



# Agenda Report

**MEETING DATE:** Tuesday, February 14, 2023

**TO:** City Council

**FROM:** ADMINISTRATIVE SERVICES DIRECTOR DURAN

**THROUGH:** CITY MANAGER MENDEZ

**SUBJECT:** CONSIDERATION OF COMPREHENSIVE FINANCIAL REPORT  
AND MID-YEAR REPORT FOR FY 2022-23

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## **STATEMENT OF ISSUES:**

Receive audited financial reports for Fiscal Year 2021-22 and a mid-year financial report for FY 2022-23.

## **RECOMMENDED ACTION:**

That the City Council:

- I. Accept by motion, the Annual Comprehensive Financial Report for FY 2021-22, and
- II. Accept by motion, the mid-year financial report for the 2022-23 Fiscal Year:
- III. Accept by motion, the Annual Measure G Audit Report for FY 2021-22, and
- IV. Approve a resolution appropriating \$1,789,759 into various funds, as shown in Exhibit A attached to the resolution, and authorizing four additional positions.

## **DISCUSSION:**

### ***I. Review of Fiscal Year 2021-22***

The City's Charter and the 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). Upon its completion, the City prepared the Annual Comprehensive Financial Report (ACFR) 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 ACFR was audited by Maze and Associates, a certified public accountant firm, who issued an unqualified opinion of the City's audit.

Highlights from the audited statements include:

- The City of Watsonville's assets exceeded its liabilities by \$265 MM. See Table 1 below.
- The City's total net position increased by \$14.6 MM with a \$5.3 MM increase in the net position for governmental activities, mainly due to the receipt of American Rescue Plan Act (ARPA) monies, and a \$9.4MM increase in the net position for business type activities, mostly due to Water ending with positive operating income.
- As of the end of the fiscal year, the City's governmental funds reported a combined ending fund balance of \$45.3 MM, a \$2.4 MM increase from the prior fiscal year. The fund balance was comprised of \$147K non-spendable, \$27.4 MM restricted, and \$17.8MM unassigned, with much of the unassigned balance created by increases in impact fees and Measure D during the fiscal year 2021-22, as well as budgetary expenditure savings.

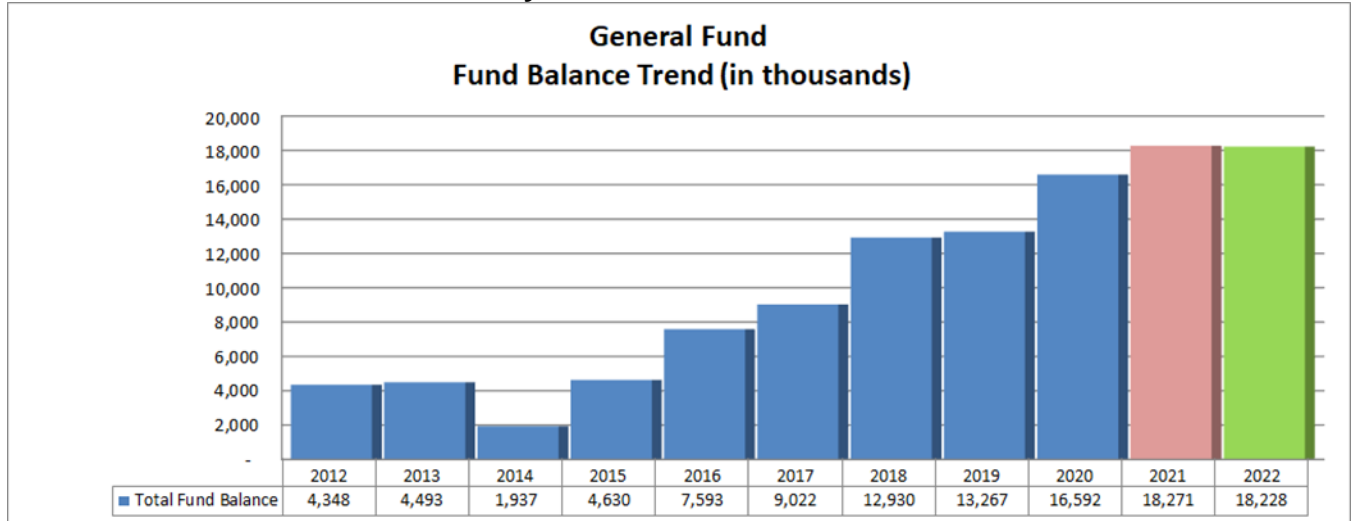
### **General Fund Balance**

The General Fund balance for the fiscal year 2021-22 was \$18.228 MM, a decrease of \$43K from the prior fiscal year. The General Fund, which encompasses 18 subaccounts, experienced a \$1 MM write-down of the City's share in the Local Agency Investment fund (LAIF) investment. This loss is recorded in the books at year-end but will not be realized. Other subaccounts, such as the computer replacement fund and grants subaccount, decreased due to expenditures on grant programs and awaited reimbursements. Despite this, the General Fund balance stands at approximately 31% of operating expenses, exceeding the Council's approved policy goal of 20%. It is expected that most of the fund balance above the reserve requirement will be spent in future years.

**Table 1:**  
City of Watsonville's Net Position  
June 30, 2022(in thousands)

	<b>Governmental Activities</b>		<b>Business-type Activities</b>		<b>Total</b>	
	<b>2022</b>	<b>2021</b>	<b>2022</b>	<b>2021</b>	<b>2022</b>	<b>2021</b>
	\$	\$		\$	\$	\$
Revenues:						
Program Revenues:						
Charges for services	12,170	11,338	56,327	56,355	68,497	67,693
Operating grants and contributions	3,541	5,100	(20)	732	3,521	5,832
Capital grants and contributions	-	-	488	107	488	107
General Revenues						
Property taxes	16,977	16,169			16,977	16,169
Other taxes	34,436	30,834			34,436	30,834
Others	2,857	2,531	1,535	1,344	4,392	3,875
Total Revenues and Transfers	69,981	65,972	58,330	58,538	128,311	124,510
Expenses:						
General government	12,246	8,599		-	12,246	8,599
Public safety	33,149	35,608		-	33,149	35,608
Housing	3,256	429		-	3,256	429
Streets	6,050	8,652		-	6,050	8,652
Culture and recreation	10,264	9,201		-	10,264	9,201
Interest on debt	42	123	64	44	106	167
Water	-	-	16,095	15,960	16,095	15,960
Sewer	-	-	13,633	14,190	13,633	14,190
Solid waste	-	-	14,355	19,189	14,355	19,189
Airport	-	-	4,470	4,235	4,470	4,235
Fiber optic	-	-	64	69	64	69
Total Expenses	65,007	62,612	48,681	53,687	113,688	116,299
Increase in net position before transfers	4,974	3,360	9,649	4,851	14,623	8,211
Internal balances	284	245	(284)	(245)	-	-
Change in net position	5,258	3,605	9,365	4,606	14,623	8,211
Net position - beginning	128,857	125,175	121,546	116,940	250,404	242,115
Prior year adjustments	-	77		-	77	77
Net position - beginning restated	128,857	125,252	121,546	116,940	250,480	242,192
Net position ending	134,115	128,857	130,911	121,546	265,103	250,403

**Chart 1:  
History of General Fund Balance**



### ***I. Review of Fiscal Year 2022-23***

#### **Revenues:**

The budget for Fiscal Year 2022-23 assumed a return to normalcy with a normal level of revenue growth after the unpredictability of the pandemic.

#### Property Taxes

The budget assumed a 3.1% growth in property taxes, considering the lower increase in the Consumer Price Index (CPI) for existing assessments would be offset by increases in assessed values of properties changing hands, as well as increases in supplemental and transfer taxes for properties changing hands. The current projections indicate that the city will slightly exceed the budget by around \$188K in property taxes, mainly in property tax in-lieu revenues.

#### Sales tax

Sales tax has been outperforming the budgeted numbers in past years, but the current fiscal year is seeing the amount level off. Consumers are responding to inflation and higher interest rates by slowing down on purchases, leading to a flattening of sales tax. Data through September 30, 2022 shows that sales tax is expected to come in at budget, collecting about the same revenue amount as last fiscal year. The city is also expecting revenues from Measure R to come in later in the fiscal year, with the first remittance expected in June 2023. Consultants project that the city will collect approximately \$1.2 MM by the end of the fiscal year.

#### Hotel tax

Hotel tax is performing close to projections and at nearly pre-pandemic levels, helped by the opening of the Hampton Inn hotel last fiscal year. Despite two hotels being taken offline for county-related housing, the opening of the Hampton Inn compensates for the loss of revenue from those two hotels.

### Other General Revenues

The city's other general revenues, including utility taxes, franchise fees, and business licenses, are performing as expected and with little variation from the budget. The city sold the Porter Building at the beginning of the fiscal year for \$1.1 MM, proceeds were used to donate towards the purchase of Watsonville Hospital and to help offset the costs of the General Plan Update. The city also loaned the County of Santa Cruz \$5 MM towards the purchase of Watsonville Hospital and was quickly repaid. We are reflecting both the expenditure of the loan and the loan proceeds in the first six months of the fiscal year.

### Departmental Revenues

The story of departmental revenues reflects the impacts of the pandemic's aftermath. The Community Development Department experienced a surge in activity last fiscal year. This fiscal year building permit issuances have slowed down, leading to revenues coming in under budgeted amounts. The police department will have slightly less revenue than budgeted due to budgeting for two School Resource Officer contracts but only obtaining one, as well as a vacancy in parking enforcement officers. The fire department will partially offset cost overruns by bringing in reimbursements from deploying their strike teams. Recreation fees continue to recover. The parks and community services department will have slightly less revenues than budgeted due to some programs taking longer to recover from the pandemic. The Ramsay Park Center was not available for the gymnastics program, as it was being used as a Covid vaccination site. The department, however, successfully negotiated a contract with the Pajaro Valley Unified School District (PVUSD) for after-school programming. The public works department is showing lower than budgeted revenue in reimbursable activities, but this will be offset by expenditure savings.

### **Expenditures:**

Most departments are staying within budget with minor savings expected. However, there are some areas where departments are facing challenges and require additional funds.

#### 1- Fire Department

The Fire Department has deployed strike teams to assist with wildland fires and provide medical support to firefighters. Despite hiring efforts, they have several vacancies which have resulted in overtime. Some of this overtime is reimbursed and offset by salary savings, but the department is still requesting \$150K in overtime. Additionally, they are proposing an appropriation of \$75K to offset training costs for the medic support program and to help recruit local EMTs to become accredited firefighters with the city. The department also needs \$7.5K for first aid supplies. The \$150K in overtime is offset by unplanned strike team revenues as described above.

#### 2- Police

The Police Department is requesting an additional appropriation of \$75K to cover overtime costs for an extra training day, as recommended by the Policing Ad Hoc Committee. Additionally, the department has received \$37K from insurance for a damaged vehicle, and it is requesting that the funds be appropriated for its replacement.

3- Community Development Department

The Community Development Department is experiencing a lower demand for building permits, but they are keeping busy by working on projects from the previous fiscal year and starting the new general plan. They are not requesting any additional funds.

4- City Clerk

The City Clerk Department is requesting an additional appropriation of \$51K for hosted services, as they have had to add more users to programs such as DocuSign to make their processes more efficient and require more funds.

5- Public Works

The General Fund divisions of public works cover building, street, and sidewalk maintenance and are requesting an increase in their budget by \$165K. This includes \$75K for reimbursable property repairs, \$20K for MSC charge increases, \$10.7K for increased custodial and building maintenance, and \$60K for temporary salaries in the gas tax fund due to temporary workers returning after Covid.

6- Parks and Community Services

The Parks and Community Services department is projected to have some savings due to programs recovering slowly after Covid. They are requesting to add 2 positions, a Recreation Specialist and a Recreation Coordinator, to manage their after-school program as a result of a new contract with PVUSD. The estimated cost for these positions through the end of the fiscal year is \$51K and will be paid from the revenues collected from PVUSD. The department is also proposing to spend down \$341.5K from their Measure Y fund balance for various center improvements such as a new gym floor, upgraded exterior lighting, benches, scoreboard, stage improvements, and other purchases.

7- Storm Costs

The City of Watsonville experienced heavy rains, storms and flooding at the end of last year and beginning of the new calendar year. The president of the United States has declared the "Winter Storms" emergency to include Santa Cruz County. This means that our City can apply for FEMA reimbursement for the damages left behind in the aftermath of the storm. The City's initial rough budget submitted to the County is about \$21MM. This estimate included an estimated \$3 MM for our residents that experienced damage and flooding of their homes.

As the City projects are reviewed and approved by FEMA, we will bring these costs back for additional appropriations request. It is estimated to date the City has spent \$886K in storm related costs. City regular staff time was about \$402K, overtime costs \$254K, materials and supplies about \$229K. The City has applied to FEMA to be considered for reimbursement of these costs. We do know some of the staff time costs will not be eligible for reimbursements as these hours are for regular hours worked. Reimbursements are usually slow to come in. It is estimated that the general fund will need additional appropriations in the amount of \$500K for the unplanned City storm costs. These costs include Emergency Operations Center, overtime staff costs and clean-up efforts.

Overall, all other departments are expected to end the year within their budgets, although some General Fund capital projects may not be completed as budgeted this fiscal year and will be rolled into the 2023-24 fiscal year. Tables 2 and 3 summarize all general fund appropriation requests and the overall projection for the general fund for FY 2021-22. Table 2 below shows a summary of all general fund appropriations requests. Table 3 summarizes the overall projection for the general fund for FY 2022-23.

**Table 2: Summary of General Fund Appropriation Requests**

	Ongoing	One-Time	Total
<b>Revenues</b>			
Fire		150,000	150,000
Public works	75,000		75,000
<b>Expenses</b>			
Fire		150,000	150,000
Public Works	105,700		105,700
City Clerk	31,000	20,000	51,000
PCS	51,051		51,051
Winter Storms		500,000	500,000
<b>Expenses Total</b>			<b>857,751</b>

**Table 3: General Fund Summary for Fiscal Year 2021-23**

General Fund Estimate Expenditures and Revenues					
Fiscal Year Ending June 30, 2023					
Department	Actuals FY 2022	Revised Budget	Actuals through 12/31/22	Projection	Variance
<b>Revenues:</b>					
Property Tax	13,195,358	13,544,545	6,866,401	13,732,801	188,256
Sales Tax-General	13,881,873	13,680,442	7,338,832	13,881,873	201,431
Hotel Room Tax	1,611,253	1,400,000	788,792	1,577,585	177,585
Utility User Tax	4,144,043	4,215,100	2,287,378	4,574,755	359,655
Transfers In	3,783,286	5,631,717	2,011,138	4,621,794	(1,009,923)
Mesure R				1,225,000	1,225,000
<b>Total Revenues</b>	<b>36,615,813</b>	<b>38,471,804</b>	<b>19,292,540</b>	<b>39,613,808</b>	<b>1,142,004</b>
CDD	2,810,180	1,959,056	915,774	1,831,547	(127,509)
Police	1,366,174	1,596,100	679,075	1,358,150	(237,950)
Fire	907,788	509,592	279,469	459,299	(50,293)
PW	125,100	212,000	39,792	51,891	(160,109)
PCS	859,122	975,250	271,085	543,814	(431,436)
Other	7,445,693	7,725,687	10,101,370	13,356,609	5,630,922
<b>Total GF Revenue</b>	<b>50,129,870</b>	<b>51,449,489</b>	<b>31,579,104</b>	<b>57,215,119</b>	<b>5,765,630</b>
<b>Expenditures</b>		<b>Budget</b>	<b>Actuals through 12/31/22</b>	<b>Projection</b>	
General Government	3,777,743	4,424,593	2,653,818	4,104,980	319,614
Community Development	2,989,112	3,156,486	915,774	3,151,681	4,805
Finance	1,749,236	1,819,599	918,833	1,733,492	86,107
Social Services	227,462	272,600	112,600	272,600	-
Parks & Community Service	5,015,410	6,152,891	3,001,696	5,470,833	682,058
Fire	8,659,210	8,450,550	5,290,244	8,592,059	(141,509)
Library	850,986	614,646	307,323	614,646	-
Non-Department	3,846,426	8,702,321	6,726,566	8,182,856	519,465
Storms	-	-	-	500,000	(500,000)
Police	19,856,154	20,717,570	12,238,397	20,391,215	326,355
Public Works	1,682,860	1,900,571	913,053	1,625,855	274,716
<b>Total Depts</b>	<b>48,654,598</b>	<b>56,211,826</b>	<b>33,078,303</b>	<b>54,640,216</b>	<b>1,571,610</b>
Capital	2,177,101	7,873,867		5,493,867	2,380,000
<b>Total Expenditures</b>	<b>50,831,699</b>	<b>64,085,693</b>	<b>33,078,303</b>	<b>60,134,083</b>	<b>1,935,416</b>
YE Change to Fund Balance	701,830	(12,636,204)		(2,918,964)	
<b>Capital Carry Forward</b>				<b>2,380,000</b>	



## Other Funds

The **Airport** Fund ended the fiscal year 2021-22 with \$359K in cash, despite facing challenges such as fuel and legal costs. However, the department's conservative approach to revenue projections helped them to end the year on a strong note. In order to offset increased costs for special events and fuel, they are seeking to appropriate \$30K and remain on track to maintain their cash balance.

On the other hand, the Utility Enterprise Funds for **Water**, **Sewer**, and **Solid Waste** are witnessing normal revenues and were able to secure state grants to pay aging account balances for customers during the pandemic. These funds expect to fully expend their operating budgets, but not their capital budgets, which will result in an increase in their cash balances by the end of the fiscal year. Additionally, the utilities are requesting two new positions: a Water Operator I to meet operational needs and the upcoming Chromium 6 demand. Also, a Wastewater Operator III is being requested to manage the Recycled Water Treatment Facility more effectively. This position will be reimbursed by the Pájaro Valley Water Agency in the foreseeable future.

Revenues from sales tax are the primary source for the **Library**, **Measure D**, and **Measure Y** funds, and as a result, these funds are projected to have better revenues in FY 2022-23 than originally projected. Each of these funds also plans to fully expend their operating budgets and have some savings in capital, leading to an increase in their cash balances and the availability of one-time funds for future projects.

**Gas Tax** and **SB1** are revenues driven more by the number of miles driven than by the cost of gasoline. They are not projected to have major fluctuations in their revenue projections though likely will have savings from capital projects that will not be completed this year. They will likely roll those projects forward and complete them in future years.

In **Information and Technology** internal service fund accumulated a balance of approximately \$1.9 MM in the prior year. The current year budget anticipated spending much of that down on citywide infrastructure projects such as upgrading the council chamber and replacing servers, switches, and other major hardware. The department is going through some growth and transition in order to provide the needed level of service to other departments. The department is currently working on modernizing City IT by rolling out Office 365 and replacing a failing 18-year-old phone system throughout all departments. IT is also working to continually increase cybersecurity awareness and enhancements through all upgrades and new systems purchased. IT will introduce a new, updated service desk software that follows current Information Technology Service Management (ITSM) and will incorporate a service desk for Facilities.

Lastly, the **Municipal Service Center Vehicle Shop**, a new internal service fund in its second year, manages the maintenance of all city vehicles. The fleet manager is making changes to the operation to yield a more efficient and data-driven fleet management. This division is facing increased costs for fuel and vehicle parts but was able to build these into their budget and is expected to absorb the increases.

For a summary of all non-General fund appropriation requests and major other funds, see tables 4 and 5.

**Table 4: Summary of Non-General Fund Appropriation Requests**

	Revenue	Expense
Airport		30,000
Gas Tax		60,000
Measure Y - Fire		82,000
Measure Y - Police		111,735
Measure Y - Parks		341,500
Wastewater		273,773
Water		33,000
<b>Total</b>	-	<b>932,008</b>

### **Next Steps**

The mid-year report officially marks the beginning of the budget season for Fiscal Year 2023-24. Based on the report's findings and projections, an updated five-year projection and budget outlook will be developed. In February, budget instructions will be provided to departments to use in preparing their budget proposals to the City Manager by March 31st. Throughout the rest of the fiscal year, both revenues and expenditures will be closely monitored and any necessary updates to the projections will be made at the end of the third quarter in April or May. On June 13th, a proposed FY 2023-24 budget will be submitted to the Council for review and approval.

**Table 5: Summary of Other Funds for FY 2022-23**

<b>Summary of Other Funds for FY 2022-23</b>						
		Starting Balance	Revenue	Expense	Capital	Ending Balance
<b>Airport</b>	Revised Budget	358,606	4,203,780	4,080,895	60,000	421,491
	Projection		4,501,511	4,423,221	34,005	402,891
	Variance		297,731	342,326	(25,995)	614,061
<b>Waste Water</b>	Revised Budget	15,202,378	17,068,157	16,362,852	8,454,016	7,453,668
	Projection		17,003,692	16,393,218	5,452,451	10,360,401
	Variance		(64,465)	30,366	(3,001,564)	(3,035,663)
<b>SW</b>	Revised Budget	10,139,218	16,631,170	16,022,059	5,102,136	5,646,193
	Projection		17,136,958	16,020,810	3,155,391	8,099,975
	Variance		505,788	(1,249)	(1,946,745)	(1,442,206)
<b>Water</b>	Revised Budget	28,121,135	23,094,698	15,364,770	17,317,942	18,533,121
	Projection		21,950,745	13,032,481	8,874,143	28,165,255
	Variance		(1,143,953)	(2,332,288)	(8,443,799)	(11,920,041)
<b>Library</b>	Revised Budget	1,977,137	4,102,329	4,510,572	10,000	1,558,894
	Projection		4,246,042	4,362,136	-	1,861,042
	Variance		143,713	(148,436)	(10,000)	(14,723)
<b>IT</b>	Revised Budget	1,858,427	3,410,335	3,410,335	1,607,964	250,463
	Projection		3,410,575	3,112,426	939,543	1,217,033
	Variance		240	(297,909)	(668,421)	(966,090)
<b>Measure Y</b>	Revised Budget	3,493,665	5,169,351	4,947,965	1,931,867	1,783,184
	Projection		5,501,774	4,390,591	678,346	3,926,502
	Variance		332,423	(557,374)	(1,253,521)	(1,478,472)
<b>Gas Tax</b>	Revised Budget	806,167	1,314,339	756,936	850,398	513,173
	Projection		1,347,109	755,932	548,487	848,858
	Variance		32,770	(1,004)	(301,911)	(270,144)
<b>SB1</b>	Revised Budget	1,954,378	950,000		1,428,188	1,476,190
	Projection		1,125,567		730,000	2,349,945
	Variance		175,567		(698,188)	(522,621)
<b>Measure D</b>	Revised Budget	3,565,669	971,903		3,748,065	789,507
	Projection		1,258,676		710,212	4,114,133
	Variance		286,773		(3,037,853)	(2,751,081)
<b>MSC Shop</b>	Revised Budget	738,091	3,411,647	3,411,647		738,091
	Projection		2,834,517	2,938,337		634,271
	Variance		(577,130)	(473,310)		(1,050,440)

**STRATEGIC PLAN:**

02-Fiscal Health: the report above meets strategic plan goal number 2 by keep the Council and the public informed as to the status of the City's finances.

**FINANCIAL IMPACT:**

The proposed appropriations listed in Exhibit A amount to \$1,789,759 and are funded by \$225,000 in revenue, with the remainder of the requests being covered by the use of fund balance from Measure Y and other funds that have the capacity to absorb these additional expenditures within their operating budgets.

**ALTERNATIVE ACTION:**

The Council has the discretion to accept some, all, or none of the recommendations presented to them.

**ATTACHMENTS AND/OR REFERENCES (If any):**

- 1) Annual Comprehensive Financial Report for FY 2021-22
- 2) Annual Measure Y Audit Report for FY 2021-22