



# STAFF REPORT – CITY COUNCIL MEETING

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March 15, 2023

**TO:** Honorable Mayor and City Council Members

**FROM:** Tabatha Miller, Finance Director

**PREPARER:** Tabatha Miller, Finance Director

**DATE:** March 07, 2023

**TITLE:** **Consider Adopting Resolution No. 223-44, A Resolution of the City Council of the City of Arcata Accepting the Mid-Year Budget Review and Approving Associated Budget Revisions for the Fiscal Year 2022-23.**

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## **RECOMMENDATION:**

It is recommended that the Council adopt Resolution No. 223-44, A Resolution of the City Council of the City of Arcata to Amend Resolution No. 223-01 Adopting the Annual Budget for Fiscal Year 2022-23.

## **INTRODUCTION:**

It is the standard policy and practice of the City Council to perform a mid-year budget review in March of each year.

## **BACKGROUND/ DISCUSSION:**

The annual mid-year review serves three purposes. It provides an opportunity to monitor the City's current budget and financial position as of 12-31-2022, to review projections for the year-end budget and financial position, and to preview to the City's financial status going into the fiscal year (FY) 2023-24 budget year.

The recommendations for adjusting the current expenditure and revenue budgets are set forth in Resolution No. 223-44 (Attachment 1) which is the culmination of a line-by-line review of every revenue and expenditure account. New projects, opportunities and unanticipated expenditures are incorporated into the recommendations, including:

- \$30,000 for Extreme Weather Sheltering provided during this winter/early spring in response to the recent severe winter storms,
- \$30,000 for a mural honoring and remembering David Josiah Lawson on the north wall of the D Street Neighborhood Center,
- \$355,000 to pre-order a Street Sweeper replacement to meet carbon emission standards and continue the City's required street sweeping program. We anticipate a 12-18 month lead time for vehicle delivery,

- \$195,252 for New Carlson Park Rural Recreation and Tourism Grant and WCB Carlson Park River Access Grant funding for pre-construction and design costs,
- Transfer \$185,000 to offset the deficit fund balance in the City’s Information Technology Internal Service Fund,
- \$86,683 net decrease to City salary and benefit accounts. This is less than .5% of the City’s original \$18.45 million salary and benefits budget, and
- \$192,934 net increase in utilities expenditures. This is due to increased utility cost and colder than normal temperatures and weather.

### **Fund Balance**

The basic budgeting and accounting entity for the City is a fund. A fund is “an independent fiscal and accounting entity used to record all financial transactions related to a specific purpose. Funds are established for the purpose of carrying on specific activities or attaining certain objectives in accordance with special regulations, restrictions or limitations.

Fund balance is the accumulation of a funds revenues minus expenditures for all prior years’ operations. It represents cumulative resources available for funding future City services. Fund balance also provides a measurement of the financial health of an organization’s governmental funds. Increasing fund balance is typically a good trend indicating growing resources and that current revenues are meeting and exceeding current expenditures.

Fund balance is a key fiscal planning tool for both the annual budget process and longer-term strategic planning. For example, agencies will often decide to build up fund balance and then fund a larger onetime or capital expenditure from available resources as opposed to financing the costs through debt. Those strategic investments from fund balance can be critical to the future of the organization. Examples include investing in facilities and critical infrastructure, paying down pension liability, and other long-term goals.

Attachment 2 is the summary of projected available City fund balances at year-end – June 30, 2023.

### **Economic Climate and Possible Recession**

The national, state and local news continues to discuss the possibility of a recession and the economic factors that may increase the chances of such a recession. Although unemployment is still at very low levels, 3.4% for Humboldt County as of December 2022, increasing inflation and the Federal Reserve continued policy of increasing interest rates to combat that inflation continue to challenge our economy. As discussed below under sales tax revenues, Humboldt County has been impacted by the plummeting cannabis market, earthquakes, unusually harsh winter storms and the ongoing lack of affordable and available housing.

Whether or not we are impacted by a local or national recession in the near future, the City has planned ahead and reserved funds for future capital needs, economic downturns and other emergencies. These funds are not included in available fund balances provided in Attachment 2. A goal of staff is to develop a more formal reserve policy for review and adoption by the Council.

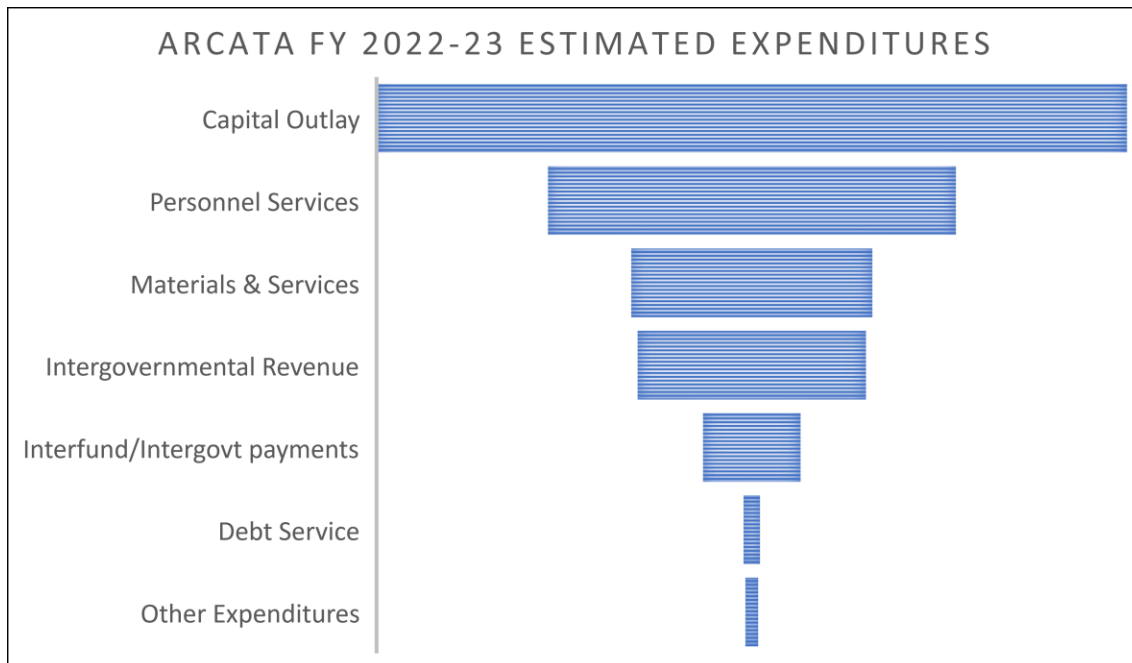
### **Expenditures**

The City’s FY 2022-23 expenditure budget reflects a significant investment in capital, with more than 40% budgeted for capital outlay. The single largest component of that investment is the City’s current \$10.5 million expense towards the Wastewater Treatment Plant Upgrade Phase 1 and the \$2.3 million Ultraviolet procurement and design project. Likewise, the City’s Water Fund is

investing more than \$5.7 million in waterline improvements and water storage. Other notable capital projects include the I Street Dock, Redwood Park improvements, Isackson Sustainable Transportation Infrastructure, the City’s annual pavement management and striping programs and two newly purchased electrical buses.

**City Expenditures by Classification**

<b>Expenditure Classification</b>	<b>FY 2022-23 Estimated</b>	<b>% of Total</b>
Capital Outlay	\$ 33,808,540	43%
Personnel Services	18,363,802	23%
Materials & Services	10,860,898	14%
Intergovernmental Revenue	10,284,282	13%
Interfund/Intergovt payments	4,382,225	6%
Debt Service	732,513	1%
Other Expenditures	577,616	1%
<b>Grand Total</b>	<b>\$ 79,009,876</b>	<b>100%</b>



The FY 2022-23 Estimated Year End expenditures are projected to be \$479k less than originally budgeted. The largest portion of the reduction is in grant programs that will be carried forward into the next fiscal year.

### City Expenditures by Fund

Funds	FY 2022-23 Estimated Expenditures	% of Total
General Fund	\$ 17,942,919	22.7%
Special Revenue Funds	23,555,302	29.8%
Water Fund	10,644,243	13.5%
Wastewater Fund	20,533,495	26.0%
A&MRTS (Transit) Fund	2,147,085	2.7%
Solid Waste Fund	515,467	0.7%
Stormwater Drainage Fund	735,521	0.9%
Internal Service Funds	2,642,511	3.3%
Redevelopment Successor Agency Debt	293,332	0.4%
<b>Total Funds Expenditures</b>	<b>\$ 79,009,876</b>	<b>100%</b>

In the FY 2022-23 expenditure budget, Special Revenue Funds together account for 30% of the City's expenditures. Special Revenue Funds are used to account for specific revenue sources that are legally restricted to expenditures for a specific purpose. These purposes include grant funding restricted to certain projects or uses by contract and award terms, special taxes such as the City's Open Space, Parks and Trails special parcel tax, Gas Taxes and other intergovernmental revenues provided to the City specifically for streets maintenance, traffic control and transportation improvements.

The City has five enterprise funds, which account for services provided to the general public where all or a substantial portion of the costs are paid in the form of user charges and fees. Those funds include the Water, Wastewater, A&MRTS, Solid Waste and Stormwater Funds. When combined the Enterprise Funds account for the largest portion of City spending at 44% or \$34.6 million of the total expenditure budget. As discussed above, for FY 2022-23, \$22.8 million of those planned expenditures are an investment in the City's capital infrastructure.

#### **General Fund**

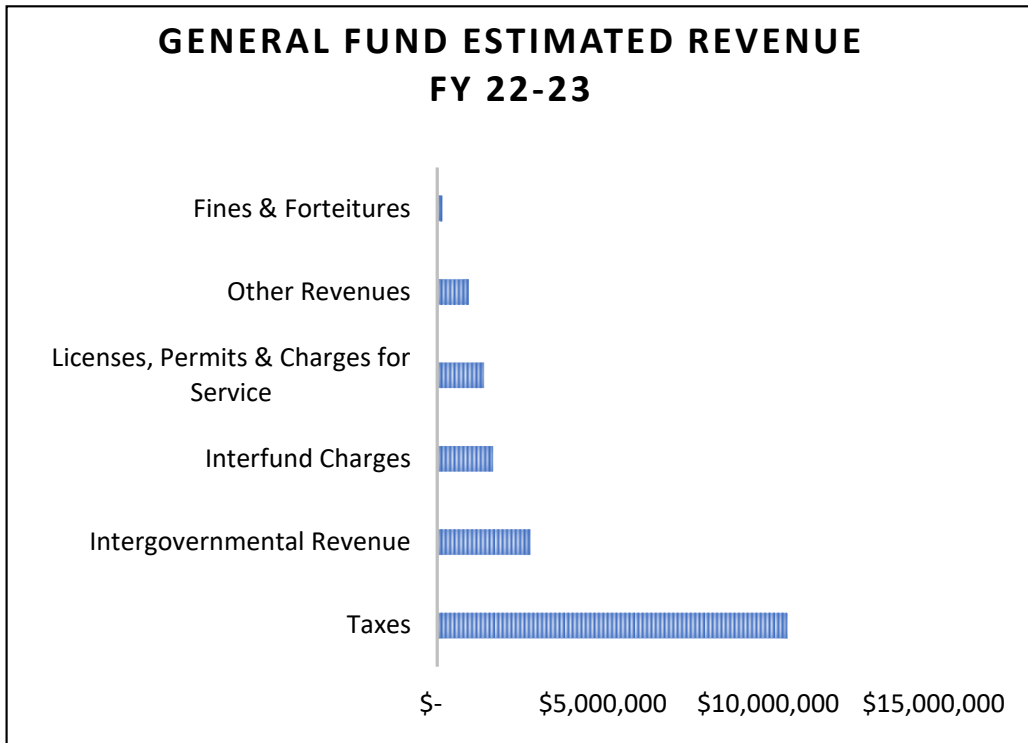
The General Fund is used to account for the general operations of the City such as Police, City Administration, etc. It is used to account for all financial resources not required to be accounted for or restricted to another fund: including property taxes, sales taxes, business license tax, transient occupancy tax, license and permits, fines and forfeits. Because the General Fund houses all revenues not restricted for a special purpose, it is the source of the most discretionary funding and as such, the most competitive for budgetary purposes.

Year-end 2022-23 total General Fund revenues are estimated to be \$692,683 above the original budget and \$1,256,355 above the estimated FY 2021-22 revenue. This is positive but much of the increase, approximately \$1.2 million is due to one-time revenues such as grants and other intergovernmental revenues.

Taxes account for 60% of total General Fund Revenues and provide the most consistent ongoing revenue stream – which makes this source critical to maintaining ongoing operations.

### General Fund Revenues

Revenue	FY 2022-23 Estimated	% of Total
Taxes	\$ 10,568,525	60%
Intergovernmental Revenue	\$ 2,807,460	16%
Interfund Charges	\$ 1,685,990	10%
Licenses, Permits & Charges for Service	\$ 1,408,867	8%
Other Revenues	\$ 949,537	5%
Fines & Forfeitures	\$ 150,000	1%
<b>Total</b>	<b>\$ 17,570,379</b>	<b>100%</b>



The City receives sales/transaction tax from two sources. The Bradley Burns Uniform Sales and Use Tax provides for a city/county rate of 1.25% as part of the state’s sales tax collections. One quarter cent of the levy is for the county-wide regional transportation fund and the balance or 1.0% supports local government general funds. Sales tax is allocated back to the jurisdiction (city or unincorporated county) where the sale transaction was negotiated, or the order taken (point of sale). As such, the Bradley Burns Sales and Use Tax received by the county is associated with sales that originate in the incorporated area of Arcata.

The Arcata City voters approved a local add-on Transaction and Use Tax (TUT) in 2008 in the amount of .75%. The tax expires in 2028. The proceeds are used primarily to support Public Safety and Streets. The TUT is collected based on place of use or destination and not point of sale. As a result, the tax is not collected uniformly with the Bradley Burns tax and as a general rule, the destination collection method favors Arcata.

Both transaction taxes are estimated to be below original budget for FY 2022-23. The Bradley Burns 1% is down year to date (YTD) 3.2% from prior year. The current estimated revenue is projected \$18k below the budget for FY 2022-23 and \$178k below FY 2021-22 actual revenues. The City’s

TUT is down 7% or \$117k YTD and estimated to finish FY 2022-23, \$196k below FY 2021-22 actual revenues.

**Transaction Tax Revenues**

Revenue	FY 2021-22 Actual	FY 2022-23 Budget	FY 2022-23 Estimated YE	Difference Budget to Estimated
Sales Tax	\$ 3,083,415	\$ 2,923,000	\$ 2,905,000	\$ (18,000)
Transactions & Use Tax	2,826,138	2,747,000	2,630,000	(117,000)
Utility Users Tax	1,030,498	880,000	1,100,000	220,000
Transient Occupancy Taxes	2,029,499	1,400,000	1,500,000	100,000
<b>Total</b>	<b>\$ 8,969,550</b>	<b>\$ 7,950,000</b>	<b>\$ 8,135,000</b>	<b>\$ 185,000</b>

Contrary to statewide trends – which are up, including most of Northern California, sales tax revenues are down across Humboldt County. The Bradley Burns sales tax collected in unincorporated Humboldt County for the first six months of FY 2022-23 was down 25% from the prior year, with southern Humboldt seeing the most significant decreases. The largest business category decline for both 2<sup>nd</sup> Quarter, and 3<sup>rd</sup> Quarter in unincorporated Humboldt was garden and agricultural suppliers, underscoring the impact of the cannabis industry on the county's local economy. Overall, Humboldt County Bradley Burns (incorporated areas and incorporated cities) sales tax was down 6.9% for 3<sup>rd</sup> Quarter and 14.4% in unincorporated areas. Contradicting this trend, the Statewide tax was up 8%. Northern California counties averaged a .9% increase which included the decrease in Humboldt.

As shown in the chart above, the City’s Utility User’s Tax (UUT) is estimated to be \$220k above budget and reflects the increases in local utility costs, including PG&E and the City’s water and sewer utilities. While the City’s Transient Occupancy Taxes (TOT) decreases are primarily due to the conversion of hotel rooms from short-term (under 30 day stays) to residential use, which is not subject to the TOT. Both the Project Homekey conversions and the use of hotel rooms by CalPoly Humboldt are responsible for the decrease in TOT revenue.

**Property Tax Revenues – Collected and Distributed by Humboldt County**

Revenue	FY 2021-22 Actual	FY 2022-23 Budget	FY 2022-23 Estimated YE	Difference Budget to Estimated
Secured Property Taxes	\$ 1,647,533	\$ 1,650,000	\$ 1,775,000	\$ 125,000
Unsecured Property Taxes	52,937	60,000	75,000	15,000
Supplemental Roll	11,246	20,000	20,000	-
Motor Vehicle In Lieu Tax	1,941,133	1,931,000	2,035,000	104,000
Homeowners Prop Tax Relief	15,809	10,000	10,000	-
<b>Total</b>	<b>\$ 3,668,658</b>	<b>\$ 3,671,000</b>	<b>\$ 3,915,000</b>	<b>\$ 244,000</b>

The decreases in sales taxes are offset by increases in property taxes and Motor Vehicle in Lieu Taxes, which combined is estimated a \$244k above budget and \$244k above FY 2021-22.

**FY 2023-24 Budget Preview and Considerations**

The Mid-Year Budget review provides a preview to the next year’s annual budget, which is tentatively set for May 9, 2022. Like most budget years, the City has both opportunities and challenges to consider in developing the next year’s budget, including:

- City Council priorities and goals,
- Completion of multi-year capital projects,
- Impacts to tax revenues including sales tax, TUT and TOT,
- Potential to place a tax measure on the ballot in 2024, to ensure ongoing programs and services can be developed and continued,
- Increasing demand for Public Safety services and continued vacancies in staff,
- Increasing pension liability costs,
- 4% increase for staff salaries, effective 7-1-2023,
- Continuing increases in liability and property insurance,
- Lack of affordable and available housing,
- Impact of Cannabis Industry collapse,
- A possible recession,
- Inflationary increases,
- Climate Change, and
- Increasing demand for City services and intervention.

**BUDGET/FISCAL IMPACT:**

The budgetary and fiscal impacts of the proposed mid-year adjustments and estimates have been described above and in the attached Resolution No. 223-44.

**ATTACHMENTS:**

- A. Resolution No. 223-44 Mid-Year Budget Adjustments (DOCX)
- B. Mid-Year Adjustments Exhibit Resolution No. 223-44 (PDF)
- C. FY 2022-23 Projected Fund Balances (PDF)