

## CITY COUNCIL STAFF REPORT

Public Hearing Item No. 8

June 10, 2020

File No. 0430-30

SUBJECT: Adoption of Fiscal Year 2020/21 Annual Operating Budget and the Appropriations Limit (GANN Limit) for Fiscal Year 2020/21

DEPARTMENT: Finance Department

RECOMMENDATION:

It is requested that the City Council adopt the following Resolutions:

1. Resolution No. 2020-71 approving the Fiscal Year 2020/21 Annual Operating Budget; and
2. Resolution No. 2020-72 approving the Appropriations Limit (Gann Limit) for FY 2020/21.

FISCAL ANALYSIS:

The proposed FY2020/21 General Fund Operating Budget is a balanced budget without the use of reserves. The appropriation total for all operating funds is \$418,822,725 and for the General Fund is \$107,596,800. The budget document can be viewed on the City's website at: <https://www.escondido.org/annual-operating-budget.aspx>.

BACKGROUND:

On May 13, 2020, the City Council was presented with the FY2020/21 Preliminary Operating Budget Status report. In order to address an ongoing structural budget deficit, Departments were required to cut on average around 8% from their prior year budgets. Prior to March 2020, most economists and investors expected the 11-year economic growth cycle to continue to rise through FY2020/21. The projected operating revenue and budget reductions proposed by Departments resulted in a balanced budget for FY2020/21. However, as a result of the COVID-19 pandemic, the economy fell from record highs to unprecedented declines in a matter of weeks, which effected the projected operating revenue, creating a budget deficit of \$4 million projected for FY2020/21.

The City Council was presented with options for closing the remaining \$4 million deficit and achieve a balanced budget. The City Council approved the staff recommendation to divert the transfer of funds from the Redevelopment Loan payment to the City. Such funds would have normally been placed in the Section 115 Irrevocable Pension Trust pursuant to prior City Council policy direction for use of one-time funds.

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**FY2020/21 Revenue Update**

On May 20, 2020, the City Treasurer made a presentation to the City Council including an economic outlook in light of the COVID-19 pandemic and resulting conditions. While the scenarios presented are within the range of potential outcomes in this unprecedented situation, staff disagrees that the revenue estimates presented previously by staff might be inaccurate. We have projected our own revenue for Escondido in both an accurate and reasonable manner. Based on the discussion presented below, Finance Staff remains confident in the General Fund revenue projections provided to the City Council on May 13, 2020.

The Sales Tax revenue projected in the Fiscal Year 2020/21 is \$36 million, a decrease of \$3 million or 7.5% over the FY2019/20 amended sales tax forecast. The projections are based on the most recent data available that included actual cash receipts reported as of December 31, 2019, and then forecast based on economic indicators that are specific to the City of Escondido's sales tax segments. On May 20, 2020, the City received the sales tax allocation for sales that occurred through March 2020 and the amount received confirms the current forecast and amounts projected for next fiscal year.

The forecast assumes that some form of the Stay-At-Home order stays in effect until July 31, 2020, with a slow reopening of the economy. Leading sales tax analysts in California are predicting a decline in sales tax revenues that are expected to continue through the fourth quarter of 2020 with only moderate gains for several quarters thereafter. With the most dramatic decreases expected during the first and second quarters of 2020, future comparisons to these periods are predicted to be positive. However, overall dollars will still be less than the same period in 2019 noting a prolonged flat rebound.

The two largest economic segments for Escondido, transportation and general retail, account for 60% of local sales tax, and are experiencing the largest declines. The transportation segment includes new and used auto sales and service stations, and is projected to decline by \$714,000 or 6% over prior year. General retail, which includes department stores, apparel stores, and furniture stores, is projected to fall by \$470,000 or 8% over the prior year. Fortunately, this lower sales tax from brick and mortar stores is being offset by increases in sales tax revenue collected from online sales. The Wayfair decision will provide the City with a new, large amount of taxable sales not received in prior years.

At the start of the calendar year, the federal, state, and local economic outlook was positive. U.S. Gross Domestic Product (or "GDP") was growing at a rate of 2%. This economic indicator measures how quickly the economy is growing with ideal growth between 2% to 3%. The U.S. economy had entered its ninth straight year in which more than 2 million jobs were created. All this new hiring had pushed the unemployment rate to a 50-year low of 3.5%. The unemployed rate in San Diego County was also at a record low of 3.1% in February. Home prices in San Diego County were at near record highs due to low mortgage interest rates. Consumer confidence was at all-time highs, which is important because high consumer confidence equates to increased consumer spending activity. The California economy was strong and there was no recession in the forecast.

Then came the pandemic. Government operations and private businesses were forced to close or drastically alter operations. Never in modern history has so much business activity come to an immediate and widespread stop. Economists describe COVID-19 as an external shock to the economy

similar to the disruption caused by war or an earthquake. The government's response to the pandemic was policies that have prevented workers from working (deepening the supply-side contraction) and consumers from consuming (deepening the demand-side contraction) creating an economic downturn that was both intentional and unavoidable, all in an effort to stop the spread of the virus.

Since the mandated shutdowns went into effect, unemployment in the San Diego region hit an all-time high of 30% and over 510,000 residents are unemployed. However, what is happening today is nothing like what has happened in past recessions. Recessions in the past have primarily been caused by asset bubbles, which lead to the permanent loss in jobs and a fall in the demand for goods and services. Asset bubbles occur when assets such as housing, stocks, or gold dramatically rise in price over a short period and are not supported by the value of the product. Examples of asset bubbles include the stock market bubble of the 1920s, the dot-com bubble of the 1990s, and the real estate bubble of the 2000s. The inevitable collapse of asset bubbles wipe out the net worth of investors and causes exposed businesses to fail. These failed businesses create a permanent loss of millions of jobs connected with the bubble. What is happening today is different in that the vast majority of people currently applying for unemployment are being laid off from profitable businesses that have been shuttered temporarily because of a health mandate. If these businesses are allowed to reopen soon, these jobs should return.

Another key economic indicator is Gross Domestic Product (or "GDP") which declined by 4.8% in first quarter 2020. This decline is the biggest drop in quarterly economic output since the fourth quarter of 2008 and was largely driven by a steep decline in consumer spending. The decline in consumer spending was primarily the result of business shutdowns, social distancing, and other initiatives aimed at containing the virus. However, many economists believe that the impact of the shutdowns has been cushioned by the federal stimulus package passed last month that provided financial assistance to U.S. households and businesses. This stimulus package could be thought of as a life preserver that is saved jobs, firms, banks, and networks from going out of business. Once the shutdown orders are lifted, businesses will reopen, production will resume, and jobs should still be there.

The economic impact from this pandemic impacted some business sectors more than others and areas where these business sectors are located will be harder hit during this downturn than other areas. The business sectors most impacted by the COVID-19 pandemic include hotels, airlines, cruises, tourism, restaurants & bars and a portion of retail. Cities dependent on large entertainment centers, stadiums, or convention centers will be harder hit. Escondido is fortunate to have a comprehensive mix of businesses and a diverse job base and is not heavily dependent on one of these hard hit sectors for the majority of our General Fund revenue.

The Great Recession had a devastating impact on Escondido's General Fund. During a three-year period, revenue fell by \$15.7 million or 19%. However, the current economic downturn is very different from the Great Recession and drawing direct comparisons between the two is ill-advised. The Great Recession was caused by an economic crisis that resulted in business failures and a permanent loss of jobs. The current economic downturn was triggered by a health-care crisis that caused the temporary closure of profitable businesses and a temporary loss in jobs. The California economy was strong

leading up to the crisis so if businesses were profitable before the recession, a two-month closure should not cause a bankruptcy, especially in light of government loans to small businesses. Once businesses reopen, jobs will return, but we agree not all the damage will be erased. Therefore, we projected a decline in sales tax revenue in Fiscal Year 2020/21, but at a slower rate.

Economists agree that the COVID-19 pandemic brought a sharp and sudden decline to the economy and this decline is expected to continue into Fiscal Year 2020/21. Where consensus among economists has not been reached, is the magnitude of this economic decline and also how quickly the economy will recover. These questions are difficult to answer because our current data is limited and we cannot look to past economic data as this unprecedented event has never happened in U.S. history.

City staff remain confident in the General Fund revenue projections provided to the City Council on May 13, 2020. However, projections are not guarantees. Staff will continue to monitor economic indicators and City revenue closely and return to Council with updates during the fiscal year. If the economic downturn is more significant than projected, more difficult decisions will be made that will significantly impact City services. We believe it is far better to proceed using this approach rather than unnecessarily make additional cuts to services simply in anticipation of worse results which may not materialize.

### **Future Financial Projections**

Prior to the economic impacts of COVID-19, the General Fund long-term financial plan projected annual deficits growing to \$14 million by Fiscal Year 2023-24 and continuing over the next 15 years. The City's most recent Multi-Year Financial Plan forecasts that the City is potentially facing a budget deficit of \$8 million by Fiscal Year 2021-22. Eliminating a deficit this large is extremely challenging when 86% of the total General Fund budget pays for the cost of staffing to provide City services, and nearly 80% is dedicated to public safety and public works personnel for law enforcement, emergency services, street and park maintenance, graffiti removal and addressing homelessness issues.

The structural budget gap consistently present in Escondido's finances, plus the inevitable lingering impacts of the COVID-19 pandemic, make addressing future City revenue the highest priority of staff, policymakers and the community in upcoming months.

In keeping with our commitment to long-term planning, Staff will continue to provide financial recommendations based on realistic revenue projections, risk assessments, and prudent spending to ensure a stable financial position. However, it will be vital for the City to address the magnitude of the projected deficits forecast in upcoming years now. The available options to close the structural operating budget gap include the consideration of new taxes and fees, complete elimination of certain programs, and radical restructuring of the City's operations and workforce. Staff will be working with the City Council to engage in thorough dialogue, build community consensus and develop strategies to address the challenge.

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APPROVED AND ACKNOWLEDGED ELECTRONICALLY BY:

*Joan Ryan*, Director of Finance  
6/3/20 3:50 p.m.

ATTACHMENTS:

1. Resolution No. 2020-71 Approving the Fiscal Year 2020/21 Annual Operating Budget
2. Resolution No. 2020-72 Approving the Gann Limit for Fiscal Year 2020/21
3. Resolution No. 2020-72 – Exhibit A - GANN Calculation
4. Resolution No. 2020-72 – Exhibit B - GANN Limit Calculation

RESOLUTION NO. 2020-71

A RESOLUTION OF THE CITY COUNCIL OF  
THE CITY OF ESCONDIDO, CALIFORNIA,  
ADOPTING OPERATING BUDGETS FOR  
CERTAIN CITY DEPARTMENTS FOR FISCAL  
YEAR 2020-21 SUBJECT TO ANY AMENDMENT  
MADE PURSUANT TO COMPENSATION PLANS  
FOR THE CITY OF ESCONDIDO AND  
ESTABLISHING CONTROLS ON CHANGES IN  
APPROPRIATIONS TO VARIOUS FUNDS AND  
DEPARTMENTS

BE IT RESOLVED by the City Council of the City of Escondido, California, as follows:

SECTION 1. That the budgets for all City Departments for the period July 1, 2020, through June 30, 2021, inclusive, contained in the Fiscal Year 2020-21 Operating Budget Document (a copy of which is on file in the Office of the City Clerk) as amended by Council, are adopted as the final budgets for the Fiscal Year 2020-21, subject to any further amendments pursuant to approval of Compensation Plans for employees of the City of Escondido.

SECTION 2. That the amount designated as Department Total for each department and each fund in the budgets on file with the City Clerk, is hereby appropriated to the department or fund for which it is designated subject to adjustments for Compensation Plan approvals. Such appropriations as adjusted shall not be increased without approval of the City Council, except that transfers within funds, may be approved by the City Manager. All amounts designated as Employee Services, Maintenance and Operation, and Capital Outlay in each budget on file with the City Clerk, are hereby appropriated for such uses to the department or fund under which they are listed, subject

to any amendments made pursuant to approval of Compensation Plans for employees of the City of Escondido, and shall not be increased without approval of the City Manager.

SECTION 3. That the approval of the Operating Budget Document, including the Department Total expressed for each department, and any subsequent amendments shall include approval for all actions of the City acting as Successor Agency of the former Escondido Redevelopment Agency as expressed in said Operating Budget Document.



RESOLUTION NO. 2020-72

A RESOLUTION OF THE CITY COUNCIL OF  
THE CITY OF ESCONDIDO, CALIFORNIA,  
ADOPTING AN ANNUAL APPROPRIATIONS  
LIMIT FOR THE FISCAL YEAR 2020-21 AS  
REQUIRED BY LAW

WHEREAS, Article XIII-B of the California State Constitution requires that the City of Escondido calculate an appropriations limit for each fiscal year, commonly known as the "Gann Limit;" and

WHEREAS, the Gann Limit is based on a combination of a population factor and an inflation factor as outlined on Exhibit "B," which is attached to this Resolution and incorporated by this reference; and

WHEREAS, the City Council desires at this time and deems it to be in the best public interest to adopt an annual Gann Limit for Fiscal Year 2020-21 as listed on Exhibit "A," which is attached to this Resolution and incorporated by this reference.

NOW, THEREFORE, BE IT RESOLVED by the City Council of the City of Escondido, California, as follows:

1. That the above recitations are true.
2. That the City Council adopts the calculation of the annual Gann Limit for the Fiscal Year 2020-21. The Gann Limit is adopted on a provisional basis, as the limit may need to be adjusted when current assessment data are available. The 2019-20 Gann Limit Calculation is finalized as shown on Exhibit "B," which is attached to this Resolution and incorporated by this reference.

**EXHIBIT A  
 GANN CALCULATION  
 2020-21**

	<u>PROCEEDS</u>	<u>NON-PROC.</u>
PROPERTY TAXES	29,859,000	
OTHER TAXES:		
Sales and Use Tax	35,991,300	
Franchise	6,255,000	
Transient Occupancy Tax	1,656,000	
RPTTF Residual Payment	2,293,000	
Property Transfer	579,000	
LICENSES AND PERMITS:		
Business Licenses	1,765,800	
Building Permits		354,000
Electrical Permits		110,000
Mechanical Permits		40,000
Plumbing Permits		32,000
Other Permits		477,500
FINES, FORFEITURES AND PENALTIES:		
Parking Fines		265,000
Library Fines and Fees		64,000
Other Court Fines		897,000
REVENUE FROM USE OF MONEY:		
Interest Income	368,971	109,029
REVENUE FROM OTHER AGENCIES:		
Rincon Fire Agreement		2,368,000
Reimbursements from Outside Agencies		340,000
Grants		656,000
VLF Revenue in Excess		121,000
Post Reimbursement		10,000
State Highway Maintenance		10,000

	<u>PROCEEDS</u>	<u>NON-PROC.</u>
<b>CHARGES FOR CURRENT SERVICES:</b>		
Paramedic Services		6,724,000
Community Services		2,412,520
Engineering Fees		1,082,000
Plan Check Fees		400,000
Special Police Services		200,000
Conservation Credit		149,000
Zoning Fees		138,000
Environmental Impact Reports		35,000
Subdivision Fees		37,000
Sale Maps and Publications		500
Other Current Services		978,000
<b>OTHER REVENUE:</b>		
Leased Property		3,540,000
Transfer Station Fee		1,119,000
Mobile Home Rent Control		64,000
Small Cell Site Revenue		180,000
Other Revenue		337,200
<b>GAS TAX FUND:</b>		
Revenue from Use of Money		
Interest Income		52,500
Revenue from Other Agencies		
State Gas Tax 2105		810,000
State Gas Tax 2106		533,000
State Gas Tax 2107		974,000
State Gas Tax 2107.5		10,000
State Gas Tax 2013		1,290,000
	<u>78,768,071</u>	<u>26,919,249</u>
<b>TOTALS</b>		
	78,768,071	26,919,249
<b>LESS: STATE MANDATES (Estimated)</b>	<u>(20,000)</u>	
<b>APPROPRIATIONS SUBJECT TO LIMIT</b>	78,748,071	
<b>GANN LIMIT FOR 2020-21</b>	<u>1,350,363,716</u>	
<b>MARGIN</b>	<u><u>1,271,615,645</u></u>	

**EXHIBIT B**  
**GANN LIMIT CALCULATION**

	<u>POPULATION FACTOR USED</u>	<u>INFLATION FACTOR USED</u>	
2004-05 Limitation		Per Capita	331,529,017
2005-06 Factor	County Growth	Personal Income	<u>1.06597</u>
2005-06 Limitation		Per Capita	353,399,986
2006-07 Factor	County Growth	Personal Income	<u>1.04937</u>
2006-07 Limitation		Non Residential	370,847,343
2007-08 Factor	County Growth	Assessed Valuation	<u>1.07955</u>
2007-08 Limitation		Per Capita	400,348,249
2008-09 Factor	County Growth	Personal Income	<u>1.05687</u>
2008-09 Limitation		Per Capita	423,116,054
2009-10 Factor	County Growth	Personal Income	<u>1.01888</u>
2009-10 Limitation		Per Capita	431,104,485
2010-11 Factor	City Growth	Personal Income	<u>0.98883</u>
2010-11 Limitation		Per Capita	426,289,048
2011-12 Factor	City Growth	Personal Income	<u>1.03269</u>
2011-12 Limitation		Non Residential	440,224,437
2012-13 Factor	County Growth	Assessed Valuation	<u>1.27787</u>
2012-13 Limitation		Non Residential	562,549,601
2013-14 Factor	County Growth	Assessed Valuation	<u>1.59242</u>
2013-14 Limitation		Non Residential	895,815,236
2014-15 Factor	County Growth	Assessed Valuation	<u>1.06226</u>
2014-15 Limitation		Per Capita	951,588,693
2015-16 Factor	County Growth	Personal Income	<u>1.05045</u>
2015-16 Limitation		Per Capita	999,596,343
2016-17 Factor	County Growth	Personal Income	<u>1.06192</u>
2016-17 Limitation		Per Capita	1,061,491,349
2017-18 Factor	County Growth	Personal Income	<u>1.04644</u>
2017-18 Limitation		Non Residential	1,110,787,007
2018-19 Factor	County Growth	Assessed Valuation	<u>1.05197</u>
2018-19 Limitation		Non Residential	1,168,514,608
2019-20 Factor	County Growth	Assessed Valuation	<u>1.10963</u>
2019-20 Limitation		Per Capita	1,296,618,864
2020-21 Factor	City Growth	Personal Income	<u>1.04145</u>
			1,350,363,716