



CITY OF COSTA MESA

77 Fair Drive
Costa Mesa, CA 92626

Agenda Report

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Meeting Date: 4/28/2026

TITLE:

FISCAL YEAR 2025-26 MID-YEAR BUDGET UPDATE

DEPARTMENT: FINANCE DEPARTMENT

PRESENTED BY: MARK KHOU, BUDGET AND PURCHASING MANAGER

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RECOMMENDATION:

Receive and file the Fiscal Year 2025-26 Mid-Year Update, including updated projections for General Fund revenues and expenditures for the fiscal year ending June 30, 2026.

BACKGROUND:

On June 3, 2025, the City Council approved a General Fund (Fund 101) balanced budget of \$186.9 million, and the All Funds (including Restricted Funds) budget totaled \$224.9 million with a total of 599 Full-Time Equivalents (FTEs) across City Departments. The Council approved a partial waiver of the Capital Asset Needs (CAN) in the amount of \$1.25 million contribution and partial waiver of the Technology Information Needs contribution in the amount of \$1.16 million to ensure a balanced FY 2025-26 budget. The repayment towards the deferral of both respective funds is spread over a 10-year period beginning in FY 2026-27. All City Departments continue to exercise fiscal prudence by monitoring their budgets to ensure focused delivery of essential services and programs.

During calendar year 2025, the U.S. economy exhibited volatility driven by market and consumer reactions to evolving federal policies and changes including the implementation of new tariffs, and the extended federal government shutdowns. The volatility continued into 2026 and so far, exacerbated by the ongoing war in Iran. The resulting spike in fuel prices along with economy-wide uncertainties has shaken consumer confidence and restrained discretionary spending for the average household. Furthermore, Federal immigration enforcement and lingering impacts from tariff policies add to unsettled consumer confidence across a range of markets including but not limited to the labor, real estate, and financial markets. Although the full impact of these policies and geopolitical developments remains uncertain, forecasts indicate that the U.S. conflict in Iran, rapid increases to fuel prices, and shifting household liquidity are likely to influence the City's revenues and expenditures in the near and longer term.

ANALYSIS:

Overall, the FY 2025-26 General Fund budget expenditures are projected to end at \$193.9 million, an increase of \$5.3 million from the amended budget of \$188.6 million. General Fund revenues are estimated to end the year at \$193.9 million, an increase of \$6.5 million above the amended budget of \$187.4 million. A detailed summary of these year-end projections is included in Attachment 1 for Council’s reference, *General Fund Financial Report*.

The City’s year-to-date revenues have reflected the continued resilience of consumers despite various macro-economic challenges, and generally low levels of consumer confidence. Despite increased tariffs, elimination of EV credits, and reduced international travels to the U.S., consumers continued to spend across most sectors, including automobiles, hotels, and dining. However, the impacts from the U.S. conflict with Iran, including the increased cost of gasoline and supply chain disruptions, will likely influence city revenue generation and collections as these challenges linger. Nonetheless, the City expects to conclude FY 2025-26 with a balanced budget.

FY 2025-26 OVERVIEW

REVENUES

City staff continually monitors and adjusts its revenue projections based on historical and currently observed revenue performance and other impactful developments in the regional and national economy. Also, it is important to note that certain key revenues are received at different times throughout the fiscal year and are typically no less than one month in arrears. Sales Tax represents approximately 40% of the total annual General Fund revenue and is the largest revenue category. Sales tax is primarily received two months in arrears. Property Tax represents 34% of the total General Fund revenues budget and is received in two large installments within the December/January and April/May periods. Transient Occupancy Tax (TOT) represents 5% of total General Fund Revenues and is received monthly. Cannabis Gross Receipts Tax represents 2% of total budgeted General Fund Revenues.

The General Fund year-end projections (including transfers) are estimated at \$193.9 million, a difference of approximately \$6.5 million from the amended budget.

Table 1: General Fund Overview

Category	FY 2024-25 Actuals	FY 2025-26 Adopted Budget	FY 2025-26 Projected	Difference	FY 2025-26 Adopted vs Projected %
Property Taxes	\$59.3M	\$62.9M	\$62.2M	-\$0.7M	-1.1%
Sales Taxes	79.6	75.0	80.9	5.9	7.9%
TOT(Hotel Tax)	9.9	9.8	10.0	0.2	2.0%
Cannabis Tax	3.7	3.7	3.7	-	0.0%
Other Revenue	37.5	35.5	37.1	1.6	4.5%
Total Revenues	190.0	186.9	193.9	7.0	3.7%
Total Expenditures	190.0	186.9	193.8	6.9	3.7%

Property Taxes - Based on assessed values are thus far running at an anticipated increase of approximately 5% growth from prior year, as property values continue to increase along with home prices. However, property tax revenues currently projected at \$62.2 million as at fiscal year-end is slightly below pace with the adopted budget of \$63.0 million.

Sales Taxes - Revenue received as of March 2026 inclusive of recent December holiday sales activity stand at \$47.1 million (4.6% increase year over year). While the City's sales tax revenue is currently trending above budget, impacts to consumer behavior in the remaining months of the fiscal year due to supply chain pressures from the current conflict with Iran, along with changing tariff policies, run the risk of dampening current trends. Our current expectation is that sales tax receipts at year end will be approximately \$80.9 million.

Transient Occupancy Tax (Hotel Tax) - Revenues are \$6.7 million as of March year-to-date (+3.2%) running modestly above prior YTD levels, as consumers thus far have continued to spend on experiences despite higher prices. However, prolonged increases to fuel prices may impact summer travel and hotel stays. TOT is anticipated to end the fiscal year slightly higher than the budget at \$10.1 million.

Cannabis Tax - As of March year-to-date, total Cannabis Tax revenues (Measure Q & X) are \$2.6 million (-4.9% to prior fiscal year) and anticipated to end the fiscal year relatively close to the adopted budget of \$3.7 million. The Cannabis Tax revenues finance two restricted special revenue funds receiving half a percent to the Arts and Culture Master Plan Fund (130) and another half a percent to the First Time Homebuyers Fund (140). The Arts and Culture Master Plan Fund has a budget of \$416,990, of which \$227,472 is funded by the Cannabis Tax and the General Fund funds the remaining balance of \$189,518. The First Time Homebuyer Program is also funded by the Cannabis Tax and has a current balance of \$537,656. Staff will be presenting an update to City Council on the First Time Homebuyer Program in June.

Since a significant portion of the City's revenues and expenses do not occur evenly throughout the year, the remaining fiscal year numbers cannot simply be extrapolated or annualized to arrive at the full year's amounts. City staff utilize historical data, macro-economic, micro-economic, and industry trends (including industry experts in particular segments), to forecast and provide estimates of the fiscal year-end performance. As of February 28, 2026, total General Fund revenues were \$105.3 million (56.1% of total revenue budget) and expenditures were \$141.4 million (75.6% of total expenditure budget). These percentages are consistent with projections for this time in the fiscal year. City Departments strive towards achieving City Council's goals for long-term fiscal sustainability by monitoring revenues and finding ways to improve performance. Moreover, departments exercise prudence with the budget to deliver effective and efficient services to the residents of Costa Mesa.

EXPENDITURES

The Fiscal Year 2025-26 adopted expenditures budget for Citywide services was \$186.9 million compared to the amended budget of \$188.6 million. As of this writing, General Fund expenditures are estimated to end at \$193.9 million, approximately \$5.4 million above the amended budget. These expenditures include \$1.3 million in subsidies towards the Housing Authority Fund (Fund 222) to help support homeless services programs. In addition, insurance premiums increased by \$300,000 from the prior fiscal year, and utilities cost continue to grow on an annual basis. The City has contractual obligations for general services, software subscriptions, landscaping and maintenance, and other

operational expenses, which have impacts on the General Fund.

The City Council's core goal to Strengthen Public Safety and Improve Quality of Life remain a top priority in the expenditure budget. As such, the combined amended Fiscal Year 2025-26 budget for the Police Department and Fire and Rescue Department of \$102.3 million reflects the City's commitment toward ensuring the safety of residents and visitors citywide; including high-traffic venues such as South Coast Plaza, Harbor Center, Metro Pointe, and Triangle Square; and at large public events such as the annual OC Fair and OC Marathon. As of March 31, 2026, the two public safety departments have combined for a total of approximately \$84.4 million in expenditures, representing approximately 59.7% of the total General Fund expenditures to date.

SALARIES AND BENEFITS

Salaries and benefits account for 73.5% of the City's FY 2025-26 General Fund budget. The rising labor cost has been a challenge for the City given limited revenue resources and rising operating costs. Previously, the job market allowed for mobility for the local workforce, which made it a challenge to retain or attract high quality staff. Through the Human Resources strategic talent acquisition, the City's March 2026 vacancy is at 34 compared to the 51 vacancies in March 2025.

The City updated its Hiring and Referral Incentive Program in September 2024 to support recruitment of Lateral Police Officers (transfers from other jurisdictions), Entry Level Police Recruits, and both Lateral and Entry Level Dispatchers. This two year pilot program was created to attract qualified candidates to hard to fill positions and encourage employee referrals, with incentives ranging from \$10,000 to \$25,000 depending on position type, plus a \$2,000 referral incentive. Since the implementation of the program, total incentive costs have reached \$242,500, including \$172,500 in FY 2024 25 and \$70,000 in FY 2025 26, and have resulted in large part to the filling of 27 Police Officer vacancies in two years among other successful recruitments.

Operationally, the hiring of Police Recruits provides a continuous pipeline of candidates. The costs for Police Recruits are funded by vacancies in the Police Officer classification. The Police Department is fully staffed in the sworn classifications.

SUMMARY

In summary, staff continue to monitor the budget. Federal policies and geopolitical uncertainty require a proactive approach to ensure expense management and financial efficiency in the delivery of essential services. The City is taking a preemptive approach to implement cost-containment measures. City staff are carrying out several strategies to ensure that the City's expenditure will stay within its revenue projections. These preemptive measures include tracking and monitoring of spending closely, limiting spending to critical expenditures, renegotiating vendor contracts, as well as analyzing and limiting overtime costs. Lastly, staff continue to pursue available grant funds and other external resources.

FY 2026-27 PROPOSED BUDGET STATUS

The Finance Department kicked off the annual budget development process in December 2025. While the City's revenue is projected to grow modestly in the next fiscal year, departments were instructed to limit their budgetary enhancement requests to core services or to meet the City's contractual obligations. Further, as a proactive cost containment measure in readying the FY 2026-27 budget, the City Manager set a 5% budget reduction target and tasked all departments to identify said reductions to their operating budget, without disruption to core services.

The FY 2026-27 budget includes several key budget drivers contributing to upward cost pressures. These include the one-time appropriation for the 2026 election, increases in general liability premiums, rising utility and external rental costs. Additionally, the City expects its annual CalPERS unfunded actuarial liability (UAL) payment to increase by approximately \$2 million, bringing the FY2026-27 payment to an estimated \$33 million. Furthermore, the City has initiated labor negotiations with Costa Mesa City Employee Association (CMCEA), Confidential Unit, Costa Mesa Police Association (CMPA) and Costa Mesa Police Management Association (CMPMA) which may result in potential MOU increases. However, at this time, the fiscal impact is unknown.

Historically, the City realized salary savings as a result of a high vacancy rate driven by fluid job markets over the past five years. However, the City is seeing a decrease in the vacancy rate by half compared to this time last year. Additionally, with fewer vacancies than in prior years, the City anticipates reduced salary savings to offset growing labor expenses. Therefore, staff is currently reviewing the previously budgeted attrition factor and recalculating these figures to be reflective of the City's budget and current staffing levels.

Capital Assets Needs Ordinance

As part of the FY 2025-26 budget adoption process, Council authorized the usage of the Capital Asset Needs' (CAN) "Emergency Exception" clause under Municipal Code section 2-209.2, Economic Downturn, to reduce the amount allocated to CIP projects by \$1.25 million and Information Technology Needs Fund by \$1.16 million. As required by the Ordinance, staff developed a plan to replenish the funds deferred in FY 2024-25 and FY 2025-26. The first five-year repayment plan for the deferrals, starting FY 2026-27 as Year 1 will be in the amount of \$717,047 combined to the CIP and Information Technology Needs Fund. The repayment amount will be reduced to \$237,876 in years six through ten.

FY 2026-27 Budget Development Next Steps

The FY 2026-27 Proposed Budget is still under development at this time. Staff plans to provide requisite budget details to FiPAC on May 7, 2026, and to City Council at a Study Session scheduled on May 12, 2026. The City has historically relied on Sales and Use Tax and Property Tax revenues to fund the City's operations; however, this revenue source fluctuates based on the economy. On April 16, 2026, the Finance & Pension Advisory Committee (FiPAC) recommended to update the 41-year-old business license tax structure for Council to review. In addition, FiPAC also recommended to Council to update the Transient Occupancy Tax, which was last updated in 2010. Both ballot measure items will be brought to City Council for a Study Session in late May.

FISCAL REVIEW:

Staff recommends continuing the proactive and prudent budget strategy that enables quality service to residents and customers while being cost conscious and aggressively pursuing new revenue opportunities. Taking preemptive measures early on during times of economic uncertainty allows for more disciplined planning and thus helps to ensure continuity in the core public services that residents rely on the most.

LEGAL REVIEW:

The City Attorney's Office has reviewed this report and approves as to form.

CITY COUNCIL GOALS AND PRIORITIES:

This item supports the following City Council Goals:

- Strengthen the Public's Safety and Improve the Quality of Life
- Achieve Long-term Fiscal Sustainability
- Recruit and Retain High Quality Staff
- Diversify, Stabilize and Increase Housing to Reflect Community Needs
- Advance Environmental Sustainability and Climate Resiliency
- Maintain and Enhance the City's Facilities, Equipment, and Technology

CONCLUSION:

Receive and file the information regarding the Fiscal Year 2025-26 Budget as described.