



Agenda Report

MEETING DATE: Tuesday, February 9, 2021

TO: City Council

FROM: ADMINISTRATIVE SERVICES DIRECTOR CZERWIN

SUBJECT: MID-YEAR FY 2020-21 FINANCIAL REPORT AND RELATED ACTIONS

STATEMENT OF ISSUES:

Receive audited financial reports for Fiscal Year 2019-2020 and a mid-year financial report for FY 2020-21.

RECOMMENDED ACTION:

That the City Council:

- I. Accept by motion, the Comprehensive Financial Report for FY 2019-20, and
- II. Accept by motion, the mid-year financial report for the 2020-21 Fiscal Year:
- III. Accept by motion, the Annual Measure G Audit Report for FY 2019-20, and
- IV. Approve a resolution appropriating \$414,665 into various funds as described in Attachment 1.

DISCUSSION:

I. Review of Fiscal Year 2019-20

The City's Charter and State of California law require that all general-purpose local governments publish a complete set of financial statements presented in conformity with accounting principles generally accepted in the United States of America (US GAAP). This report is commonly referred to as a comprehensive annual financial report and also by the acronym "CAFR". Upon completion of the City's CAFR, the City prepared and submitted it to the Government of Finance Officers Association (GFOA) for consideration in receiving the "Certificate of Achievement for Excellence in Financial Reporting."

The CAFR was audited by Maze and Associates, an independent firm of certified public accountants (CPA), who issued an unqualified opinion of its audit of the City's CAFR. Some of the highlights presented in the audited statements include (all figures are in thousands unless otherwise indicated):

- The assets of the City of Watsonville exceeded its liabilities at the close of the most recent fiscal year by \$242,116. See Table 1 below.
- The City's total net position increased by \$1,723. Governmental activities net position decreased by \$2,864 most of this decrease was due to an increase in long term liabilities notably pension liability. Business type activities net position increased by \$4,586. Most of this increase was from the Water Utility ending with positive operating income.
- As of the close of the fiscal year, the City's governmental funds reported combined ending fund balances of \$38,820 an increase of \$5,432 in comparison with the prior fiscal year's balances. The non-spendable portion of the fund balance was \$114, the restricted portion was \$20,610 and the unassigned amount was \$18,096. A large portion of the unassigned fund balance was created by increases in taxes by the general fund during fiscal year 2019-20 and budgetary expenditure savings, and collection of receivables from grants.

General Fund Balance

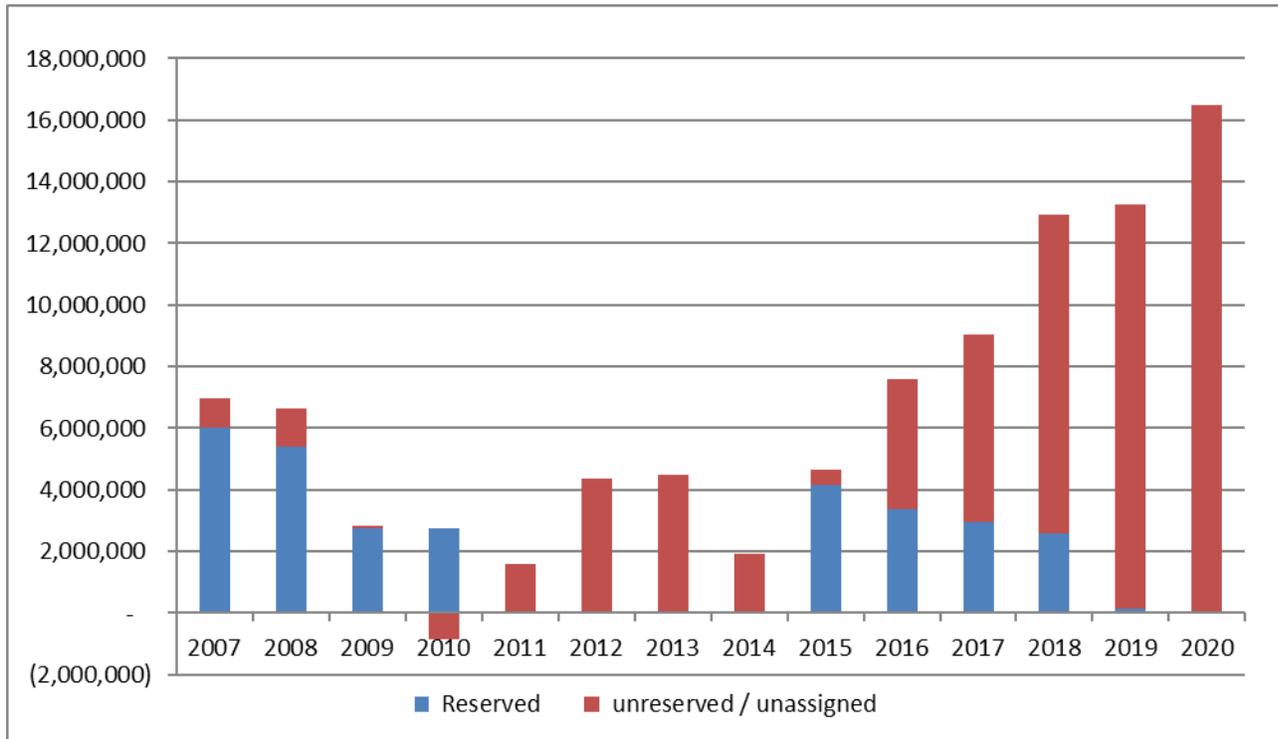
In Fiscal Year 2019-20 the General Fund ended with a Fund Balance of \$16,592, a \$3,325 increase from FY 2018-19. The General Fund as reported in the CAFR includes eighteen subaccounts that are operationally distinct, one of which serves as the chief operating fund for the City, also referred to as the 0150 General Fund. The balance in the General Fund grew, as had been presented to Council in prior FY 2019-20 budget updates, due to property tax growth, sales tax performing better than expected, and a late year freeze and reduction of expenditures due to the COVID-19 pandemic.

Other subaccounts that increased their balances this year included grants, cannabis, Civic Center Plaza, and computer replacement accounts. The grants subaccount in particular increased its balance by over \$1 million as a result of the Finance Department working with other City departments to aggressively pursue pending grant reimbursements and improve our process for booking these receivables. The General Fund's fund balance now is approximately 35% of annual operating expenses, exceeding the Council's approved policy goal of 20%. The 20% policy goal was established in 2018 at a time when the available balance was closer to 10%, well below the GFOA minimum recommended of 20%. Now that the General Fund's fund balance has achieved and exceeded the 20% minimum for more than two years, staff will be looking for ways to review possible updates to our reserve policy to ensure the reserve levels are aligned with our needs as a city and address our unfunded of capital and CalPERS liabilities. (See Table 2 below)

Table 1:
City of Watsonville's Net Position
June 30, 2020 (in thousands)

	Governmental		Business-type		Total	
	Activities		Activities			
	2020	2019	2020	2019	2020	2019
	\$	\$	\$	\$	\$	\$
Revenues:						
Program Revenues:						
Charges for services	11,936	16,222	53,011	49,935	64,947	66,157
Operating grants and contributions	5,988	2,501	787	2,016	6,775	4,517
Capital grants and contributions	-	-	163	94	163	94
General Revenues						
Property taxes	16,243	15,669	-	-	16,243	15,669
Other taxes	26,704	26,965	-	-	26,704	26,965
Others	4,555	4,050	811	1,014	5,366	5,064
Total Revenues and Transfers	<u>65,427</u>	<u>65,407</u>	<u>54,772</u>	<u>53,059</u>	<u>120,199</u>	<u>118,466</u>
Expenses:						
General government	13,812	15,143	-	-	13,812	15,143
Public safety	35,811	31,221	-	-	35,811	31,221
Housing	2,059	2,289	-	-	2,059	2,289
Streets	6,931	8,560	-	-	6,931	8,560
Culture and recreation	9,850	9,152	-	-	9,850	9,152
Interest on debt	78	491	38	-	116	491
Water	-	-	19,369	13,996	19,369	13,996
Sewer	-	-	14,099	14,195	14,099	14,195
Solid waste	-	-	12,567	11,926	12,567	11,926
Airport	-	-	3,803	5,117	3,803	5,117
Fiber optic	-	-	59	67	59	67
Total Expenses	<u>68,541</u>	<u>66,856</u>	<u>49,935</u>	<u>45,301</u>	<u>118,476</u>	<u>112,157</u>
Increase in net position before transfers	(3,114)	(1,449)	4,838	7,758	1,723	6,309
Internal balances	251	272	(251)	(272)	-	0
Change in net position	<u>(2,863)</u>	<u>(1,177)</u>	<u>4,586</u>	<u>7,486</u>	<u>1,723</u>	<u>6,309</u>
Net position - beginning	128,039	129,216	112,354	104,867	240,392	234,083
Prior year adjustments	-	-	-	-	-	-
Net position - beginning restated	128,039	129,216	112,354	104,867	240,392	234,083
Net position ending	<u>125,175</u>	<u>128,039</u>	<u>116,940</u>	<u>112,354</u>	<u>242,116</u>	<u>240,392</u>

**Table 2:
History of General Fund Balance**



For several years now, departments have highlighted the significant unfunded liability regarding capital assets, infrastructure and facility needs in the City. During the FY 2020-21 budget process, the City updated its Capital Plan and identified over \$40 million in unfunded capital needs. Another way to demonstrate this growing liability is through the decreasing total value of our governmental assets as identified in the FY 2019-20 CAFR. Referring to page 62 of the CAFR you will see that, depreciation and deletions are outpacing additions to capital assets. Further evidence of the City’s need to invest more sustainably in capital. See Table 3.

**Table 3:
Governmental Activities Capital Assets FY 2019-20**

Capital Asset	FY 2020	FY 2019	Change	% Change
Land	16,468	14,472	1,996	13.79%
Building and Improvements	76,670	79,470	(2,800)	-3.52%
Machinery & Equipment	6,259	5,061	1,198	23.67%
Infrastructure	10,130	10,982	(852)	-7.76%
Construction in progress	3,812	4,332	(520)	-12.00%
Totals	113,339	114,317	(978)	-0.86%

II. Review of Fiscal Year 2020-21

Revenues

This is now our third update since the adoption of the FY 2020-21 budget. As each of the prior updates had indicated, our revenues have continued to exceed our expectations despite the pandemic. The declines projected in our tax revenues in particular have not come to pass. Property and Utility taxes are marching along at a relatively normal pace. Hotel tax (TOT) is tracking close to the budgeted 25% decrease, but we are hopeful some activity along with the new hotel opening in the spring will push this slightly above budget. Business licenses are essentially level from the prior year.

Sales tax continues to be a surprise. We now have data through the end of September 30th. If you recall, the summer months were fairly optimistic in terms of the pandemic. New daily cases were relatively low; this was before the fall and winter second wave of shut downs. This quarter had sales receipts up 15% from the same quarter the prior year. These trends are masking struggles in other parts of our economy, including, fuel sales were down -29%, restaurants down - 8%, and business and industry down -9%. However, these decreases were more than offset by increases in auto sales and increases in the state and county pools from online sales. We believe the increase in auto sales reflects some one-time activity that gave an extra boost to this category for this quarter and that future quarters will reflect more normal sales levels (though not the decrease we expected in the Budget).

In regards to online sales there are a couple of moving parts at work. First, this is the last quarter to include new online sale tax revenues resulting from the *Wayfair* court decision as compared to the prior year. Second, under the pandemic many people have turned to online shopping. New models of shopping such as “buy online and pick-up in the store” are being included in the pools. Third, as our tourism-based neighbors have experienced a drop in their sales, our share of the county online sales pool has increased. Therefore, we do not expect the increase seen in this quarter to continue as the tourism economy starts to recover in other parts of the county. Sales tax will likely level off and even decline slightly as the economy begins to open up and tourists return to the surrounding areas. Overall, we had budgeted for a 25% decline in sales tax revenues and are now projecting an increase of 6%.

In departmental revenues the story is more mixed. We have discussed several times the surge of activity that the Community Development Department is experiencing. They have essentially had no decline in revenues from prior years. However, our Police Department will have much less revenue than in prior years. As you recall, PVUSD canceled its contract for school resource officers earlier this year. Furthermore, staffing issues and policy choices around parking enforcement are reducing normal revenues from parking citations. The Parks and Recreation Department is another area where revenues will not meet budgeted targets. When building the budget, we assumed recreation activities would be able to resume in some way in September. We are now in February of 2021 and that has not happened. Therefore, revenues we would normally see from charges for recreation activities and rentals are far below target. We

still hope that come late spring and summer some amount of activity will be able to resume and we are therefore keeping the Department's expenditure budget intact, including the funding allocated for Youth Sports.

Overall the General Fund revenue story has been consistent over the past few months. We expect to end the year about \$5 million better than budget and only slightly below prior years.

Expenditures

In order to balance the budget, \$4.4 million was reduced from operating budgets in the FY2020-21 Budget. Just as we have not seen the anticipated revenue declines we have also not seen declines in demand for services. Departments that were reduced are feeling strained in their operations and in their ability to meet demand. Current projections show that without budget adjustments departments will go over budget by the end of the fiscal year. Therefore, we are asking to add some expenditures to help them operate efficiently and respond to community needs.

- 1- Fire Department Overtime: The Fire Department had strike teams deployed around the state assisting with massive fires for most of July through October. In December we requested \$492,759 consistent with expected reimbursements. Since then, the Department has been dealing with staff turnover and mutual aid requests (COVID, wildfires, and vaccination support) that have resulted in increased overtime. We request an additional overtime appropriation of \$216,000 offset by \$50,000 in additional reimbursement revenue. We consider this to be a one-time allocation.
- 2- Community Development Department: The Community Development Department's budget was reduced by 25% after what initially seemed to be a devastating loss of revenues and activity. Since then, demand for the Department's services and therefore their revenues have stabilized. Through the end of December, the Department's revenues are at their historical average level. The Department asks to add two positions, a permit technician and a principal planner. The permit technician is a restoration of a position cut during the budget process and is currently being filled through a contract. The principal planner will be shared by the Community Development and Public Works Departments. The City has had increased workload on a number of large-scale projects and has been using a planning consultant to meet the need. Consultants do not provide the same level of service to applicants and is not ultimately cost-effective. CDD is also requesting increases in contract dollars because as stated above they have relied on consultants to fill in for staffing gaps over the last several months. We expect the consultant dollars to be a one-time bridge until staff can be hired and trained. Together the proposed increases total \$150,310 and are backed by revenue increases.
- 3- Parks and Community Services: The Parks and Community Services Department budget was perhaps the most impacted this budget cycle, partly due to cost saving needs but primarily because their normal activities were and continue to be prohibited under shelter in place restrictions. We built the FY2020-21 Budget hoping that many

of the programs could resume by September. Unfortunately, the prolonged pandemic and continued health restrictions have delayed the reopening of most department programs. However, the Department continues to serve the public through the Excel in Place camps for school children and by maintaining our parks and outdoor spaces. We also hope that at some point during this fiscal year more activities will be able to be provided. The Department is asking for a few additional items. First, salary dollars for the recently approved contract with OE3 staff. Second, \$80,000 for nexus and impact fee studies to research more sustainable funding sources for our parks and arts programs. And finally, an additional \$30,000 in capital dollars to be able to maintain our parks and recreation spaces while they have lower than normal utilization. In total a request of \$131,000.

- 4- Police: The Police Department, similar to the Fire Department, is dealing with staff turnover and staff intensive cases resulting in higher than normal overtime costs. Some of that overtime is offset by the savings from vacant positions, however the Department still needs some additional funding. We request \$50,000 for additional overtime. Furthermore, the Department requests additional salary dollars to fund the recently approved labor contract with the Police sergeants and upgrading one police officer position to a police sergeant to better meet their staffing needs. The overall request for the Police Department is \$89,041.
- 5- City Clerk: The City Clerk is required post-census to conduct a redistricting study. We had budgeted \$40,000 for this project however bids for this work have come in much higher. On a separate item on today's agenda, the City Clerk requests an additional \$76,800 to complete this state mandated obligation.
- 6- Non-Departmental: The City responded to two emergencies this year, including the continuation of COVID-19 response efforts and the CZU lightning fires where we supported the County's response efforts. Due to their emergency nature neither one of these efforts had explicit appropriations. We ask for an acknowledgement of the costs of this response: \$100k for COVID-19, and \$56,784 for the fires. The fire amount reflects an amount that will not be reimbursed from FEMA. The COVID-19 portion may be partially reimbursed however FEMA has been slow in responding to COVID-19 reimbursements and it is unclear at this time how much will be eligible.

All other departments are expected to end the year within their budgets. Table 4 on the following page shows the overall projection for the General Fund for FY 2020-21 without the additional appropriation requests and Table 5 summarizes General Fund appropriation requests. If the requests are approved, we will likely end the year on budget.

Table 4: Summary of General Fund for FY 2020-21

Revenues	FY 2020-21					
	Original Budget	Revised Budget	6 mo Actuals	6 mo % of Budget	Feb. Projection	better / (worse) than Budget
Property Tax	12,171,268	12,171,268	6,673,855	54.8%	13,093,361	922,093
Sales Tax	8,173,255	8,173,255	6,262,600	76.6%	11,458,159	3,284,905
Utility	3,852,945	3,852,945	1,854,740	48.1%	4,146,672	293,727
Hotel	586,720	586,720	380,957	64.9%	704,684	117,964
Transfer In	3,952,808	3,952,808	1,853,029	46.9%	3,952,808	-
Other Revenues	3,874,331	3,874,331	2,188,341	56.5%	4,364,690	490,359
	32,611,327	32,611,327	19,213,523	58.9%	37,720,374	5,109,047
CDD	834,409	1,071,985	685,650	64.0%	1,344,534	272,549
Police	1,437,500	1,437,500	417,035	29.0%	875,675	(561,825)
Fire	248,310	741,069	186,775	25.2%	813,587	72,518
PCS	503,818	536,818	204,668	38.1%	417,083	(119,735)
PW	274,056	274,056	70,534	25.7%	112,562	(161,494)
Other	2,711,972	2,711,972	823,632	30.4%	2,711,857	(115)
CARES Funding			530,053		530,053	530,053
FEMA Reimbursement						
Total GF Revenue	38,621,392	39,384,727	22,131,869	56.2%	44,525,724	5,140,997
Expenditures	Original Budget	Revised Budget	6 mo Actuals	6 mo % of Budget	Feb. Projection	better / (worse) than Budget
Police	18,951,725	18,951,725	11,387,207	60.1%	19,017,089	(65,364)
Fire	7,150,127	7,642,886	4,791,827	62.7%	7,858,886	(216,000)
PCS	3,408,817	3,487,976	1,983,280	56.9%	3,508,976	(21,000)
General Gov't	3,201,022	3,280,014	1,691,426	51.6%	3,421,184	(141,170)
Non Dept	2,301,470	2,460,237	1,121,404	45.6%	2,598,414	(138,177)
CDD	1,877,969	2,215,545	1,053,611	47.6%	2,340,934	(125,389)
Finance	1,590,665	1,590,665	896,084	56.3%	1,590,665	-
PW	1,410,113	1,410,113	755,799	53.6%	1,386,979	23,134
Library	541,484	541,484	270,742	50.0%	541,484	-
IT	-	-	-	-	-	-
Total Depts	40,433,392	41,580,645	23,951,380	57.6%	42,264,611	(683,966)
Capital	645,500	787,929	155,920	19.8%	553,015	234,914
COVID			88,571		98,571	(98,571)
Fires					56,784	(56,784)
Total Expenditures	41,078,892	42,368,574	24,195,871	57.1%	42,972,981	(604,407)
YE change to Fund Balance	(2,457,500)	(2,983,847)			1,552,743	4,536,591

**Table 5:
Summary of General Fund Requested Budget Changes FY 2020-21**

General Fund	Expenditures	Revenues	Balance
One Time	632,784	50,099	(582,685)
Ongoing	110,351	150,310	39,959
	743,135	200,409	(542,726)

Other Funds

The **Airport Enterprise** Fund did a fantastic job of controlling costs and obtaining reimbursements during FY 2019-20 and ended the year with \$565k in cash. In FY 2020-21 they significantly reduced their budget anticipating a drop in commercial lease revenue and fuel sales. Like elsewhere, that has not happened. They ask to add one FTE back to their budget to help with staffing shortages and to ensure their staff do not burn out. They are on track to further increase their balances by the end of the year giving them a solid cushion on which to base their future capital planning.

The Utility Enterprise funds of Water, Sewer, and Solid Waste have seen relatively normal revenues considering the circumstances. The utilities have stopped shutting off services due to non-payment of utility bills. They do have a growing number of customers who are over 120 days delinquent on payments valued at about \$500,000. The utility enterprises are working with community groups and customers to find assistance and create payment plans where possible. Staff will continue to be sensitive to the very difficult situation we are in, and at the same time, encourage people to pay what they can.

The utility funds continue to be relatively healthy but are dependent on a future rate increase to be able to continue to meet the infrastructure needs of the customers and their systems. The water and sewer enterprise funds will likely add to their cash balances by the end of the year due to not completing all budgeted capital projects. The Solid Waste Enterprise Fund, which is having to adapt to new organics requirements and vehicle needs is likely to draw down on some of its balance this year.

The utility funds request some budget updates. They request to add a Safety Coordinator to oversee workplace safety for all utility operations. This is a previously budgeted position that was removed when it became vacant. The position will be budgeted in the Public Works Administrative Division and allocated to all utility funds. Water and Sewer are asking for movement of some funds and an overall decrease to match their updated capital plan with their budget. And finally, as mentioned during the last update the MSC vehicle shop has been moved to an internal service fund and is requesting appropriations to meet historical spending levels. These increases will be recovered from departments across the City, though primarily the utilities, who use their services.

Revenues from sales are the primary revenue source for the **Library, Gas Tax, Measure D, SB1, and Measure G (Y) funds**. Therefore, as discussed above, each of these funds

are projected to have better FY 2020-21 revenues than originally projected. All of these funds had been budgeted to dip significantly into their reserves in order to fund their operating expenses. The additional revenues anticipated will mean these funds will likely not have to dip so far into their reserves. We do not anticipate mid-year adjustments in these funds, but this will perhaps shape future expenditure plans.

Table 6 is a summary of projected activity in each of the fund mentioned above. Table 7 summarizes the requested budget changes.

**Table 6:
Summary of Other Funds for FY 2020-21**

		Starting Balance	Revenue	Expense	Ending Balance
Airport	Revised Budget	565,192	3,538,288	3,534,266	569,214
	Projection	565,192	3,971,596	3,534,266	1,002,522
	Variance		433,308	-	433,308
Water	Revised Budget	20,922,426	19,259,317	27,599,239	12,582,504
	Projection	20,922,426	19,259,317	22,454,161	17,727,582
	Variance		-	5,145,078	5,145,078
Sewer	Revised Budget	6,945,784	17,962,377	22,617,546	2,290,615
	Projection	6,945,784	19,274,877	19,148,328	7,072,333
	Variance		1,312,500	3,469,218	4,781,718
Solid Waste	Revised Budget	4,453,845	14,205,811	16,733,403	1,926,253
	Projection	4,453,845	14,205,811	16,733,403	1,926,253
	Variance		-	-	-
Library	Revised Budget	1,026,412	2,685,696	3,308,728	403,380
	Projection	1,026,412	3,095,068	3,308,728	812,752
	Variance		409,372	-	409,372
Gas Tax	Revised Budget	537,214	947,436	921,871	562,779
	Projection	537,214	1,390,552	1,321,871	605,895
	Variance		443,116	(400,000)	43,116
SB1	Revised Budget	1,176,330	577,160	2,032,088	(278,598)
	Projection	1,176,330	944,214	2,032,088	88,456
	Variance		367,054	-	367,054
Measure D	Revised Budget	2,093,206	2,176,600	2,819,898	1,449,908
	Projection	2,093,206	1,108,320	2,819,898	381,628
	Variance		(1,068,280)	-	(1,068,280)
Measure G	Revised Budget	2,812,330	2,935,100	3,870,077	1,877,353
	Projection	2,812,330	4,161,630	3,559,976	3,413,984
	Variance		1,226,530	310,101	1,536,631

**Table 7:
Summary of Other Funds Requested Budget Changes FY 2020-21**

Fund	Expenditures	Revenues
Airport	19,074	19,074
Sewer	(872,344)	
Water	(7,000)	
MSC Internal Service Fund	531,800	531,800

Next Steps

Staff will come back to Council with a budget outlook presentation in March. At that time, we will present an updated five-year outlook to inform the Council of what our revenue capacity is going forward. Staff will continue to monitor both revenues and expenditures for the remainder of the fiscal year. Department budgets are much tighter than in normal years and if need be we will come back to Council for a 9-month report sometime in May. However, if the situation remains consistent with what is presented here we will forgo that update and return to Council in June to present a proposed two-year budget.

STRATEGIC PLAN:

02-Fiscal Health: the report above meets strategic plan goal number 2 by keeping the Council and the public informed as to the status of the City’s finances during the midst of this recession and pandemic.

FINANCIAL IMPACT:

The recommended appropriations detailed in Attachment 1 total \$2,269,845. Those appropriations are offset by \$1,849,180 in reduced appropriations and funded by \$751,283 in revenue. The remaining requests are being funded with anticipated tax revenues for the General Fund.

ALTERNATIVE ACTION:

Council may choose to accept some, all, or none of the recommendations before them.

ATTACHMENTS AND/OR REFERENCES (If any):

- Attachment 1: Recommended Appropriation Detail
- Attachment 2: Comprehensive Financial Report for FY 2019-20
- Attachment 3: Annual Measure G Audit Report for FY 2019-20