City of Long Beach
Working Together to Serve

Memorandum

Date: April 13, 2020

To: Thomas B. Modica, Acting City Manager

From: John Gross, Director of Financial Management

For: Mayor and Members of the City Council

Subject: **Preliminary Multi-Year Budget Projection and the Fiscal Year 2021 Budget Process as Impacted by the COVID-19 Pandemic**

The COVID-19 Pandemic (pandemic) has created a health and economic emergency that affects residents, businesses, and workers in the City of Long Beach (City). The pandemic is also having a substantial impact on the City's finances. As required by the City Council's financial policies, this memorandum provides an initial indication of that impact on FY 20 and the multi-year budget projection; identifies the necessary changes to the FY 21 budget development process as a result of the pandemic; and, provides an initial list of actions being taken to ensure that all City financial funds remain as fiscally sound as feasible and to minimize the future impact upon services.

The situation with the pandemic is constantly changing and currently appears to be having a worse and potentially longer economic impact than anticipated at the beginning of the pandemic in the United States, when a significant part of the assumptions for this analysis were made. As a result, this preliminary assessment may understate the financial impacts of the pandemic on the City. It is important that this projection be periodically updated as more information becomes available.

Current Assumptions Used for the Pandemic's Economic Impact

This initial financial assessment assumes that the pandemic is going to have severe budget and financial impacts lasting through the end of at least May 2020, followed by a recovery period through the remainder of FY 20 and through at least early FY 21. It then assumes a return to a very strong economy thereafter. Because these assumptions may turn out to be optimistic, updates to this projection are important and the City should be prepared for more adverse impacts than this initial assessment indicates.

The pandemic is occurring at a time when there are significant one-time funding needs, as well as trends and factors that indicate significant shortfalls in out-years. The resulting financial impact for FY 20 is substantial and will likely also impact future years, especially if there is a resulting economic slowdown.

FY 20 Projection Update as a Result of COVID-19

In FY 20, at least five funds are expected to be heavily impacted by the pandemic with at least $38 to $44 million in overall revenue losses or expenditure increases as shown in the table below. These revenue losses or expenditure increases do not necessarily result in shortfalls in the funds of the same amount. That would be dependent upon whether revenues and expenses were separately trending above or below budget and will be impacted by what corrective budget actions the City is able to take.

Preliminary Impact of the COVID-19 Pandemic on FY 20
(in $ millions)

Fund	Revenue Losses or Expenditure Increases Caused by COVID-19 Pandemic
General Fund	13 to 19
Measure A	7
Special Advertising and Promotion	2
Tidelands Operating Fund	6
Airport	10
Total	38 to 44

- The General Fund is projected to have a total combined revenue loss and increased expenditure impact of at least $13 to $19 million resulting in a potential budget shortfall of $14 to $22 million in FY 20 (assuming no corrective actions). The areas of potential revenue losses included in this projection are in sales tax, oil revenue, and the Transient Occupancy Tax, but there are likely other areas that will be impacted and have yet to be fully evaluated. There are also costs increases related to staff time, including unbudgeted overtime, and unbudgeted material purchases, that are being incurred as part of the pandemic response. The City stood up the Incident Management Team (IMT) on March 3rd and the Emergency Operation Center (EOC) in mid-March. Through the end of March, $2.8 million All Funds ($1.9 million General Fund) in unbudgeted overtime and material costs have been incurred related to the pandemic response. Total costs, including soft costs, are $5.5 million All Funds ($3.4 million General Fund). Staff will be working to maximize cost recovery for eligible expenses from available State and Federal COVID-19 funding sources, but it is anticipated that there will be some expenditures that will not be reimbursed. At present, due to the current levels of uncertainty and need for additional information, this projection only assumes potentially up to $5 million in both additional revenue losses and unreimbursed expenditures. There exists the potential for significant un-reimbursable costs and additional revenue shortfalls related to the pandemic. This will be further evaluated and the projection updated as new information becomes available.

  The projection does not include any costs resulting from direct assistance to businesses in the form of rent deferral, tax rebates, or loans. Some portion of the shortfall could be partially offset using special reserves intended for other purposes, such as the use of the Health Fund funds available, or a potential reallocation of planned one-time capital Measure A funds. To the extent these reserves or other sources are not sufficient, the City's operating and emergency reserves may need to be used. The need to use operating and potentially emergency reserves in FY 20 and/or FY 21 seems possible.

- Measure A appears as if it might end up within its adopted revenue budget, but the anticipated revenue surplus in FY 20 (based upon a strong FY 19 performance) is no longer expected to occur with the pandemic projecting to result in a $7 million revenue loss from the higher revenue projection.

- The Special Advertising and Promotion (SAP) Fund is primarily supported by Transient Occupancy Tax revenue paid by hotel guests. That is a highly volatile revenue source and sensitive to economic downturn. Several hotels have temporarily closed or have very low occupancy. The loss of revenue is estimated to be at least $2 million, and the SAP funds available may drop from $5 million to $900,000, if budgeted expenses in FY 20 are not reduced.

- The Tidelands Operating Fund is projected to have a revenue shortfall of at least $6 million, primarily in oil revenue. Not included in this projection is the potential loss of ancillary revenue used to pay the debt service on Tidelands bonds including the Aquarium, the Queen Mary and Rainbow Harbor; potential problems with the debt service revenue for these bonds may significantly increase the adverse impact on Tidelands, but there is not enough information at this time to include those issues in the projection. In addition, the cost needed to pay for the potential high rate of oil well abandonment in 2020 may further impact revenue and is also not included in the projection.

- The Airport Fund is expected to have a revenue loss of $10 million due to low passenger volume. The Airport is currently experiencing a high cash drain due to loss of revenue and the capital cost of a number of improvement projects.

Other funds are also impacted by the pandemic but likely have much less of an impact on the City's financial status. No specific analysis has been done on other funds at this time.

FY 21 and Future Years Budget Projection Update as a Result of COVID-19

The table below provides the updated multi-year budget projection for FY 21 through FY 24 as a result of the pandemic, the Measure M litigation, other required operating costs, and general updates to revenue and expenditure projections as of February information. At least one additional update will be made before the FY 21 budget process is restarted.

Projected General Fund Surplus(Shortfall)
from COVID-19 and Measure M Litigation
($ in millions)

FY 21	FY 22	FY 23	FY 24
(9) – (16)	(20) – (27)	(13) – (24)	(14) – (27)

- Measure M Litigation Impact – Measure M, approved by 54% of the voters in June 2018, allows the City to continue transfers of water, sewer and gas fund monies that have historically supported City services for over 60 years. Litigation on the Measure M transfers brought in 2019 is challenging the constitutionality of the water and sewer transfer, but not the gas transfer, which will continue, and is about half the total transfer. On January 2, 2020, the Los Angeles Superior Court (Court) ruled in favor of the plaintiffs and against the City. The City is appealing the decision and believes it has the ability to legally transfer the water and sewer revenue funds to the General Fund. The Court did not rule as to whether the water and sewer fund transfers and expenditure of them could continue during the appeal. Pending the results of the appeal (which may take several years), the City has reached a tentative agreement to escrow parts of the transfer. That tentative agreement is generally reflected in the shortfalls presented in the above table. The projection assumes the appeal is lost effective in FY 24, and a judgement bond is issued in FY 24 to cover the cost of refunding Measure M transfers. Alternatively, if the appeal is won by the City, the City would have over $20 million in one-time funds available in FY 24.

- <u>CalPERS Pension Costs</u> – Costs are increasing as the City meets the CalPERS contribution requirements to eventually fully fund pension costs. The contribution requirements are heavily dependent on investment earnings. Significantly, the projection does not include the potentially large impact beginning in FY 23 of CalPERS investment losses that may occur in FY 20 due to the pandemic. (There is a three-year delay before CalPERS investment gains or losses impact the City). We do not currently know the investment losses that CalPERS may have due to the pandemic, but they seem likely to be significant. Staff is looking into this and also evaluating how much of the loss may be recoverable if investment returns improve after the pandemic.

- <u>Revenue and Expense Trends</u> – The FY 21 projection includes some significant revenue and expense changes from the FY 20 budget. Overall, while there were positive revenue increases, the pandemic, expenditure increases, and Measure M litigation impacts outweighed the revenue growth, and results in a substantial projected shortfall. The projection includes the anticipated costs for negotiated contacts that have been established with the Police Officer's Association (POA), Fire Fighters Association (FFA), and the Association of Long Beach Employees (ALBE). For all the other groups, an assumption of increases similar to the CPI was included.

- <u>One-Time Costs</u> – In addition to the large one-time unfunded revenue losses and costs expected in FY 20 due to the Pandemic, there are significant other one-time expenditures that will be needed both in FY 20 and in FY 21. A key significant one-time item is the FY 20 negotiated labor agreement costs, estimated to cost $12 million. It is likely that there will be other high priority general purpose one-time funding needs that cannot be funded with dedicated funds such as transportation, Tidelands, or enterprise funding. The normal source for one-time General Fund critical needs in FY 21 would typically be from any potential FY 20 year-end surplus funds or oil revenue surplus, but it is almost certain there will be no such surplus but rather a shortfall. This situation could impact the need to draw on operating and, potentially, emergency reserves.

- <u>No recession or economic slowdown included in the projection</u> – The projection assumes no economic slowdown/recession in the next few years. A growing number of economists consider a slowdown/recession likely over the next few years. But, as there has been no consistent indication of the timing and magnitude of a slowdown, a slowdown has not been included in this projection. A slowdown would likely substantially increase the projected shortfalls.

- New development and economic activity will help but more is needed – The long-term projection of shortfalls is consistent with the constraints the City inherently has on its land-use and revenue generation flexibility. Absent substantive new solutions, the City may have consistent future challenges maintaining services and even more challenges increasing services. The tremendous development and economic activity that is occurring in Long Beach is helpful now and will be a significant help in the future. However, economic growth will ease, but not eliminate, the budget balancing problems. In the recent past, the major solutions used to solve budget issues included termination of the Redevelopment Agency, pension reform, and the voter's adoption of Measure A to preserve and enhance police and fire services. No major solutions of this scale are currently evident to address these cost issues for the future. The expected 2020 passage of the new Measure A protects a substantial portion of existing Measure A revenues and is critical to helping to maintain current services. New Measure A revenue, above what is currently allocated in the Measure A out-year plan when it was assumed that the tax would decrease and then sunset, would become available in FY 23 as a result of the passage of Measure A. This additional revenue, above what is currently allocated in the plan, was previously projected to be $15 million but this may change due to changing projections due to the pandemic.

FY 21 Budget Development Process

Due to the significant reallocation of resources and staff time being diverted to respond to the pandemic, the FY 21 Budget development process has been temporarily suspended. As soon as the situation allows, the budget process will be restarted with a modified budget review process, timetable, and a potentially abbreviated budget document.

It is hoped that the diversion of the City staff as a result of the pandemic will lessen by May and June, which would allow for the budget process to be formally restarted and for updates to the out-year budget projections based on some stabilization of the pandemic crisis. Once the budget process recommences, staff is anticipating a budget study session to update the City Council and the public on the financial status and multi-year projections for major funds impacted by the pandemic, the development of updated budget reduction targets, and disclosure of any other steps recommended at that time.

As part of the FY 21 budget process, the City Manager will continue to evaluate potential budget balancing options, efficiencies, and other solutions available to minimize the impact on services. In the meantime, the City Manager is taking strategic actions in FY 20 to minimize the shortfall and protect the City financially. These actions should help not only the shortfalls in FY 20 but also help prepare for a difficult FY 21 budget year.

Summary of Actions Being Taken

The pandemic is a worldwide crisis and the City will do its part to address the crisis for its residents and businesses. At the same time, it is also essential to look at and manage the pandemic's financial impact and the City's ability to provide and maintain services to residents and businesses in the future. The following actions will be taken to achieve financial goals and protect future services as much as feasible.

1. Update COVID-19 financial impact and recommendations

   Staff will periodically update the projected financial impact of the pandemic.

2. Take actions to minimize the pandemic's financial impact on the City

   Take actions to control costs associated with the pandemic, minimize revenue losses, delay or suspend projects where feasible, and maximize State and Federal government reimbursement. The City Manager has implemented budget actions with regard to non-pandemic spending that include the following: the evaluation of one-time projects and one-time spending to assess potential areas of savings; reduction of non-pandemic operating expenditures where feasible, including scaling back costs not essential for the pandemic response and assessing staffing hires; and, actively looking for funding or other mechanisms to offset costs.

3. Minimize the FY 20 shortfall by taking appropriate budget management actions

   Where feasible, place on hold or cancel discretionary one-time non-pandemic related expenditures; avoid starting or expanding approved but discretionary structural programs; reduce budgeted structural costs; and increase vacancy savings.

4. Take actions, where appropriate, to manage cash because of the unknown long-term impacts of the pandemic

   City staff are evaluating potential actions that might be necessary to manage the City's cash levels. Areas of evaluation include whether to make the CalPERS pension prepayment; considering a line of credit; and, potential other actions to preserve cash should it be needed in the future.

While there are significant challenges to tackle in managing the FY 20 budget and the development of a FY 21 budget, the City will address both the pandemic crisis and the resulting adverse financial situation in the most strategic and effective way that is consistent with the City Council's financial policies and priorities.

If you have questions regarding any of this information, please feel free to contact me at (562) 570-6427 or Budget Manager Grace H. Yoon at (562) 570-6408.

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