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Date	Ver.	Action By	Action	Result
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TITLE:

FISCAL YEAR 2022-23 PROPOSED BUDGET STUDY SESSION

DEPARTMENT: CITY MANAGER'S OFFICE, FINANCE DEPARTMENT

PRESENTED BY: LORI ANN FARRELL HARRISON, CITY MANAGER, CAROL MOLINA, FINANCE DIRECTOR

FOR FURTHER INFORMATION CONTACT: CAROL MOLINA, FINANCE DIRECTOR, (714) 754-5243

RECOMMENDATION:

Conduct a Study Session regarding the Fiscal Year 2022-23 Proposed All Funds Budget of \$206.0 million, with a General Fund component of \$163.5 million, and provide initial feedback and direction to staff in advance of final adoption of the budget by June 30, 2022.

BACKGROUND:

The Proposed Budget for FY 2022-23 supports a first-class local government capable of meeting essential community needs and providing a solid foundation for recovery.

Over the past year, City operations have been streamlined to provide the core services on which our community relies - public safety; recreation, arts, and cultural programming; economic development and community planning; infrastructure creation and maintenance; and, safe, clean and enjoyable public spaces.

Operating departments have restructured to support organizational effectiveness and interdepartmental coordination; internal processes have been redesigned; and digital customer service tools have been developed with more in the works to enhance responsiveness and maximize efficiencies.

The FY 2022-23 Budget recognizes our interconnectedness as a community. As one of the most desirable residential communities in the County, we have long sought to model new ways to live sustainably and care for one another. As we recover from the pandemic, we seek a more equitable, more inclusive community, with an economic recovery that lives up to our values, by keeping our most vulnerable residents in their homes, providing safe places for our children to recreate, celebrating our local artists, preserving our small businesses, and encouraging our citizens to speak with authenticity regarding their passions and our neighborhoods.

Given the fragile state of the economy, expenditure enhancements received a high level of scrutiny during this budget process, and proposed spending increases were selected based on critical need and the continuation of essential services to our community.

Guiding Principles

The guiding principles that inspired the recommendations for the FY 2022-23 Budget were created when the City Council conducted a Strategic Planning workshop identifying key priorities, as well as a new Mission Statement for Costa Mesa, as follows:

“The City of Costa Mesa serves our residents, businesses, and visitors by promoting a safe, inclusive, and vibrant community.”

In addition, the City Council has developed five Three-Year Strategic Plan 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.

The recommendations contained in the FY 2022-23 Proposed Budget are rooted in the Strategic Plan Goals created by the City Council for a safe, inclusive and vibrant City.

ANALYSIS:

The theme for the FY 2022-23 Proposed Budget, “**Paving a Brighter Future Together,**” conveys the revival of our community as we work together, building a brighter future for our community, our youth, our seniors, and our businesses, as we incorporate key strategies to ensure long-term fiscal sustainability.

Costa Mesa’s local economy has fared better than both the nation and California based primarily on the strength of our local businesses and the types of industries located within our City limits. Our

strong tax base has also offered some insulation from the turbulent economy. However, our City is not immune to the larger economic influences and the current market environment continues to require fiscal prudence.

Thus, all budget proposals submitted in the FY 2022-23 Proposed Budget underwent a thorough review and in-depth analysis, only considering the very few that are necessary for long term sustainability and to continue essential core services.

Overview of FY 2021-22 Proposed All Funds Budget

The Proposed FY 2022-23 Budget totals \$206.0 million in All Funds. This reflects an increase of \$8.1 million, or four percent, from the FY 2021-22 All Funds Budget of \$197.9 million.

Table 1

Appropriations All Funds	<u>FY 2022-23 PROPOSED BUDGET - ALL FUNDS</u>			
	Adopted FY 2021-22	Proposed FY 2022-23	Increase/(Decrease)	
			Amount	Percent
Operating Budget	\$163,522,932	\$170,095,673	\$6,572,741	4.0%
Transfers Out	9,841,585	10,627,990	786,405	7.9%
Capital Budget	24,566,362	25,312,023	745,661	3.0%
Total	\$197,930,879	\$206,035,686	\$8,104,807	4.1%

The All Funds Budget for the City includes governmental, proprietary and internal service funds; including grants and other restricted funds designated for specific services and purposes provided by higher levels of government (i.e., Federal, State and County governments and agencies). Many of the City's special and restricted funds receive ongoing revenue streams, while some are one-time competitive grants and require careful monitoring and record keeping. In some instances, a Fund can have available fund balances that have accumulated over time and are expended as the need arises and/or to complete specific projects within assigned timeframes.

As such, the All Funds Budget contains many funds that are separate entities with specific accounting and reporting requirements as per government regulations and in some cases, statutes. The City's General Fund is not restricted and can be used to provide a broad array of public services and is comprised of multiple revenue sources including taxes (such as property, sales and hotel taxes, among others), user fees, fines, facility rentals, and development related fees, to name a few.

The main factors attributed to the year-over-year increase in the FY 2022-23 Proposed All Funds Budget are as follows:

Operating Budget

The proposed increase of \$6.6 million, for a total of \$170.1 million in the Operating Budget's portion of the FY 2022-23 All Funds Budget is mostly comprised of increased staffing and service levels to restore essential services, most of which is housed in the General Fund.

Transfers Out

Transfers Out from All Funds total \$10.6 million. The Transfers Out are from the General Fund which

transfers monies into three funds, the Capital Improvement Fund (\$5.4 million) to support the Capital Assets Needs Ordinance (CAN), and the five percent of General Fund revenues required to fund the annual Capital Improvement Plan; the 1.5 percent transfer to the Information Technology Replacement Fund (\$2.4 million) for the planned replacement of aging technology and software systems throughout the City; and, finally the Equipment Replacement Fund (\$2.8 million) to support the replacement of the City's aging fleet and ongoing fleet maintenance costs.

The transfer to the Equipment Replacement Fund is a new transfer proposed to correct the longstanding deficit in the City's Equipment Replacement Fund, which is responsible for the financing, maintenance and repair of the City's entire vehicle/apparatus/heavy equipment fleet and the fleet maintenance crew of 7.6 FTEs currently responsible for repairing and maintaining this diverse fleet which is comprised of diesel, gasoline, propane, compressed natural gas, hybrid and electric vehicles. The fleet is comprised of more than 350 vehicles/apparatus/equipment including fire engines, fire ladder/tiller trucks, ambulances, patrol officer vehicles, tractors, medium duty trucks, asphalt trucks, hydraulic vactors, heavy equipment trailers, ten-wheeler trucks, motorcycles, emergency generators, and three Cal OES firefighting apparatus to name a few.

The Equipment Replacement fund has been historically underfunded causing a severe backlog of vehicles/apparatus in need of replacement and many other vehicles far exceeding their useful life resulting in costly repairs that surpass the asset's replacement value. As of June 30, 2019, the Equipment Replacement Fund ended the fiscal year with zero cash. For a full service City such as Costa Mesa, there needs to be sufficient funding to adequately support the City's fleet, especially the public safety and public services teams that are critical to emergency response. The FY 2022-23 Proposed All Funds Budget contains a recurring \$2.8 million to fully fund all staff performing fleet maintenance functions and sufficient funding to replace a larger portion of the City's fleet at the end of the useful life of the asset.

Capital Budget

The All Funds Capital Budget of \$25.3 million reflects the City's annual Capital Improvement Program (CIP) Budget that contains an increase of \$745,661 as a result of the full funding of the CAN, as well as changes in other special and restricted funds for Capital projects. Additional detail regarding the CIP Budget was presented at the April 26, 2022 Study Session for the CIP and will be contained in further detail in the CIP section of the FY 2022-23 Proposed Budget Book. At the CIP Study Session, City Council requested that staff include a capital project to upgrade the workspace of the City's telecommunications center. As requested, the Capital Budget was increased by \$330,000 to accommodate this additional capital project.

FY 2022-23 Proposed General Fund Budget Overview

The Proposed FY 2022-23 General Fund expenditure budget is a balanced budget and totals \$163.5 million. This reflects an increase of \$9.1 million or 5.9 percent, from the FY 2021-22 Adopted Budget of \$154.4 million, and is fully balanced by ongoing General Fund revenue. Table 2 is a summary of the FY 2022-23 General Fund Proposed Revenue and Expenditure Budget.

Table 2**FY 2022-23 GENERAL FUND PROPOSED BUDGET**

	Adopted FY 2021-22	Proposed FY 2022-23	Increase/(Decrease)	
			Amount	Percent
Estimated Revenues	\$144,622,060	\$163,507,538	\$18,885,478	13.1%
Transfers In	6,561,529	-	(6,561,529)	(100.0%)
Use of Fund Balance	3,219,091	-	(3,219,091)	(100.0%)
Total Resources	\$154,402,680	\$163,507,538	\$9,104,858	5.9%
	136,637,270			
Operating Budget	\$145,421,745	\$152,879,548	\$7,457,803	5.1%
Transfers Out	8,980,936	10,627,990	1,647,054	18.3%
Total Appropriations	\$154,402,680	\$163,507,538	\$9,104,858	5.9%

General Fund Revenue Highlights

The FY 2022-23 Proposed Budget for Total General Fund Resources totals \$163.5 million, a \$9.1 million, or 5.9 percent increase from the \$154.4 million FY 2021-22 Adopted Budget.

Recurring General Fund Revenue is recovering favorably with several categories already back to or above pre-pandemic levels such as Sales and Use Tax, Licenses and Permits, Use of Money and Property, and Fees and Charges. Recurring General Fund revenue projected for next year is \$163.5 million and reflects the funds typically used to cover public safety, parks and community services, development services, and other activities and programs known to residents. It is anticipated that for the Fiscal Year commencing July 1, 2022, the budget will be balanced without the use of Federal American Rescue Plan Funds and/or General Fund reserves.

Sales and Use Tax: Sales tax is the largest revenue category in Costa Mesa, and is estimated at \$72.6 million, or a 4.9 percent increase over the FY 2021-22 Amended Budget; \$6.3 million above FY 2018-19 actuals, the last year with no pandemic fiscal impacts. The increase is mostly attributed to the pent-up demand of sales, including an increase in the sale of luxury items, vehicles and transportation, restaurants, and the growth of online purchases.

Property Tax: All combined Property Tax revenues are estimated at \$52.0 million, reflecting a 5 percent growth over the prior fiscal year, largely attributed to a steady increase in assessed valuations for multiple property types and an increase in home sales surpassing the prior year.

Transient Occupancy Tax (TOT): While hotel occupancy has not yet recovered to pre-pandemic levels, the estimated \$7.4 million is higher than the FY 2021-22 adopted budget of \$5.6 million. Hotel occupancy is still lagging behind FY 2018-19 as business and international travel slowly recovers. Also, growth from this category may be stunted as consumers react to volatile fuel prices.

Fees and Charges: Fees and Charges are showing signs of recovery at \$8.4 million. FY 2018-19 actuals were \$8.9 million. There are increases in plan check fees due to building activity, and the Measure Q cannabis implementation coming to fruition with the payment of cannabis application fees paid up-front for cannabis delivery and retail storefront businesses.

Measure Q Retail Cannabis Business Tax: On November 3, 2020, voters approved the “City of Costa Mesa Retail Cannabis Tax and Regulation” Measure, also known as Measure Q, which allows cannabis retail storefront and delivery uses. City Council voted to adopt a 7 percent tax on cannabis retail businesses. The FY 2022-23 Proposed Budget includes an estimated \$2.5 million in cannabis taxes for the first year that cannabis retail businesses will begin to open. Revenue received from this Measure is subject to annual audits, for which the City has set aside \$50,000 to retain an independent qualified auditing firm.

Due to the reallocation of one percent of the seven percent of Measure Q tax funding as approved by the Council, the Proposed Budget has two restricted Funds: the Arts and Culture Master Plan Fund and the First Time Homebuyers Fund. Each have a distinct and dedicated Special Revenue Fund for these programs.

1/2 Percent for the Arts: Of the total 7 percent cannabis tax rate, half a percent is dedicated to the Arts and Culture Master Plan in the FY 2022-23 Proposed Budget, and another half percent to a new First Time Homebuyers Program. The Arts and Culture Master Plan Fund will support the full implementation of Year Two of the Arts and Culture Master Plan including the new Arts Coordinator position hired in Year One.

1/2 Percent for a First Time Homebuyers Program: The FY 2022-23 Proposed Budget also includes funding for the first-time homebuyer program for current City residents as well as graduates of the Newport Mesa Unified School District. The first-time homebuyer program is intended to provide mortgage assistance to qualified lower-income homebuyers to encourage homeownership for those who otherwise cannot qualify or afford to purchase a home in Costa Mesa without assistance. This program will be funded by Measure Q in the FY 2022-23 Proposed Budget.

Federal American Rescue Plan (ARPA) Fund: The American Rescue Plan (ARPA) of 2021 passed by the United States Congress and signed into law by President Biden on March 11, 2021, is a \$1.9 trillion economic stimulus bill providing for a wide variety of funding efforts to offset the economic losses resulting from the worldwide pandemic, COVID-19.

The American Rescue Plan (ARPA) includes \$360 billion in direct funding to states, counties and

cities to offset economic losses and increased expenses resulting from the pandemic. Costa Mesa received half of its allocation of \$13.6 million in FY 2020-21 and is expected to receive the remaining half this fiscal year (FY 2021-22).

The use of these funds is more flexible than the previous CARES Act funding to cover expenditures related to the pandemic. Expenditure reductions due to revenue losses incurred due to the pandemic are eligible as long as they do not cover pension costs. Staff will be returning to City Council with a proposed plan to best utilize the second available tranche of ARPA funds to offset economic losses as a result of the pandemic. As a reminder, the FY 2022-23 Proposed General Fund Budget is fully balanced with estimated annual recurring General Fund revenue.

FY 2022-23 General Fund Budget Expenditure Highlights

The Proposed General Fund Budget for FY 2022-23 reflects total expenditures of \$163.5 million. Of this amount, \$152.9 million in operating costs represents an increase of \$7.5 million, or 5.1 percent, from the current year adopted operating budget of \$145.4 million. The remaining \$10.6 million represents the Transfers Out to the Capital, Information Technology and Equipment Replacement Funds described earlier. The FY 2022-23 Proposed Budget for expenditures includes the following key items, to name a few:

- A Table of Organization reflecting 549 full time employees and 114 part-time employees for a total of 663;
 - This reflects a net of 11.95 additional full time employees added to the Table of Organization, of which 6.5 were previously approved at mid-year in March of 2022. An additional 5.45 new positions are proposed in the Table of Organization; however, only 0.65 FTE will be funded from the General Fund;
 - The five new positions include: one (1) Police Officer funded by the restricted Orange County Auto Theft Task Force; one (1) Associate Engineer funded by restricted National Pollutant Discharge Elimination System monies; one (1) Programmer Analyst II and one (1) Senior Programmer Analyst, both of which are funded from the Information Technology Replacement Fund as per the Five Year IT Strategic Plan; and a 0.65 FTE in the General Fund related to the conversion of three (3) part-time positions to full-time (one Office Specialist and two Storekeepers) and 0.50 FTE Office Specialist II funded by the IT Replacement Fund;
- A \$2.5 million increase in the annual required CalPERS contributions;
- An additional \$800,000 in funding for medical, dental and vision benefits as per contractual MOU requirements;
- A total of \$5.4 million in capital spending, and a \$2.8 million debt service payment for the Lions Park bonds, for a total of \$8.2 million required by Ordinance to comply with the Capital Assets Ordinance (CAN), or five percent of estimated General Fund revenues;
- \$2.4 million for the Council-approved Five Year Information Technology Strategic Plan (Year 3) reflecting 1.5 percent of General Fund revenues in FY 2022-23;
- A new ongoing transfer of \$2.8 million to the Equipment Replacement Fund to correct the deficit in the fund and to replace aging equipment including a 38 year old S.W.A.T. vehicle purchased in 1984, with a modern BearCat armored vehicle and a long range communication device to better address public safety;
- The continuation of the \$4.0 million vacancy factor (negative appropriation);

- No use of General Fund Reserves; and,
- No use of American Rescue Plan Act (ARPA) funds.

Staffing Levels

The Proposed Budget includes 549 full-time employees. Previously approved mid-year staffing adjustments of 6.5 FTEs are included. The Proposed Budget incorporates an additional 5.45 full time equivalents; however all but 0.65 FTEs are funded from non-General Fund sources. During the Great Recession, the City lost 146 full time positions. Even with the proposed changes, full time staffing levels are still ten percent under FY 2009-10 pre-recession levels.

Commitment to Public Safety:

One of the main priorities of the FY 2022-23 Proposed Budget is the City's continued commitment to public safety. As such, more than 56 percent of the General Fund Proposed Budget, approximately \$90 million is designated for public safety.

The Police Department budget now contains 140 full time sworn personnel, reflecting one Police Sergeant position approved at mid-year and one Police Officer funded by the County Auto Theft Task Force included in the Proposed Budget. We are pleased to report this is the highest level of Police Department sworn staffing since the Great Recession.

In addition, the Police Department's maintenance and operations budget increased by \$134,500, mostly for uniforms, janitorial, and necessary contractual services. As part of the City's multi-pronged approach to balance the General Fund budget, the Police Department still retains a vacancy factor of approximately \$3.7 million in the FY 2022-23 Proposed Budget to capture its routine annual vacancy rate.

The Fire Department budget contains 97 total full time personnel. The Fire Department provides emergency response services and staffs six fire stations, 24 hours a day, seven days a week, 365 days a year. The EMS Captain position approved at mid-year is included in the FY 2022-23 Proposed Budget as well as the new 9-1-1- Telecommunications Manager (split 50/50 with Police). We are pleased to also report this is the highest level of Fire Department sworn staffing since the Great Recession.

Transfers Out

The Transfers Out proposed budget of \$10.6 million, an increase of \$1.6 million, or 18.3 percent, provides full funding for the Capital Asset Needs (CAN) requirement of 5 percent of General Fund Revenues, the 1.5 percent towards the Information Technology Replacement Fund and \$2.8 million for the ongoing replacement and maintenance of the City's aging fleet. These transfers invest in the Council approved IT Strategic Plan, where there is a significant need to update and maintain the multitude of software systems in the City, and the addition of two Information Technology full time positions.

Capital Asset Needs (CAN):

On March 3, 2020, the City Council updated the City's Financial and Budget Policies providing that the City allocates a minimum of five percent of General Fund revenues to fund capital expenditures and reallocating one and a half percent previously dedicated to the Capital Facilities Account to the City's Information Technology needs. The Proposed FY 2022-23 General Fund Budget includes the full allocation of five percent (\$8.2 million) to fund investments to the City's infrastructure and capital assets and to fund existing debt for the \$30 million Lions Park Capital Projects Bonds, and one and a half percent to fund the City's Five Year IT Strategic Plan (\$2.4 million).

ALTERNATIVES

The City Council can provide alternative direction to staff on the Proposed Budget for FY 2022-23 through June 30, 2022.

FISCAL REVIEW:

Staff is requesting City Council provide feedback and direction in advance of final adoption of the FY 2022-23 Budget. Staff will be bringing the FY 2022-23 Proposed Budget forward to a Public Hearing on June 7, 2022 for additional feedback or final adoption. An additional Study Session can be conducted on Tuesday, June 14, 2022, if needed, with a second alternative final adoption date of Tuesday, June 21, 2022, if desired.

LEGAL REVIEW:

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

CITY COUNCIL GOALS AND PRIORITIES:

This item supports the 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:

The overview of the Proposed General Fund expenditure and revenue projections for FY 2022-23 was fully vetted by staff, being prudent in any proposed increases, knowing that we are still in a state of emergency.

To continue providing essential services to the community coupled with the above stated goals in mind, staff recommends that the City Council discuss and provide feedback on the FY 2022-23 Proposed Budget.

The chart below reflects the eight (8) planned Study Sessions, Commission and Committee meetings, and City Council Public Hearings that have been held or will be held to assist the City Council in obtaining input regarding the City's budget for FY 2022-23. In addition, one or more

Special Meetings can be held later in June, if necessary, to finalize the City Council's review of the budget.

FY 2022-23 PROPOSED BUDGET REVIEW	ENTITY	DATE
FY 2022-23 Proposed CIP Budget Study Session	City Council	April 26, 2022
FY 2022-23 Proposed CIP Budget Review	Parks, Arts and Community	May 26, 2022
FY 2022-23 Proposed CIP Budget Review	Planning Commission	May 9, 2022
FY 2022-23 Proposed Budget Study Session	City Council	May 10, 2022
FY 2022-23 Proposed Budget and CIP Review	FiPAC	May 11, 2022
FY 2022-23 Proposed Budget Public Hearing	City Council	June 7, 2022
FY 2022-23 Proposed Budget Special Meeting / Study Session #2, if necessary	City Council	June 14, 2022
FY 2022-23 Proposed Budget Adoption, if necessary	City Council	June 21, 2022

The strong commitment of our City Council, residents and community partners for healthy, sustainable neighborhoods and balanced economic activity, both facilitate and aid us to continue the quality of services we provide.

The high degree of professionalism, commitment and effort of City staff to our community, our neighbors, and our businesses has provided us the ability to meet our overall goals, objectives and programs, of which we are proud.

It is our hope and belief that the FY 2022-23 Proposed Budget creates a solid foundation for **“Paving a Brighter Future Together.”**