



City of Palo Alto

City Council Staff Report

(ID # 11328)

Report Type: Action Items

Meeting Date: 6/16/2020

Summary Title: Various FY 2020 Budget Adjustments to Address COVID-19 Impacts & Q3 Financial Report

Title: Review of the Third Quarter Financial Report and Approval of Various FY 2020 Budget Adjustments to Address Projected COVID-19 Impacts

From: City Manager

Lead Department: Administrative Services

Recommendation

Staff recommends that the City Council review the financial report for the third quarter of Fiscal Year 2020 and amend the Fiscal Year 2020 Budget Appropriation for various funds and various capital projects, as identified in Attachment C (requires five votes for approval).

Executive Summary

On March 16, 2020, the State of California and the County of Santa Clara ordered a Shelter in Place and the City of Palo Alto transitioned a majority of its workforce to remote (telework) status in order to slow the spread and contain the novel coronavirus (COVID-19). The financial impacts of this public health emergency are presenting challenges not only for the City but worldwide.

The third quarter financial results are not yet materially affected but significant impacts on the coming months and potentially years are expected. The revenues for categories such as transient occupancy tax, sales tax, documentary transfer tax, and revenue from licenses, permits, and charges for services are forecasted to decrease. This has prompted the City to defer non-essential spending such as travel, training, meals, and others expense categories in FY 2020.

This report differs from the normal quarterly financial report by also providing the 4th quarter revised forecast to show the most likely actual performance for FY 2020 and recommended budget amendments in the General Fund for FY 2020 based on current projections. These projections address the impacts of COVID-19 including a recommended \$23.7 million reduction in estimated revenues. These adjustments will bring various revenue sources in-line with current year-end projections for FY 2020 as well as account for expense savings to partially

offset the revenue reductions and minimize the impact to the General Fund Budget Stabilization Reserve (BSR).

Overall, this report recommends a draw on the General Fund Budget Stabilization Reserve of \$11.6 million in FY 2020, a decrease to \$32.7 million or 14.2 percent of the FY 2020 budgeted expenses.

Background

Considering the disruptions caused by the current COVID-19 public health emergency, staff has been working with the City Council on a modified budget process for the development of the FY 2021 proposed operating and capital budgets. Based on the action approved by the City Council on March 23, 2020, [CMR #11208](#), and in accordance with the City Charter, staff provided a baseline budget on April 20, 2020 for both the operating and capital budgets. At the time of the development of the FY 2021 budget, the world continues to grapple with the global ramifications of the COVID-19 pandemic. The financial implications of this public health emergency are significant, with regional, national and global impacts on economies in response to shelter in place orders required by the State of California and the County of Santa Clara and related social distancing restrictions.

Staff provides quarterly financial reports to provide information on the financial condition of the City's General Fund and Enterprise Funds. During the third (3rd) quarter of fiscal year (FY) 2020, the City Manager, acting as the Director of Emergency Services, issued a Proclamation of Local Emergency regarding the presence and community spread of COVID-19 in Santa Clara County and our region on March 12, 2020. On Sunday, March 15, 2020, the City Manager activated the Emergency Operations Center (EOC) and since that time, the City has managed the EOC virtually through a cross-functional multi-departmental team. On March 16, 2020, the City Council ratified the Proclamation of Local Emergency which continues today.

This quarterly financial report has been augmented and includes information and recommended actions based on forecasted performance in the fourth (4th) quarter of FY 2020 in addition to the normal quarterly reporting. Staff initially provided an estimated FY 2020 financial impact of \$15 million to \$20 million in the General Fund as a result of preliminary estimated impacts due to COVID-19.

Discussion

This report summarizes the actual financial activity of the General and Enterprise Funds for the nine-month period from **July 1, 2019 through March 31, 2020**, which includes the initial weeks of the Shelter in Place orders as issued by the State and Santa Clara County, and compares those amounts to the FY 2020 Adjusted Budget and to the report for the same period in FY 2019. In addition, this report recommends budget adjustments in the General Fund and several other funds to address impacts of COVID19 in FY 2020. These adjustments will bring various revenue sources in-line with current year-end projections for FY 2020 as well as accounting for expense savings to partially offset the revenue reductions and minimize the impact to the General Fund Budget Stabilization Reserve (BSR).

General Fund revenues (excluding operating transfers) for the 3rd quarter FY 2020 total \$133.1 million, which is 3.1 percent higher than the same period in FY 2019 and comprises 62.5 percent of the current year Adjusted Budget. The 4th quarter or year-end revised operating revenue forecast for FY 2020 total is estimated to fall \$23 million to \$25 million below budgeted levels of \$233.6 million, which is approximately 10 percent lower than the Adjusted Budget.

General Fund expenses (excluding operating transfers) for the 3rd quarter total \$138.6 million, which is 4.4 percent higher than the prior year. The expenses are in line with the Adjusted Budget at 65.6 percent of the full-year budgeted amounts which is similar to the prior year trend. The 4th quarter revised operating expenditure forecast for FY 2020 is expected to fall below budgeted levels as a result of prudent management, through a hiring freeze, management of capital contributions, as well as savings due to the pausing or canceling of specific initiatives. Overall, this report recommends recognition of a net \$12.0 million reduction in expense budget in the General Fund.

Following is a detailed discussion of:

- 1) General Fund significant revenue and expense items for the 3rd quarter actual financial activities and the 4th quarter or year-end projections in FY 2020;
- 2) A summary of the recommended budget adjustments in FY 2020 to address the current year-end projected forecasted revenues and expenses; and
- 3) Enterprise Fund 3rd quarter actual activity and year-end projections summary

Attachment A provides a breakdown of revenues by source and expenses by function, with separate columns for the Adopted Budget and the Adjusted Budget. The Adjusted Budget column includes prior year commitments that were carried forward into this fiscal year and Council approved budget amendments to the FY 2020 Adopted Budget through March 31. Encumbrances and actual expenses for the nine-month period are also reported.

Attachment B provides details on public safety overtime through the 3rd quarter.

Attachment C provides details on the specific transactions recommended to amend the FY 2020 budget by department and program.

GENERAL FUND

Revenue Highlights for 3rd Quarter Actual Activities and Year-end Projections in FY 2020

Following is a table which highlights the City's major revenue sources for the 3rd quarter, compared to the same quarter of the prior year. The first three quarter's revenue is expressed as a percentage of the Adjusted Budget for each year.

City of Palo Alto General Fund Revenue FY 2020 3rd Quarter Actuals (000's)							
	3rd Quarter Actuals			Adjusted Budget			
	FY 2020	FY 2019	% change	FY 2020	%	FY 2019	%
Property Tax	\$ 30,054	\$ 29,429	2.1%	\$ 50,576	59.4%	\$46,232	63.7%
Sales Tax	20,645	21,674	(4.7%)	36,085	57.2%	31,746	68.3%
Charges for Services	17,872	16,157	10.6%	30,267	59.0%	28,419	56.9%
Transient Occupancy Tax	16,378	15,251	7.4%	26,555	61.7%	25,390	60.1%
Utility User Tax	11,908	11,626	2.4%	17,572	67.8%	16,092	72.2%
Permits and Licenses	4,506	6,107	(26.2%)	9,027	49.9%	8,545	71.5%
Documentary Transfer Tax	5,770	4,801	20.2%	8,100	71.2%	8,034	59.8%
All Other Revenue Sources	25,931	23,984	8.1%	34,629	74.9%	32,875	73.0%
Total Revenue	\$133,064	\$129,031	3.1%	\$212,811	62.5%	\$197,333	65.4%

Property tax revenue – at the close of 3rd quarter Property Tax Revenue received was \$30.1 million, an increase of 2.1 percent over the same period in the prior year. Property tax is received from the County of Santa Clara during the 2nd, 3rd and 4th quarters of the year. The receipts are at 59.4 percent of the adjusted budget which is lower than prior year due to mid-year adjustment of \$1.9 million attributable to excess ERAF to be collected in 4th quarter. The past five-year compound annual growth rate (CAGR) for this revenue has been 6.4 percent due to higher assessed values because of continued robust commercial and residential real estate markets prior to the COVID-19 impacts materializing.

FY 2019 actual property tax revenue was \$47.3 million which included unusual receipts of \$2.7 million for Excess Educational Revenue Augmentation Fund (ERAF)¹ distributions from the County of Santa Clara. Though Excess ERAF receipt has steadily grown the last five years, it's not considered a permanent local revenue source.

Historically, during an economic downturn such as a recession and/or COVID-19, impact to property tax are delayed by at least a year. As a result, the pre-COVID-19 projected receipts for FY 2020 is not expected to be impacted so the revised forecast is \$50.9 million, \$0.3 million or 0.6 percent higher than the adjusted budget.

The FY 2020 adjusted budgeted amount is \$50.6 million which include \$3.9 million in Excess ERAF, 7.0 percent higher than the prior year's actual revenue. Though the expectation is the budgeted revenue estimate will be met, there remains uncertainty on the horizon. The State is asserting the five counties (Marin, Napa, San Francisco, San Mateo, and Santa Clara) that have Excess ERAF are calculating excess ERAF in ways that are contrary to state law and shift too much property tax revenue from schools to other local agencies. Per the County of Santa Clara, if the State were to prevail and in a worst-case scenario, the loss of Excess ERAF could be up to 40 percent or \$1.5 million for Palo Alto. The resolution of this dispute is expected to occur in FY 2021.

Sales Tax revenue – as of the 3rd quarter Sales Tax revenue is down by \$1.0 million or 4.7 percent, from the same period last year. Due to the timing delay in sales tax collection by the State and remittance to the City, this only represents seven months' sales tax activity. The seventh and eighth-month's payments (the latter received in April) were estimated advance payments and not based on actual sales tax collection. Actual performance for this fiscal year will not be known until August/September.

As of the writing of this report, April sales tax is down by \$2.4 million or 9.9 percent. Though there remain many uncertainties in future sales tax performance resulting from COVID-19, the current forecast for the FY 2020 receipts anticipates a decline by \$5.5 million, reducing the adjusted budget to \$30.6 million, approximately \$5.9 million below the FY 2019 receipts. The full impact of COVID-19 will occur in the 4th quarter for which the actuals will not be fully known until next fiscal year. This estimate reflects significant reductions of up to a 75 percent loss in revenues in certain tax categories during the 4th quarter. This estimate has been developed in collaboration with the City's sales tax consultant. A portion of this decline is due to timing difference in receipts rather than performance. For example, FY 2019 receipts are higher by \$0.7 million due to delay of distribution in sales tax in fiscal year 2018 from California Department of Tax Fee Administration (CDTFA) resulting from transition of the new technology and collection process.

¹ ERAF is the fund used to collect and disburse property taxes that are shifted to/from cities, the County, and special districts prior to their reallocation to K-14 school agencies. When the state shifts more local property tax than required to support schools these funds are returned and known as excess ERAF.

Transient Occupancy Tax (TOT) – TOT revenues reached \$16.4 million through the end of the 3rd quarter, an increase of \$1.1 million or 7.4 percent over the prior year. Due to the timing delay in receipts, this represents 7.5 months of TOT receipts. The increase is solely attributable to the 1.5 percent TOT rate increase that began in April 2019. The base TOT, which began to decline almost a year ago, has declined by 3.1 percent in the current fiscal year. As a result, a downward mid-year budget adjustment of \$2.8 million was recommended and approved. In comparison, most northern California regions have also seen TOT declines during this period.

The following table contains average room rates and occupancy percentage for northern California regions in December 2019 as well as the City of Palo Alto’s December data. For Palo Alto, daily average room rates increased by 1.5 percent from \$277.13 per day to \$281.36 per day while the occupancy rate declined by 1.2 percent from 76.5 percent to 75.6 percent during the first eight months of FY 2020 (July 2019 to February 2020). This is in line with a similar trend reported in December for local northern California regions.

Table 2						
Month of December only						
	Avg. Daily Room Rate			Occupancy Percentage		
	2019 (\$)	2018 (\$)	Chg.	2019	2018	Chg.
San Francisco	\$244.80	\$229.03	6.9%	79.6%	77.8%	1.8%
San Francisco Airport	175.39	173.29	1.2%	78.4%	77.2%	1.2%
San Jose/Peninsula	199.44	195.08	2.2%	62.8%	64.2%	-1.4%
Oakland/East Bay	155.76	153.69	1.3%	66.9%	67.0%	-0.1%
Monterey/Carmel	238.53	234.85	1.6%	64.6%	60.8%	3.8%
Central Valley	112.67	109.26	3.1%	62.7%	62.2%	0.5%
Sacramento	138.59	138.28	0.2%	66.2%	72.5%	-6.3%
Marin County	171.37	159.59	7.4%	58.9%	64.0%	-5.1%
Napa County	200.82	199.78	0.5%	59.3%	56.8%	2.5%
Sonoma County	170.37	169.24	0.7%	60.8%	62.3%	-1.5%
Other Northern California	142.72	134.76	5.9%	58.8%	65.5%	-6.7%
Overall Average	186.74	179.58	4.0%	68.2%	68.9%	-0.7%
City of Palo Alto (December only)	243.70	234.42	4.0%	60.6%	58.5%	3.6%

Source: CBRE Hotels December 2019 report, Trends in the Hotel Industry except for Palo Alto

As the most significant revenue source impacted by COVID-19, the year-end forecast for TOT is expected to be \$19.6 million, a decline of \$7.0 million or 26.2 percent over the adjusted budget, which is \$5.8 million below FY 2019 receipts. As of May 2020, the City has received TOT revenue and related performance through March 2020. Therefore, staff used information from the San Mateo County/Silicon Valley Convention and Visitors Bureau, outreach to local hotels, and looking at regional and state actuals and projected performance.

Almost a dozen hotels, which represent 30 percent of available rooms, have fully suspended operations (see list below) while the remaining hotels' occupancy rate are in the single digit and average room rates have dropped by nearly 2/3 prior levels. As such TOT receipts in the last three months are expected to decline by over 95 percent over the prior year.

<i>Palo Alto Hotels That Have Suspended Operation as of April 17, 2020</i>		# of Rooms
1	Cardinal Hotel	63
2	The Clement Hotel	23
3	Cowper Inn	16
4	Garden Court Hotel	62
5	Glass Slipper Inn	25
6	Hotel Keen	42
7	The Nest	54
8	Nobu Hotel	72
9	Stanford Terrance Inn	55
10	Travel Lodge	29
11	The Westin	184

Utility User Tax revenue for the nine months ended March 31, 2020 totals \$11.9 million, an increase of \$282,000, or 2.4 percent, from the prior year. The utility commodity rate increases (e.g. electric, gas and water) have contributed to this growth while the telephone UUT has slightly declined. However, due to the COVID-19, the year-end results are expected to be below the adjusted budget and the prior year's receipts. Utility User Tax revenue's revised forecast for FY 2020 is \$16.1 million, a decline of \$1.4 million or 8.2 percent over the adjusted budget. Both the utility commodity and telephone UUT have declined.

Documentary Transfer Tax cash receipts total \$5.8 million, or 71.2 percent of the FY 2020 budgeted amount, and are \$969,000 million higher than prior year receipts for the same period. Though cash receipts are up due to higher average sales price; the number of property sales is down by 3.3 percent. This revenue source is volatile since it is highly dependent on sales volume and the mix of commercial and residential sales. For example, in FY 2018, receipts were boosted due to large commercial sales resulting in total annual receipts of \$9.2 million while FY 2019 had fewer and smaller commercial sales resulting in annual receipts of only \$6.9 million.

However, the COVID-19 impact in the last four months of the fiscal year is expected to result in a FY 2020 decline over (both) the adjustment budget and prior year's actual. The year-end forecast for FY 2020 is \$6.7 million, a decline of \$1.4 million to the adjusted budget and \$1.3 million below the prior year's actuals. Besides the lower cash receipts, the number of property sales is down by 11.4 percent. Thus far, initial data suggests a 50 percent decline in these revenues during the shelter in place order. Again, this revenue source is volatile since it is highly dependent on sales volume and the mix of commercial and residential sales.

Charges for services reached \$17.9 million through the end of the third quarter, an increase of \$1.7 million or 10.6 percent from prior year. This increase is mainly due to the following items:

- \$1.8 million resulting from timing difference in the billings to Stanford University for fire and emergency services
- Zoning plan check fees, inspection fees, and plan check fees for the 3rd quarter have increased by \$742,000 from same period prior year due to a higher volume of activity.
- Paramedic service fees have increased \$211,000 over the same period last year due to an increased number of trips billed and increased average amount billed per account.
- The increases explained above were partially offset by a \$1.1 million decrease in class program fee and registration fee. This was due to change in income recognition this year which is set to be deferred until the respective activities commences. However due to COVID-19 some of the fees have been refunded in the 4th quarter.

Permits and Licenses revenue for 3rd quarter is down \$1.6 million, or 26.2 percent from prior year, primarily due to a \$1.3 million and \$300,000 decrease in new construction permit and street open permit revenues, respectively. The new construction revenue category will be adjusted at year-end to defer a portion of revenue to FY2021 that are in progress and to recognize revenue for those permits issued in prior years that are completed at June 30.

Between Charges for Services and Permits and licenses, year-end revenues are projected to fall by \$7.6 million and several department budget adjustments are recommended to align with anticipated FY 2020 actual revenue:

- Community Services will be reduced by \$3.6 million to account for reduced programs and classes (\$2.3 million) as well as the closure of the golf course (\$1.3 million) during the initial phases of the COVID19 Shelter in Place order and limited operations during the more recent phases.
- Planning and Development Services will be reduced by \$3.8 million to account for fewer plan reviews and inspections being performed as a result of the COVID-19 Shelter in Place order.
- Revenue in the Administrative Services Department is recommended to be reduced by \$0.2 million as a result of the Council's decision to reimburse all business registration fees in FY 2020 ([CMR 11289](#)).

Overall, staff is recommending reducing the FY 2020 revenue in the General Fund by \$23.7 million which will bring the adjusted budget excluding transfers in to \$189.1 million. The adjustments by department and revenue category are detailed further in Attachment C.

Expense Highlights for 3rd Quarter Actual Activities and Year-end Projections in FY 2020

Following is a table which highlights the City's expenses by function for the 3rd quarter, compared to 3rd quarter of the prior year. Each quarter's expense is expressed as a percentage of the Adjusted Budget for each year.

Table 3

**City of Palo Alto
General Fund Expenses
FY 2020 3rd Quarter Actuals**

(000's)

	3rd Quarter Actuals			Adjusted Budget			
	FY 2020	FY 2019	% change	FY 2020	%	FY 2019	%
	inc (dec)						
Police	\$ 32,974	\$ 31,546	4.5%	\$ 45,249	72.9%	\$ 42,336	74.5%
Fire	26,859	24,511	9.6%	35,984	74.6%	33,950	72.2%
Community Services	21,649	21,659	(0.0%)	32,517	66.6%	30,314	71.4%
Public Works	12,493	12,236	2.1%	19,983	62.5%	18,440	66.4%
Planning and Development Servi	13,575	14,445	(6.0%)	22,597	60.1%	23,511	61.4%
Library	7,388	6,814	8.4%	10,582	69.8%	9,786	69.6%
Administrative Services	5,985	5,600	6.9%	9,050	66.1%	7,860	71.2%
All Other Departments	17,668	15,982	10.5%	35,258	50.1%	30,490	52.4%
Total Expenses	\$ 138,591	\$ 132,793	4.4%	\$ 211,220	65.6%	\$ 196,687	67.5%

Total expenses (excluding operating transfers) for the 3rd quarter of the fiscal year is 65.6 percent of full year budgeted and represents a \$5.8 million, or 4.4 percent increase from the same quarter last year due to the following:

- Disability / workers compensation expenses increased by \$829,000
- Employer Pension expenses increased by \$1.8 million
- Additional \$2.9 million pension contribution to Section 115 irrevocable Pension Trust (In prior years Section 115 contribution was recorded as Operating Transfer Out). This is based on a 6.2 percent discount rate for the Normal Cost approved by the City Council.
- Retiree Premium expenses increased by \$198,000.

In FY 2020, the Office of Transportation was established as its own office in the City Manager’s Office: it was a division of the Planning and Community Environment Department. Additionally, the Development Services Department was combined with the Planning and Community Environment Department to form the Planning and Development Services Department. These reorganizations are reflected in the FY 2020 figures by reporting the Office of Transportation under “all other departments” and combining the two prior departments of Development Services and Planning. This is causing much of the year over year variances in that department.

Police and Fire comprises 43.2 percent of the total General Fund expenditures for the 3rd quarter, which is comparable to the prior year. Police and Fire expenses are up mainly due increase of pension expenses and the proactive funding strategy to Section 115 to contribute to the City's Pension Trust assuming a normal cost for contribution with a 6.2 discount rate (CalPERS is currently at 7.0 percent discount rate).

In order to partially offset the \$23.7 million reduction in General Fund revenue and reduce the impact on the Budget Stabilization Reserve (BSR), reductions of \$12.0 million in expenses are recommended. These reductions are detailed by department and category in Attachment C. Of this, approximately \$3.8 million is expected as a result of departmental salary and non-salary savings. The remaining adjustments reflect reductions in transfers to the capital improvement fund and non-departmental expenses and are detailed below.

Public Safety Overtime

Following is a table which highlights Police and Fire salaries and overtime expenditures for the 3rd quarter.

Table 4							
Police and Fire Salaries and Overtime Expense FY 2020 3rd Quarter YTD							
(000's)							
	3rd Quarter YTD Actuals			Adjusted Budget			
	FY 2020	FY 2019	% change	FY 2020	%	FY 2019	%
Inc (Dec)							
Police - Salaries	\$ 13,425	\$ 13,180	1.9%	\$ 19,484	68.9%	\$ 18,991	69.4%
Police - Overtime	2,224	1,921	15.8%	1,842	120.7%	1,813	106.0%
Total Police	15,649	15,101	3.6%	21,326	73.4%	20,804	72.6%
Fire - Salaries	10,589	9,770	8.4%	14,131	74.9%	14,356	68.1%
Fire - Overtime	1,749	2,580	(32.2%)	2,087	83.8%	2,094	123.2%
Total Fire	12,338	12,350	(0.1%)	16,218	76.1%	16,450	75.1%
Total Public Safety							
Salaries & Overtime	\$ 27,987	\$ 27,451	2.0%	\$ 37,544	74.5%	\$ 37,254	73.7%

Police overtime has increased \$303,000, or 16 percent from prior year due to the following:

- Backfill for the workers' compensation vacancies which is higher during the same period in FY 2019.
- Additional patrol services for a shopping center and one retailer in the area in response to spikes in retail theft. This increase in overtime is offset by the increase in unbudgeted revenues from this activity.

- President of the United States (POTUS) visit (\$26,000) and a major incident in first quarter.

The department continues to manage its overtime in the fourth quarter with the suspension of the Parent Project and Citizen's Academy. This will likely be offset by increased overtime due to the most recent protests for black lives matter. On a combined basis, salaries and overtime are 75 percent of the budget through the 3rd quarter of the fiscal year. The Department's overtime analysis is included in Attachment B.

Fire overtime is 33 percent lower than FY 2019 primarily due to fewer vacancies this year than the same period in prior year. On a combined basis, salaries and overtime are 76 percent of the budget through the 3rd quarter of the fiscal year. The Department's overtime analysis is included in Attachment B.

The Fire and Police salaries increases are due to new labor contracts and an increased number of filled positions when compared to this period in FY 2019.

FY 2020 RECOMMENDED BUDGET ADJUSTMENTS

As a result of the impacts of COVID-19 discussed in the year-end projections above, adjustments to the FY 2020 budget appropriations are recommended to more closely align revenues and expenses with projections. Overall, staff is recommending reducing the FY 2020 revenue in the General Fund by \$23.7 million. In order to partially offset the reduction in General Fund revenue and reduce the impact on the Budget Stabilization Reserve (BSR), reductions of \$12.0 million in expenses are recommended. These reductions are detailed by department and category in Attachment C. This results in a recommended draw on the General Fund Budget Stabilization Reserve (BSR) in the amount of \$11.6 million in FY 2020, decreasing the reserve to \$32.7 million or 14.2 percent of the FY 2020 budgeted expenses.

General Fund revenue reductions, discussed in detail earlier in this report, are summarized below. These are in line with expectations shared with the City Council earlier when the Shelter in Place order was executed, and staff began revising the assumptions behind the FY 2021 proposed budget. At that time, staff estimated a net impact of \$15 million to \$20 million deficit in FY 2020 General Fund financial activities. With the limited additional data over the past month, staff has updated those early estimated and recommend this \$23.7 million adjustment downward to revenues in the following categories. Details are outlined in Attachment C.

	FY 2019 Actual Revenues	FY 2020 Adjusted Budget	FY 2020 Recommended Budget Adjustment
Property Tax	\$47,327	\$50,576	277
Sales Tax	36,508	36,085	(5,468)
Transient Occupancy Tax	25,649	26,555	(6,959)
Utility User Tax	16,402	17,572	(1,439)
Charges for Services / Permits and Licenses & Other Revenue	35,756	39,294	(8,695)
Documentary Transfer Tax	6,923	8,100	(1,424)

Working diligently to closely manage expenses and the prioritization of projects and investments, staff recommends that we reduce FY 2020 General Fund expenses by \$12.0 million to assist in offsetting the impact to the BSR as a result of the loss of revenues due to COVID-19. Below is a summary of the major actions recommended to recognize savings due to vacancies, lower than expected costs, or project cancellations.

- Departmental salary and non-salary expense savings as a result of delays in projects, a citywide hiring freeze, and judicious management of non-essential services resulting in a reduction of \$3.8 million. These projected expenses include current costs through May, including administrative leave usage and forecasts the final month of costs. Overall, citywide 27,800 hours of administrative leave have been used between March and May, \$1.5 million across all funds.
- Reduce the transfer to the capital improvement fund by \$6.7 million, due to reduced TOT revenue dedicated for infrastructure improvements (\$3.2 million) and a reversal of a FY 2020 Mid-Year action to transfer \$3.5 million of FY 2019 savings to the Capital Improvement Fund. These were both assumed in the development of the FY 2021 proposed budget and are not expected to have an adverse impact on the current FY 2021 Proposed Capital Budget.
- Reduce operational reserves in the amount of \$1.6 million, specifically: eliminate remaining funding set aside for operations in FY 2020 (\$0.5 million), eliminate and correspondingly stop work on a Retention and Recruitment Initiative (\$0.5 million) and liquidate Development Services Reserve (\$0.6 million) to help partially offset revenue losses from development related activities.
- Recognize savings from the City Manager Employment contract (housing; CMR 10925) of \$0.6 million, reducing the original appropriated level of \$4.0 million that was approved by the City Council.

These reductions will be slightly offset by two investments. The first is an allocation of \$500,000 for the advancement of racial equity. In light of the current national and local movement, the recently approved resolution supporting racial equity, and the expected workplan to address system inequities for the Council review, this funding will be set aside to help fund these initiatives as directed by the City Council in the future. The second adjustment is \$0.1 million in additional funding needed to be transferred to the Downtown Business Improvement District (BID) Fund. This funding is needed to offset expenses in that fund that

already occurred prior to the Council’s decision to rescind the levy of assessments for the Downtown BID and reimburse all business registration fees in FY 2020 ([CMR 11289](#)).

General Fund Budget Stabilization Reserve (BSR) Balance

The Fiscal Year 2020 General Fund Adopted Budget reflected a surplus position of \$1.3 million. Based from the Fiscal Year 2019 Comprehensive Annual Financial Report (CAFR) there was \$13.4 million of savings in Fiscal Year 2019 than previously anticipated ([CMR 10644](#)). As detailed in Attachment A, after giving effect to Budget Amendments including adjustments from the Mid-Year Budget Review ([CMR 10959](#)) approved by the City Council, the projected ending BSR balance was \$44.4 million, or 19.2 percent of the Fiscal Year 2020 General Fund Adopted Budget. As a result of the impacts of COVID-19, and the recommended adjustments included in this report, the BSR would be reduced by \$11.7 million to \$32.7 million. This is below the City Council targeted range of 15 percent to 20 percent of General Fund budgeted expenses and is 14.2 percent.

ENTERPRISE FUNDS

Following is a summary of change in net position for each of the Enterprise Funds for the nine months ended March 31, 2020, including a comparison of results from the same period last year.

Table 6				
City of Palo Alto				
Enterprise Funds Change in Net Position				
FY 2020 3rd Quarter				
	3rd Qtr FY 2020	3rd Qtr FY 2019	Increase (Decrease)	% Change
Water	\$ 9,625	\$ 9,149	\$ 475	5.20%
Electric	17,921	12,227	5,693	46.56%
Fiber Optic	1,175	2,278	(1,103)	-48.42%
Gas	4,995	5,121	(126)	-2.46%
Wastewater collection	1,596	2,126	(530)	-24.92%
Wastewater treatment	5,278	14,547	(9,269)	-63.72%
Refuse	1,609	5,751	(4,142)	-72.02%
Storm Drainage	2,152	1,973	179	9.06%
Airport	361	1,458	(1,097)	-75.22%
Total Change in Net Position	\$ 44,711	\$ 54,629	\$ (9,919)	-18%

Water Fund increased \$0.5 million from prior year due to a 4 percent rate increase effective July 1, 2019 and an increase in service connection fees offset by the increase in operating expenses.

Electric Fund increased \$5.4 million from prior year as a result of 9 percent rate increase effective July 1, 2019, a decrease in interest expense and a refund from the Northern California Power Agency (NCPA) for FY18 and FY19 debt service payments offset by the increase in operations and maintenance costs and operating transfers out for supplemental pension costs.

Fiber Optics Fund decreased \$1.1 million from prior year due to a decrease in operating revenues mainly from the Dark Fiber Backbone Commercial Lease.

Wastewater Collection Fund decreased \$0.5 million from prior year due to an increase in sewer and treatment costs and operating and capital costs.

Wastewater Treatment Fund decreased \$9.3 million from prior year as a result of the decrease in State Revolving Fund Loan cost reimbursement of \$8.5 million for the Dewatering & Loadout Facility Project and an overall increase in operating costs.

Refuse Fund decreased \$4.1 million from prior year due to a decrease in operating revenues and an increase in GreenWaste costs and vehicle replacement costs.

Airport Fund decreased \$1.1 million from prior year due mainly to operating and grant revenues for the Airport's Apron Reconstruction Project. There is a lag in the collection of grant revenues as it is a reimbursement grant where the revenues are collected after the expenses are submitted to the granting agencies for reimbursement. In addition, increased operating costs and operating transfers out also contributed to the decrease in net position.

Coronavirus (COVID-19) Impacts on Utilities and Public Works Enterprise Funds

Due to shelter in place, the City of Palo Alto Utilities (CPAU) is projecting a 10% decrease in electric sales for the remainder of FY 2020. The revenue loss for the electric utility is roughly \$3.75 million, which is partially offset by \$2.25 million in supply cost savings for a net loss of \$1.5 million. Other utilities (gas, water, and wastewater collection) have not seen significant decreases in sales, so CPAU is not projecting any revenue or expense decreases for FY 2020. Additional details for CPAU FY 2020 Financial Projections will be presented to Council on June 22, 2020 (CMR 11341).

For the other Enterprise Funds, Wastewater Treatment, Storm Drain, Refuse and Airport funds, it was projected that there are no significant decreases in revenues for FY 2020. Refuse Fund revenues for FY 2020 are expected to be about 2% less than budgeted due to the pandemic impact on construction projects and debris box service including commercial service.

Stakeholder Engagement

This report has been prepared by the Accounting Division and reviewed by partner departments, the Treasury team and the Office of Management and Budget for certain sections.

Resource Impact

The recommended actions in the report reflect a recommended \$11.7 million draw on the General Fund BSR, funding of \$500,000 for racial equity initiatives, a \$70,000 subsidy to ensure financial solvency of the Downtown BID fund, and a reduction of \$6.7 million in the General Capital Improvement Fund. These have all been assumed and included as part of the planning and balancing of the FY 2021 proposed budget scheduled for Council adoption on June 22, 2020.

Environmental Review

This is not a project for purposes of the California Environmental Quality Act (CEQA).

Attachments:

- Attachment A General Fund Third Quarter Financial Report
- Attachment B Public Safety Overtime Analysis for Q3FY 2018 - 2020
- Attachment C Recommended FY20 Q3 Clean-up Actions

ATTACHMENT A
CITY OF PALO ALTO
GENERAL FUND THIRD QUARTER FINANCIAL REPORT
FISCAL YEAR ENDING JUNE 30, 2020
(in thousands)

Categories	BUDGET		ACTUALS (as of 3/31/2020)			
	Adopted Budget	Adjusted Budget	Pre Encumbr	Encumbr	Actual	% of Adj Budget*
Revenues & Other Sources						
Sales Tax	\$ 34,346	\$ 36,085	-	-	20,645	57%
Property Tax	48,634	50,576	-	-	30,054	59%
Transient Occupancy Tax	29,309	26,555	-	-	16,378	62%
Documentary Transfer Tax	8,369	8,100	-	-	5,770	71%
Utility Users Tax	17,581	17,572	-	-	11,908	68%
Motor Vehicle Tax, Penalties & Fines	2,032	2,032	-	-	1,036	51%
Charges for Services	30,127	30,267	-	-	17,872	59%
Permits & Licenses	8,667	9,027	-	-	4,506	50%
Return on Investment	1,388	1,388	-	-	1,117	80%
Rental Income	16,326	16,326	-	-	12,824	79%
From Other Agencies	2,756	3,302	-	-	2,039	62%
Charges To Other Funds	10,908	10,908	-	-	8,457	78%
Other Revenues	587	672	-	-	458	68%
Total Revenues	211,030	212,811	-	-	133,064	63%
Operating Transfers-In	20,999	20,840	-	-	15,626	75%
Encumbrances and Reappropriation	-	6,469	-	-	-	-
Contribution from Budget Stabilization Reserve	-	-	-	-	-	-
Total Sources of Funds	232,029	240,120	-	-	148,690	62%
Expenditures & Other Uses						
City Attorney	3,387	3,896	60	302	2,632	68%
City Auditor	1,235	1,347	41	36	681	51%
City Clerk	1,346	1,451	-	51	820	57%
City Council	498	542	-	89	236	44%
City Manager	4,546	5,253	50	460	2,999	57%
Administrative Services	8,519	9,050	55	488	5,985	66%
Community Services	30,913	32,517	172	3,235	21,649	67%
Fire	34,864	35,984	104	373	26,859	75%
Human Resources	3,902	4,097	6	120	2,862	70%
Library	10,314	10,582	7	220	7,388	70%
Office of Emergency Services	1,728	1,853	6	186	950	51%
Office of Transportation	2,312	3,044	174	420	1,262	41%
Planning and Development Services	20,356	22,597	95	2,291	13,575	60%
Police	44,666	45,249	4	476	32,974	73%
Public Works	19,142	19,983	569	2,354	12,493	63%
Non-Departmental	9,024	13,775	-	80	5,226	38%
Total Expenditures	196,752	211,220	1,343	11,181	138,591	66%
Operating Transfers-Out	5,023	7,978	-	-	6,877	86%
Transfer to Infrastructure	28,962	31,023	-	-	23,267	75%
Total Use of Funds	230,737	250,221	1,343	11,181	168,735	67%
Net Change to BSR	1,292	(10,101)			(20,435)	

Attachment B
Public Safety Departments
Overtime Analysis for Fiscal Years 2018 through 2020

	2018	2019	Q3 2020
POLICE DEPARTMENT			
Overtime Expense			
Adopted Budget	\$1,700,000	\$1,776,500	\$1,842,231
Modified Budget	1,700,000	1,812,931	1,842,231
Net Overtime Cost - see below	<u>347,677</u>	<u>185,811</u>	<u>545,596</u>
Variance to Budget	<u>1,352,323</u>	<u>1,627,120</u>	<u>1,296,635</u>
Overtime Net Cost			
Actual Expense	<u>\$2,286,527</u>	<u>\$2,604,366</u>	<u>\$2,224,116</u>
Less Reimbursements			
California OES/FEMA (Strike Teams)	-	36,431	-
Stanford Communications	75,275	91,001	92,956
Utilities Communications Reimbursement	38,227	46,158	45,752
Local Agencies (A)	11,431	12,172	7,264
Police Service Fees	73,600	125,025	172,284
Total Reimbursements	<u>198,533</u>	<u>310,787</u>	<u>318,256</u>
Less Department Vacancies	<u>1,740,318</u>	<u>2,107,768</u>	<u>1,360,265</u>
Net Overtime Cost	<u>\$347,677</u>	<u>\$185,811</u>	<u>\$545,596</u>
Department Vacancies (number of days)	5,777	7,538	4,790
Workers' Compensation Cases	8	24	2
Department Disabilities (number of days)	219	217	183

FIRE DEPARTMENT**Overtime Expense**

Adopted Budget	\$1,396,436	\$1,911,761	\$1,672,872
Modified Budget (B)	1,571,436	2,093,761	2,086,872
Net Overtime Cost - see below	<u>2,675,517</u>	<u>2,403,254</u>	<u>1,590,041</u>
Variance to Budget	<u>(1,104,081)</u>	<u>(\$309,493)</u>	<u>496,831</u>

Overtime Net Cost

Actual Expense	<u>\$3,839,426</u>	<u>\$3,047,510</u>	<u>\$1,749,230</u>
Less Reimbursements			
Stanford Fire Services (C)	-		
California OES/FEMA (Strike Teams) (B)	<u>489,062</u>	<u>182,000</u>	<u>114,000</u>
Total Reimbursements	<u>489,062</u>	<u>182,000</u>	<u>114,000</u>
Less Department Vacancies	<u>674,847</u>	<u>462,256</u>	<u>45,189</u>
Net Overtime Cost	<u>\$2,675,517</u>	<u>\$2,403,254</u>	<u>\$1,590,041</u>

Department Vacancies (number of days)	5,293	1,229	103
Workers' Compensation Cases	4	26	2
Department Disabilities (number of days)	732	343	109

NOTES:

- (A)** Includes Animal Control Services contract with Los Altos and Los Altos Hills.
- (B)** FY 2020 includes overtime adjustments recommended as part of the FY 2020 Mid-Year review for Strike Team reimbursements (\$114,000) and to extend the cross-staffing of Medic 61 for six months (\$300,000).

ATTACHMENT C

CITY OF PALO ALTO

RECOMMENDED AMENDMENTS TO THE CITY MANAGER'S FY 2020 BUDGET

Department		Revenues Adjustment	Expenses Adjustment
GENERAL FUND (102)			
<i>Administrative Services</i>	Permits and Licenses - Business Registration Fee	(175,000)	\$ -
<i>Administrative Services</i>	Non Salary General Expense Savings	-	\$ (50,000)
<i>Administrative Services</i>	Salaries & Benefits Savings	-	\$ (150,000)
<i>City Auditor's Office</i>	Salaries & Benefits Savings	-	\$ (190,000)
<i>City Clerk's Office</i>	Non Salary Contract Services Savings	-	\$ (50,000)
<i>City Manager's Office</i>	Salaries & Benefits Savings	-	\$ (185,000)
<i>Community Services</i>	Salaries & Benefits Savings	-	\$ (475,000)
<i>Community Services</i>	Charges for Service and Rental Income Revenue/Non Salary Savings (Excluding Golf)	(2,600,000)	\$ (500,000)
<i>Community Services</i>	Charges for Service - Golf Course Revenue	(1,300,000)	\$ -
<i>Library</i>	Salaries & Benefits Savings	-	\$ (350,000)
<i>Library</i>	Penalties and Fines & Other Revenue/Non Salary Savings	(115,000)	\$ (45,000)
<i>Non-Departmental</i>	Transient Occupancy Tax/Transfer to Capital Improvement Fund	(6,959,000)	\$ (3,179,000)
<i>Non-Departmental</i>	Property Tax	277,000	\$ -
<i>Non-Departmental</i>	Sales Tax	(5,468,000)	\$ -
<i>Non-Departmental</i>	Utility Users' Tax	(1,439,000)	\$ -
<i>Non-Departmental</i>	Documentary Transfer Tax	(1,424,000)	\$ -
<i>Non-Departmental</i>	Transfer to Capital Improvement Fund (FY 2019 year-end BSR surplus)	-	\$ (3,500,000)
<i>Non-Departmental</i>	Transfer to Business Improvement District (BID) Fund	-	\$ 70,000
<i>Non-Departmental</i>	Eliminate Operations Reserve	-	\$ (475,000)

ATTACHMENT C

CITY OF PALO ALTO

RECOMMENDED AMENDMENTS TO THE CITY MANAGER'S FY 2020 BUDGET

Department		Revenues Adjustment	Expenses Adjustment
GENERAL FUND (102)			
<i>Non- Departmental</i>	Eliminate Reserve for Recruitment and Retention Initiatives	-	\$ (500,000)
<i>Non- Departmental</i>	City Manager Employment Contract (Housing)	-	\$ (600,000)
<i>Non- Departmental</i>	Advancing Racial Equity	-	\$ 500,000
<i>Office of Emergency Services</i>	Non Salary Contractual Expense Savings	-	\$ (275,000)
<i>Office of Transportation</i>	Salaries & Benefits Savings	-	\$ (170,000)
<i>Office of Transportation</i>	Non Salary Contractual Expense Savings	-	\$ (140,000)
<i>Planning & Development Services</i>	Charges for Services - Planning	(750,000)	\$ -
<i>Planning & Development Services</i>	Salaries & Benefits Savings - Planning	-	\$ (290,000)
<i>Planning & Development Services</i>	Charges for Services - Development Services	(3,000,000)	\$ -
<i>Planning & Development Services</i>	Salaries & Benefits Savings - Development Services	-	\$ (300,000)
<i>Planning & Development Services</i>	Development Services Reserve Fund (DSRF)	-	\$ (595,000)
<i>Police</i>	Taxes, Penalties, and Fines	(875,000)	\$ -
<i>Police</i>	Salaries & Benefits Savings	-	\$ (150,000)
<i>Police</i>	Non Salary Contractual Expense Savings	-	\$ (200,000)
<i>Public Works</i>	Salaries & Benefits Savings	-	\$ (250,000)
<i>Public Works</i>	Charges for Service - Street Cut Fees	30,000	\$ -
<i>Public Works</i>	Other Revenue - EV Chargers	70,000	\$ -
<i>Public Works</i>	Permits and Licenses - Encroachment Fees	20,000	\$ -
<i>Fund Balance</i>	Adjustment to Budget Stabilization Reserve	-	\$ (11,659,000)
GENERAL FUND (102) SUBTOTAL		(23,708,000)	\$ (23,708,000)

ATTACHMENT C

CITY OF PALO ALTO

RECOMMENDED AMENDMENTS TO THE CITY MANAGER'S FY 2020 BUDGET

Department		Revenues Adjustment	Expenses Adjustment
CAPITAL IMPROVEMENT FUNDS			
<u>GENERAL FUND CAPITAL IMPROVEMENT FUND (471)</u>			
<i>Capital</i>	Transfer from General Fund	\$ (6,679,000)	\$ -
<i>Fund Balance</i>	Adjustment to Infrastructure Reserve		\$ (6,679,000)
		GENERAL FUND CAPITAL IMPROVEMENT FUND (471) SUBTOTAL	\$ (6,679,000) \$ (6,679,000)

ATTACHMENT C

CITY OF PALO ALTO

RECOMMENDED AMENDMENTS TO THE CITY MANAGER'S FY 2020 BUDGET

Department		Revenues Adjustment	Expenses Adjustment
SPECIAL REVENUE FUNDS			
<u>BUSINESS IMPROVEMENT DISTRICT FUND (220)</u>			
<i>Administrative</i>			
<i>Services</i>	Transfer from General Fund	\$ 70,000	\$ -
<i>Department</i>			
<i>Fund Balance</i>	Adjustment to Fund Balance	\$ -	\$ 70,000
		BUSINESS IMPROVEMENT DISTRICT FUND (220) SUBTOTAL	\$ 70,000
		\$ 70,000	\$ 70,000