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CITY OF COSTA MESA

Agenda Report

File #: 25-143 **Meeting Date:** 3/11/2025

TITLE:

FISCAL YEAR 2024-25 MID-YEAR BUDGET UPDATE

DEPARTMENT: **FINANCE DEPARTMENT**

PRESENTED BY: **CAROL MOLINA, FINANCE DIRECTOR**

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RECOMMENDATION:

Receive and file the Fiscal Year 2024-25 Mid-Year Update, including updated projections for General Fund revenues and expenditures for the fiscal year ending June 30, 2025.

BACKGROUND:

On June 4, 2024, the City Council approved a General Fund (Fund 101) balanced budget of $189.9 million and the All Funds (including Restricted Funds) budget totaled $239.8 million with a total of 602 Full-Time Equivalents (FTEs) across City Departments. All City Departments continue to exercise fiscal prudence by monitoring their budgets to ensure there are sufficient appropriations for essential programs and expending actual revenues that have been received or awarded in grants or restricted funds.

During most of calendar year 2024, the U.S. economy experienced solid growth driven by continued consumer spending, but at the end of 2024 and leading into 2025 persistently higher interest and inflation rates began to drag on growth and consumer spending. The weight of high interest rates on home and auto loans has slowed activity in those markets, and the persistently high cost of goods for the average consumer has reduced disposable incomes and reduced household savings. At the Federal level, volatility in the financial markets and uncertainty over the impacts of immigration policies, government layoffs, and new tariffs, have challenged consumer confidence and business outlooks for 2025 and beyond.

ANALYSIS:

The FY 2024-25 General Fund Adopted Budget is $189.9 million. Based on the most recent analysis, it is anticipated General Fund expenditures will come in under budget at $187.1 million, a reduction of $2.8 million. However, General Fund revenues are estimated to end the year at $183.5 million, resulting in a revenue shortfall of $3.6 million when comparing estimated year end expenses to revenues. To address the revenue shortfall, Staff will be recommending the transfer of $720,000 in annual street sweeping costs from the General Fund to the Gas Tax Fund, and the temporary deferment of up to $2.9 million in unspent Capital Improvement Fund 401 projects until the economy shows signs of improvement. These two strategies will ensure a balanced budget by year end and

the continuation of core public services to the community.

Economic and consumer challenges, which impacted Sales Tax in FY 2023-24, continue to worsen in Fiscal Year 2024-25 impacting City, County, and State Sales Tax revenues. As of February 2025, on a year-over-year basis, the City's Sales Tax revenues are trending 3.4% lower than the prior fiscal year, despite a solid holiday sales period in December 2024. Autos and Transportation revenues, one of the City's largest sectors, has been negatively impacted as a result of high interest rates and increased prices on inventory in both new and used vehicles. In the General Consumer Goods sector, the City's largest sector, weakened consumer activity due to sustained inflation, as well as a reduction in consumer savings, have impacted results on a year-to-date basis.

GENERAL FUND FORECAST

While the budget forecast does not currently reflect a recession per se, it does recognize several risk factors that could negatively affect the national, state, and local economies and, therefore further impact City revenues. Overall inflationary pressures on consumers still persist, and it is anticipated the scheduled tariffs on goods manufactured outside the United States may reduce consumer spending and decrease discretionary incomes. Higher interest rates on increasing credit card balances, coupled with layoffs in the public and private sectors will likely present additional economic challenges going forward. Further, a shift in policy by the Federal administration on tariffs has led to sharp stock market declines and volatility thereby decreasing consumer confidence. Additionally, geopolitical instability has destabilized global markets. On March 4, 2025, the Federal Reserve Bank of Atlanta released its First Quarter projection of the nation's Gross Domestic Product (GDP) as a negative 2.4 percent. A recession is generally declared if there are two consecutive negative quarters in the nation's Gross Domestic Product.

EXPENDITURES

The Fiscal Year 2024-25 adopted expenditures budget for Citywide services was $189.9 million. As of this writing, General Fund expenditures are estimated to end at $187.1 million, approximately $2.8 million below the adopted budgeted, due to salary savings and reduced expenditures by Departments Citywide.

REVENUES

City staff continually monitors and adjusts its expenditure and revenue projections based on actual performance and other unexpected developments that impact City financials. It is important to note that certain key revenues are received at different times throughout the fiscal year and typically no less than one month in arrears. Sales Tax represents 43% of the total annual General Fund revenue. It is the largest revenue category and is primarily received two months in arrears. Property Tax represents 32% of the total General Fund revenue budget and is primarily received in 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 and is also received monthly.

The General Fund year-end revenue projections (including transfers) are estimated at $183.5 million, a shortfall of $6.4 million from the adopted budget. As General Fund expenditures are also projected

to come in lower at year end at $187.1 million, the resulting revenue shortfall is $3.6 million.

Table 1: General Fund Overview

Category	FY 2023/24 Audited Actuals	FY 2024-25 Adopted	FY 2024-25 Projected	Diff	FY 2024/25 AD vs Proj. %
Property Tax	$56.5M	$60.5M	$60.4M	$(0.1)M	-0.2%
Sales Tax	77.8	81.6	75.2	(6.4)	-7.8%
TOT (Hotel Tax)	10.2	10.1	9.7	(0.4)	-4.0%
Cannabis Tax	2.9	305	3.6	0.1	2.9%
Total Revenue	**184.5**	**189.9**	**183.5**	**(6.4)**	**-3.4%**
Expenditures	**183.2**	**189.9**	**187.1**	**(2.8)**	**-1.5%**
Net Gain/(Loss)	**$1.3M**	**-**	**$(3.6)M**	**$(-3.6)M**	

Property Taxes are running at an anticipated increase of approximately 4% growth from prior year, as property values continue to increase along with home prices. At this time, Property Tax revenues are $32.5 million as of February (+3.7% growth year over year) and anticipated to be on pace with the adopted budget of $60.4 million by year end.

Actual Sales Taxes received as of February were $39.0 million (-3.4% decline year over year), inclusive of recent December sales activity, and anticipated to fall short of the current adopted budget. At this time, the fiscal year end projection is $75.2 million.

Hotel Tax (Transient Occupancy Tax) revenues are $5.7 million as of this February YTD (-4.6%) running modestly behind prior year-to-date levels, and on a similar pace to 2023 results, as consumers continue to spend on experiences despite higher prices, but at seemingly decreased levels. TOT is anticipated to end the fiscal year nearly in line with the adopted budget of $10.0 million, but slightly lower.

Cannabis Tax (Measure Q) revenues are $1.5 million as of February YTD (+31.1%) outpacing prior year receipts as more stores are in operation for a full fiscal year, and at a relatively consistent pace. Currently, total Cannabis Tax revenues (Measure Q & X) are anticipated to end the fiscal year relatively close to the adopted budget of $3.4 million.

Since a significant portion of the City's revenues and expenses do not occur evenly throughout the year, the remaining third and fourth quarter 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 project fiscal year-end performance.

As of February 26, 2025, total General Fund revenues were $99.0 million (52% of total revenue budget) and expenditures were $126.1 million (65% of total expenditure budget). These percentages are consistent with projections for this time in the fiscal year. City Departments strive towards achieving the City Council's goals to achieve long-term fiscal sustainability by monitoring revenues and identifying strategies to improve performance while exercising prudence with the budget to

deliver effective long-term sustainability.

PRELIMINARY RECOMMENDATIONS

Deferment of Capital Projects and Transfer of Costs to Other Eligible Funding Sources

To address the currently anticipated $3.6 million General Fund revenue shortfall, Staff recommends the realignment of eligible street sweeping expenses in the General Fund to the Gas Tax Fund (Fund 201) in the amount of $720,000, and the temporary deferment of $2.9 million in Capital Projects that are not critical to public health and safety.

The Gas Tax Fund (Fund 201) is funded by gasoline tax collected from fuel purchases at gas stations. The State distributes the taxes collected to cities, counties, and State Highway accounts. These funds, in turn, are eligible to be spent on road and mass transit maintenance, safety projects, and street-related expenses such as street sweeping and cleaning. The City's current street sweeping contract totals $1.4 million with 50 percent budgeted in the General Fund and 50 percent budgeted in the Gas Tax Fund to ensure the City can meet its annual Maintenance of Effort (MOE) requirement in General Fund spending as per State guidelines. As per our recent analysis, the City will meet its General Fund MOE spending requirement across other eligible operations without the need to include General Fund supported street sweeping costs. As such, it is recommended that the $720,000 in General Fund budgeted street sweeping costs be transferred to the Gas Tax Fund. There are sufficient fund balances in the Gas Tax Fund to absorb this expense.

A temporary deferment of Capital Improvement Fund (Fund 401) projects of $2.9 million is also recommended to ensure a balanced budget by year end. The City currently has over 120 capital projects scheduled over the next five years, and several of those projects have not yet been initiated and can be temporarily deferred until further notice. Staff will prepare various options for the City Council to consider at the Study Session totaling $2.9 million in order to help ensure budgetary balance.

Table 2: Recommended FY 2024-25 General Fund Reductions

Fund	Description	Amount
Gas Tax	Realign street sweeping	$0.7M
Capital Fund	Defer Capital Projects	2.9M
Total		$3.6M

Soft Hiring Freeze (Non-Sworn Only)

A soft hiring freeze will be implemented effective April 1, 2025, as a stop-gap measure in response to these economic conditions. The soft hiring freeze will not impact public safety personnel, and/or other positions essential for the health and safety of the public. This strategy will keep salary-related expenses from growing in the final quarter of the fiscal year and into next fiscal year. The Finance Department will continue to update the City Council regularly on the status of both revenues and expenditures, as well as any policy changes that may impact financial outcomes for the City for this year and next.

FEDERAL FUNDING

On January 27, 2025, President Trump signed an executive order entitled "Temporary Pause of Agency Grant, Loan, and Other Financial Assistance Programs," essentially freezing all federal funding. The January 27th Executive Order on federal funding, and several subsequent Executive Orders, are currently frozen or suspended due to challenges within the courts but may still pose a threat to anticipated City funding.

The recurring Federal grants the City receives include the Community Development Block Grant (CDBG) and Home Investment Partnerships Program (HOME) Grant totaling approximately $1.4 million combined - which are from the Department of Housing and Urban Development (HUD). Other Federal grants the City has been awarded include the Justice Assistance Grant from the Department of Justice, Emergency Management Performance Grant (EPMG) from the Department of Homeland Security, and multiple road and safety grants provided by the U.S. Department of Transportation. The dollars received from direct recurring Federal grants help to support 4.17 FTE positions at a cost of approximately $785,000, and multiple community-based non-profits.

The City also receives additional Federal funding, which is passed through the State from the Office of Traffic Safety. If funding from recurring grants were to be curtailed, then staff costs would have to be charged to the General Fund, thus putting an additional strain on the fund, or the related services would need to be curtailed.

The City receives approximately $1.4 million a year of recurring Federal funds that support community services with CDBG and HOME funds, including senior services programs such as Labors of Love, and counseling services for seniors; youth services providing for counseling; and housing rehabilitation projects. Table 3 shows a list of annual amounts the City receives to assist in funding these programs. No reduction have been made to these programs or to City funded positions at this time. Please note that there are sufficient fund balances in these funds to allow for at least one year of continued operations if Federal funding is eliminated moving forward.

Table 3: Annual Recurring Federal Funding Grants

Dept	Description	Grant Agency	Amount
Development Services			
	Community Development Block Grant (CDBG)	Housing and Urban Development	$971,431
	HOME Investment Partnerships Program	Housing and Urban Development	395,571
Total			**$1,367,002**

The City has also been awarded over $13.5 million in capital projects for various improvements. Table 4 shows a breakdown of the Federally funded capital projects.

Table 4: Federally Funded Capital Projects

Federally Funded Capital Projects	Amount
Adams Ave Active Transportation Improvements - Multipurpose Trails	$4,223,000
Signal Modernization for Systemic Safety Improvements	3,906,090
Fairview Road Active Transportation Improvements – Adams Ave to Fair Dr	1,935,000
Adams Ave Bicycle Facility Project	1,760,000
Safe Routes to School Action Plan	630,472
Adams Ave and Pinecreek Dr Intersection Project	620,336
Pedestrian Safety Festival	400,000
TOTAL	**$13,474,898**

For the time being, the City continues to draw down on approved Federal funds for its recurring staffing costs and already initiated capital projects as the freeze on Federal funding has been lifted at the moment. However, Staff is remaining vigilant and tracking all Federal Executive Orders and court rulings to determine if and when budgetary changes need to be made. Staff will keep the City Council apprised of the status of both recurring and Capital Projects funds from now through the end of the next Fiscal Year, or June 30, 2026, to help ensure budgetary balance.

Summary

In summary, City staff anticipates a revenue shortfall in the General Fund of an estimated $3.6 million primarily due to a reduction in sales tax revenues, among other factors. Multiple cost-saving measures are recommended for immediate implementation to mitigate current shortfalls and an anticipated downturn in the economy. Additional strategies are being considered and will be proposed for the next fiscal year's budget as well, for FY 2025-26, which begins on July 1, 2025. The budgetary recommendations for next year's budget will be presented over multiple meetings and Study Sessions in the months of April, May and June to ensure a balanced budget for next year. Staff will continue to monitor all revenue trends and financial conditions closely and advise of any additional actions that should be taken, if needed, if economic conditions worsen.

FISCAL REVIEW:

The fiscal impact from the revenue shortfall will continue to be closely monitored and the appropriate actions will be taken to close the gap on any potential revenue shortfalls. While some local jurisdictions may take a "wait and see" approach for the next several weeks (or months) with the hope that the local and national economies will experience a rebound, this reactive approach is strongly discouraged. As in the past, Staff recommends a more proactive strategy that reduces spending as soon as possible thereby protecting the City from taking more drastic measures in the future. Taking swift action early on during an economic decline allows for more disciplined planning and helps ensure there is 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

CONCLUSION:

Receive and file the information regarding the Fiscal Year 2024-25 Revised Budget as described in the FY 2024-25 General Fund Financial Report in Attachment 1.