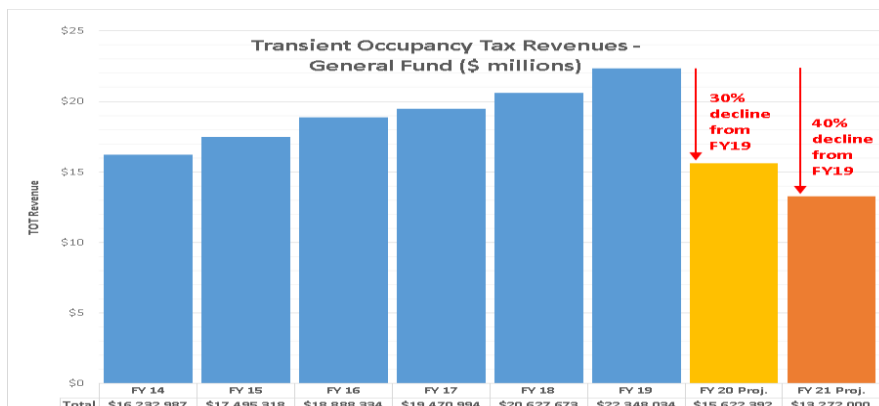
Deficits	FY Adopted	Updates	FY Amended	Proposed Solutions	Comments
FY20 COVID-19	\$0	\$13M	\$M	\$10M \$3M	\$10M of CIP/NCIP \$3M of other solutions
FY21 Structural Deficit	\$2.8M	\$0.4M	\$3.2M	\$3.2M	Measure G ½ sales tax
FY21 COVID-19	\$0	\$18M	\$18M	\$18M	Various Reductions
<b>Total COVID-19 Loss in 2 years</b>		<b>\$31M</b>			

Staff collaborated with various subject matter experts, regional leaders, staff program managers, and others, and corroborated various data resources to derive estimates. Keeping in mind this fluid financial situation, below is Staff's assessment of the FY21 City General Fund revenue losses by major categories.

**Loss by Revenue Categories:** The table below shows the least worst (\$15.8M) ("scenario A") and worst (\$20.9M) ("scenario B") scenarios of COVID-19 deficits by revenue categories. The scenario A assumes significant easing of the shelter-in-place order effective June 1, 2020. The scenario B assumes a second COVID-19 case spike in fall 2020. The average scenario of \$18M will be used for budgeting and operations. Staff will continue to monitor, analyze and adjust services (restoring them) as revenues improve and propose budget adjustments upwards or downwards.

FY20/21 General Fund Revenue	Revenue as a % of Budget	Total Budget	Loss Due to COVID-19 Scenario A	% Loss	Loss Due to COVID-19 Scenario B	% Loss
Transient Occupancy Tax	29%	\$23.8	(\$9.1)	-38%	(\$10.6)	-44%
Sales Tax	11%	\$8.9	(\$1.4)	-16%	(\$2.1)	-24%
Property Tax	15%	\$12.7	(\$0.4)	-3%	(\$0.6)	-5%
Rents (Commercial)	3%	\$2.2	(\$0.1)	-2%	(\$0.1)	-2%
Conference Center Rents, etc.	3%	\$2.2	(\$1.2)	-53%	(\$1.6)	-70%
Parks & Rec Fees	8%	\$6.5	(\$2.8)	-43%	(\$4.0)	-61%
CDD Fees/License & Permits	5%	\$4.0	(\$0.0)	-1%	(\$0.6)	-15%
Business License	5%	\$3.7	(\$0.1)	-3%	(\$0.2)	-5%
Interest Income	1%	\$0.6	(\$0.3)	-41%	(\$0.3)	-41%
Other Revenues	22%	\$17.8	(\$0.2)	-1%	(\$0.4)	-2%
<b>Total</b>		<b>\$82.6</b>	<b>(\$15.5)</b>	<b>-19%</b>	<b>(\$20.4)</b>	<b>-25%</b>

**TOT Revenue Losses** – Below is the TOT revenue historical trend and FY20 & FY21 projections.



California Pension System (CalPERS) -- As for CalPERS pension, COVID-19 caused a worldwide economic crash of stock markets resulting in significant CalPERS investment portfolio losses. Based on the CalPERS webinar on April 8th, the March 2020 year-to-date portfolio loss is 4%. CalPERS did not provide an estimated portfolio loss for FY2020 and/or any estimate for future employer higher costs. We do not know the extent of how the FY20 investment losses will increase employer pension costs starting in FY22/23 with a 5-year ramp up and 20-year level payment amortization. CalPERS plans to publish the annual valuation reports in fall 2020, which will include the FY20 actual investment loss and provide more specific COVID-19 fiscal ramifications on employer costs. The City will need to find solutions to resolve this pension obligation.

**FY21 Big Picture Strategy / Policy** -- This section proposes various strategies and policies to solve FY21 General Fund Budget, which Staff seeks feedback.

- Paradigm Shift Strategies -- With this strategy, the City: (1) recognizes that COVID-19 is unprecedented relative to prior City catastrophes; (2) considers solutions with the idea of "Go Big / Go Broad / Go Simple!" (Jason Furman, Harvard Professor); and (3) act swiftly -- unfortunately there is no time for a traditional reiterative community based process. The City needs to re-examine operations and consider what are core City functions and cost-recovery policies.
- Structural Deficit will be addressed with Measure G Funding Strategy -- Fixes the pre-existing General Fund structural deficit with the new voter-approved Measure G ½ cent per dollar sales tax.
- Pension and Facility Funding Strategy -- Monitoring and instituting long-term solutions to tackle pension liabilities and fix City facilities. Unfunded pension and unfunded facility repairs are pre-existing problems which magnify with COVID-19.
- Fiscal Health Response Plan (FHRP) -- CORE Strategies -- The City continues its FHRP CORE strategies to address COVID19. (1) C - Change Business (2) O - Operational Reductions (3) R - Revenue Enhancements (4) E - Employee Concessions
- Economic Uncertainty Reserve ("rainy day fund") Strategy -- The City Economic Uncertainty Reserve of \$13.7M represents 16.6% of General Fund or the equivalent of almost 2 months of City general fund operations. Some of this balance may be used to solve COVID-19 revenue losses. Keep in mind this is one-time money (not recurring) and in the future, the City will need to restore the rainy day fund and possibly set a higher reserve goal given what the City learns from this pandemic.
- One-time versus Ongoing Solutions Strategies -- The portfolio of costs and revenues will include one-time and ongoing components. To address the immediate challenges and maintain long-term financial stability, the strategies will include one-time strategies that infuse immediate dollars but do not repeat readily in future periods, while recurring strategies infuse dollars repeatedly each period. Examples of one-time strategies are unfunding CIP projects and technology projects. Examples of recurring strategies are workforce reduction, employee concessions, new tax or fee revenues, etc.
- Priority Based Strategy -- To facilitate decision making, this strategy focuses efforts on immediate and urgent priorities. Those include: (1) public safety - serve residents, save lives (2) fix the budget (3) jumpstart local economic recovery
- Labor Negotiation Strategy -- This strategy balances the City's ability to recruit and retain talented employees with the ability to pay for labor costs, and to the end, the strategy seeks employee concessions to possibly avoid some budget cuts and/or layoffs.

FY21 Big Picture Strategies of Proposed Solutions to Solve COVID-19 -- Below is a summary of the proposed COVID-19 fiscal solutions.

- The City will focus on the average scenario of \$21M, comprising \$3M FY20 COVID-19 deficit balance and \$18M FY21 COVID-19 deficit.
- NCIP projects would not be appropriated for FY21.
- Employee layoffs would reduce costs and services.
- Further program costs would be reduced to balance the budget.
- Economic reserve would be used as a one-time solution.
- One-year suspension is proposed for Other Post-Employment Benefits (“OPEB”, retiree medical) savings, vehicle replacement savings, technology projects and/or CIP/facility repairs.
- Revenue solutions -- such as taxes, fees, cost-recoveries -- are all possible, and Staff seeks Council direction before making financial assumptions of additional new revenues. Revenues are discussed further in the “Paradigm Shift Ideas” section.

	Scenario A	Average Scenario	Scenario B
% of GF Budget	22.2%	25.2%	28.1%
Scenario Targets	\$18,525,530	\$21,000,000	\$23,363,980
<b>COVID-19 SOLUTIONS</b>	<b>\$18,525,530</b>	<b>\$20,971,005</b>	<b>\$23,363,980</b>
NCIP	\$3,000,000	\$3,000,000	\$3,000,000
Lay offs - April 2020	\$8,100,000	\$8,100,000	\$8,100,000
Lay offs / Freeze / Retirements - June 2020	*	\$2,433,808	*
Program Cuts - Other Costs	\$5,725,530	\$5,137,197	\$8,263,980
Economic Reserve	\$0	\$600,000	\$1,000,000
Revenue solutions	TBD	TBD	TBD
1-year Reduction of CIP (\$1.4M to \$0.5M)	\$900,000	\$900,000	\$900,000
1-year Suspend OPEB (pay-go only)			\$800,000
1-year Suspend Savings for Vehicle Replace			\$500,000
ISD One Time Savings	\$800,000	\$800,000	\$800,000
*Layoffs/Freezes/Retirements are included in Program Cuts-Other Costs			

**General Fund - Broad Budget Reductions** -- Staff recognizes that service (program) cuts are difficult but facing this financial devastation, significant service cuts will be necessary. Staff proposes these budget reductions and seeks feedback from the Council and general public. Some of the service reductions may be avoided with employee concessions, new revenues and/or other cost reduction strategies.

	A	B	C	D = (B+C)	E (A+D)	F	G = (E/F)
General Fund Department	General Fund Layoff (April 2020)	Additional Position Freezes/Layoff/Anticipated Retirements	Program Cuts Other Reductions	General Fund Program / Staff Cuts (June 2020)	Total Reduction	FY21 Adopted GF Budget	Total Reductions as % of FY21 GF Adopted
	\$8,134,707	\$2,433,808	\$5,137,197	\$7,571,005	\$15,705,712	\$83,285,071	18.9%
Police	\$0	\$1,143,000	\$447,000	\$1,590,000	\$1,590,000	\$19,457,419	8.2%
Fire	\$73,414	\$635,631	\$743,202	\$1,378,833	\$1,452,247	\$23,413,852	6.2%
Parks	\$101,342	\$217,355	\$30,214	\$247,569	\$348,911	\$4,562,561	7.6%
MSC & Rec	\$3,990,263	\$0	\$1,900,000	\$1,900,000	\$5,890,263	\$9,722,721	60.6%
Library	\$1,857,021	\$0	\$83,434	\$83,434	\$1,940,455	\$3,221,469	60.2%
Museum	\$206,463	\$0	\$13,762	\$13,762	\$220,225	\$372,608	59.1%
PW	\$341,529	\$166,424	\$1,024,642	\$1,191,066	\$1,532,595	\$6,980,249	22.0%
CDD	\$0	\$72,183	\$263,100	\$335,283	\$335,283	\$3,578,088	9.4%
Conf. Center	\$1,293,280	\$0	\$120,388	\$120,388	\$1,413,668	\$4,024,515	35.1%
CMO	\$121,751	\$0	\$208,534	\$208,534	\$330,285	\$1,489,073	22.2%
ISD	\$149,644	\$0	\$40,700	\$40,700	\$190,344	\$706,770	26.9%
CAO	\$0	\$0	\$56,221	\$56,221	\$56,221	\$1,124,426	5.0%
HR	\$0	\$0	\$44,000	\$44,000	\$44,000	\$800,001	5.5%
Finance	\$0	\$199,215	\$162,000	\$361,215	\$361,215	\$3,031,214	11.9%
Non-Dept						\$800,105	

- Police - anticipated retirements/hiring delays of multiple positions and reduced services, training, overtime and supplies. Core functions will be maintained but public safety services will be impacted or reduced such as the traffic officers, School Resource Officer, Community Action Team, general police presence, the Multi-Disciplinary Outreach Team (MDOT) and others. These actions will create a lag in the one-year training cycle for officers to be "street ready." The positions in police can be funded at any time as they will not be eliminated, they will just not be funded.
- Fire - freezes/layoff/anticipated retirements of multiple positions and reduces services & supplies. Core functions will be maintained but some public safety services will be impacted or reduced such as training and emergency preparedness.
- Parks - freezes/layoff/anticipated retirements, reduced services and operational supplies.
- Public Works - freezes/layoff/anticipated retirements of multiple positions and temporarily assigns multiple positions other funds. There will be an impact to the City's ability to maintain its infrastructure. Other services, supplies and utility costs were also reduced.
- Finance - freezes/layoff/anticipated retirements of multiple positions and reduces services and supplies.
- Human Resources -- reduces service, supplies and recruitment costs.
- City Attorney's Office -- reduces court costs and third party service costs.
- City Manager's Office --freezes/layoffs, labor cost allocation to other funds and reduces services and supplies.

- Museum - freezes/layoff/anticipated retirements of multiple positions and reduces services and supplies.
- Library - freezes/layoff/anticipated retirements of multiple positions and reduces services and supplies.
- Sports Center and Recreation -- freezes/layoff/anticipated retirements of multiple positions and reduces services and supplies.
- Information Services Department -- freezes/layoff/anticipated retirements of multiple positions and reduces services and supplies.
- Conference Center - freezes/layoff anticipated retirements of multiple positions and reduces services and supplies.

**Paradigm Shift Ideas** -- COVID-19 is causing a paradigm shift -- defined as a fundamental change to the approach or underlying assumptions. The City should consider solutions with the idea of “Go Big / Go Broad / Go Simple!”. Moreover, COVID-19 imposes swift action without time for the traditional reiterative process. Below is a list of some “Go Big / Go Broad / Go Simple” ideas in no particular order -- and such list is not all inclusive either and Staff certainly seeks more feedback. Lastly, this list is meant as a starting point for multiple analyses and evaluations. Some of these suggestions will create a robust and, probably, adversarial discussions between interest groups and stakeholders. In other words: we put everything on the table. In presenting this list, Staff has a responsibility to provide solutions / options with potential timeframes:

**Decision-Making: Next 1-2 Months**

- Transient Occupancy Tax (TOT)
  - Potential rate increase (August deadline for November Ballot)
  - Adjust NCIP allocation (August deadline for November Ballot)
  - Streamline reporting and collection to monthly (Introduce Ordinance in June)
- Monterey County Convention & Visitors Bureau (MCCVB)
  - Set new contribution formula @ 3% (June 2020)
  - Consider one-time infusion of funds for economic recovery (June 2020)
  - Determine one-time forgiveness of rental for Visitor Center/French Consulate (June 2020)
- Binding Arbitration
  - Meet and Consult before potentially placing a measure on the ballot to adjust a binding arbitration provision in the City’s charter (August deadline for November Ballot)
- Monterey City Disposal Service
  - Renew refuse franchise, increase franchise rate / revenues
- Consolidate Staff in Multiple Facilities/Locations
  - Reduce utility, technology, infrastructure costs

**Potential Implementation: Next 2-3 Months**

- Cost Recovery Analysis / Fee Increases
  - Potential fee increases to offset costs (June/July)
  - Establish facility fees to fund capital improvements/projects at Sports Center (June/July)
- Fire Department



- Discontinue Paramedic Pilot Program (June/July)
  - Explore Fire/Medical Response Fee (July - October)
- Explore Outsourcing Options
  - Conference Center - potential partnership with MCCVB
  - Veterans Memorial Park Campground
  - Harbor/Marina Operations
  - Custodial Services

Potential Implementation: Next 3-6 Months

- Reduce Hours of Services for Administrative Offices
- More Self-Services - automations, website, internet based
- Developer Deposit - approach and administration
- Internal Service Funds - reduce cost, allocation methods, enhance programs
  - Information technology cost allocations and cost reduction opportunities
  - Continue progress with return-to-work programs to reduce worker's compensation expenses
  - Re-examine general liability plans and risk pool strategies

Potential Implementation: Next 6-9 Months

- Private / Non-Profit Funding Support
  - Continued support from Friends and Foundation of the Monterey Public Library
  - "Sports & Wellness Foundation" for Sports Center
  - Partnership with Non-Profits for Senior Center Operations
  - Continued partnership with sports groups for Ballfield Operations
- Fire Department
  - Standards of Cover Study (June-October)
  - Potential reductions in staffing (Early 2021)

**Conclusion** -- Staff requests that the City Council receive this financial report on COVID-19 impacts on the City General Fund FY21 along with various proposed budget reductions and revenue enhancement. Staff also seeks feedback with the goal of continuing the discussion and approving elements of the FY 2020/21 Budget on June 2, final adoption of the budget on June 16, and consideration of short and mid-term budget strategies.

Monterey's economy including our City's revenues will bounce back. The recent Memorial Day weekend showed how popular the Monterey Peninsula is. However, for the foreseeable future, the short-term and long-term impacts of COVID-19 continues to remain unpredictable and impact the speed of Monterey's economic recovery.