

REPORT FROM

OFFICE OF THE CITY ADMINISTRATIVE OFFICER

Date: September 11, 2020

CAO File No. 0220-05775-0000

Council File No. 20-0948

Council District: All

To: The Budget and Finance Committee

From: Richard H. Llewellyn, Jr., City Administrative Officer 

Reference: Budget and Finance Committee action on August 24, 2020 regarding motion (Krekorian – Buscaino), C.F. 20-0948

Subject: **Update on the Status of City Finances**

RECOMMENDATION

That the City Council instruct the Office of the City Administrative Officer to coordinate the development of spending reduction proposals in all City departments, as included in the Mayor's September 11, 2020, Instructions for Fiscal Restraint memorandum, and in upcoming financial status reports, present these proposals and other concrete actions required to reduce City expenditures to address the revenue shortfall estimated for Fiscal Year 2020-21.

SUMMARY

On August 24, 2020, the Budget and Finance Committee (Committee) heard a motion (Krekorian – Buscaino) requesting the Office of the City Administrative Officer (CAO) to provide reports to the Committee on the status of the City's finances, including updates on revenues, expenditures, the Separation Incentive Program (SIP), and other pertinent details that substantially impact the City's finances. At that meeting, this Office provided a verbal report stating that while it was premature to project year-end revenues, following one month of revenue data it appeared that the revenues included in the 2020-21 Budget were at risk. Therefore, the Committee continued the item until September 14 and requested that this Office provide an update at that time.

Consistent with the Committee's request and in order to provide the Mayor and City Council with the latest information concerning the financial health of the City, this Office is transmitting this status of City finances with an update on General Fund revenue receipts through August and identified impacts for final 2020-21 revenue. Also included in this report are updates to the major cost reduction efforts assumed in the 2020-21 Budget as well as a recommendation to develop additional spending reduction proposals for the current fiscal year, consistent with the Mayor's Fiscal Restraint memorandum of September 11, 2020. As detailed herein, the high risk of revenues falling substantially short of budget, combined with various challenges to achieving the expenditure reductions assumed in the budget, make it abundantly clear that the City must implement additional

and arguably more severe austerity measures.

Since the August meeting, the City has taken significant actions to address growing budget concerns including officially declaring a fiscal emergency for Fiscal Year 2020-21. Along with this declaration, in September 2020, the City Council and Mayor instructed City departments to implement 18 days of furloughs, beginning on October 11, 2020 (C.F. 20-0600-S57). The City Council also approved a revised Separation Incentive Program (SIP) without a minimum participation threshold requirement (C.F. 20-0600-S56). Despite the extraordinary nature of these actions, the 2020-21 Budget already assumed the savings derived from these measures. Consequently, the revenue shortfalls that this Office is now estimating for 2020-21 will require more action.

While revenue data for large General Fund revenue sources including business and property taxes will not be recorded until the latter half of the fiscal year, the two months of receipts for other General Fund revenue sources present a dire fiscal outlook for 2020-21. Budgeted 2020-21 revenue through August is \$509.5 million, \$86.6 million below the budgeted plan of \$596.1 million, with large shortfalls in economically sensitive tax receipts and department reimbursements. These receipts are not expected to be recovered. Furthermore, based on current trends and even with an expectation that economic activity returns to some normalcy early in 2021, we estimate that revenue in the current fiscal year could fall short of budgeted levels by as much as \$200 million to \$400 million. This estimate assumes social-distancing restrictions continue to be relaxed through the end of 2020 and do not include revised assumptions for the economic recovery after these restrictions end.

Therefore, with revenues at high risk of not meeting 2020-21 Budget levels and expenditures likely to exceed the 2020-21 Budget, this Office recommends that all City departments develop spending reduction proposals for the current fiscal year. Furthermore, we recommend that the City Council instruct us to report in the next Financial Status Report on these proposals and present other actions required to achieve savings in order to mitigate the estimated revenue shortfall. These reductions will likely impact all expenditure accounts and may require staff reductions through layoffs.

Revenues

Key Findings

- *Budgeted 2020-21 revenue through August is \$86.6 million below the budgeted plan. These receipts are not expected to be recovered.*
- *Due to pandemic-related economic losses, total August receipts-to-date are 85.1 percent of General Fund receipts this time last year. As social distancing efforts continue to impact local businesses and City services, receipts will continue to fall short of planned receipts, as well as below those of the prior year.*

- *Based on current trends, assuming social-distancing restrictions continue to be relaxed through the end of 2020, and anticipating the return of most economic activity by early 2021, we estimate that 2020-21 revenue could fall short of budget by \$200 million to \$400 million.*

The 2020-21 Budget is \$6.69 billion in General Fund revenue. Revenue assumptions for 2020-21 Budget were derived in April and based on projections that the original Safer at Home order would end in May and the economy would recover quickly under the stable financial system and increased government reserves that developed after the Great Recession. The Budget does not assume extended and new business closures. The monthly plan for economically sensitive revenues assumes steady recovery from the pandemic-driven recession and tax and department receipts also assume the City would quickly and safely return to full service delivery. Furthermore, revenue estimates also assume one-time receipts for the recovery of delayed 2019-20 tax and departmental revenues.

Since the pandemic and efforts to contain it are still ongoing, City receipts are coming in well below the budgeted plan—a plan that had been already been reduced to reflect the impact of the post-pandemic recession. Excluding the receipt of CARES Act pass-through monies, total General Fund revenue through August is \$509.5 million, \$86.6 million below the budget plan of \$596.1 million. This total shortfall is due to lower receipts in economically sensitive revenues (property, utility, business, sales, documentary, and transient occupancy taxes), as well as departmental receipts and parking fines, the sum of which can be attributed to the pandemic. This shortfall will not be recovered, but will grow with lower anticipated September and October receipts attributed to businesses closures, travel restrictions, and reduced City services that remain in place through September.

Other known shortfalls that have been identified but are not reflected in August receipts include: a lower Power Revenue Fund Transfer as approved in the Department of Water and Power (DWP) budget; reduced interest earnings due to lower rates; reduced department reimbursements as a result of audit findings and disputed billings; lower sales tax as estimated by the City's tax consultant; and reduced property tax revenue attributed to delinquencies by the County of Los Angeles (County). The combined impact of these shortfalls are anticipated to fall in the range of \$200 million to \$400 million. Other receipts also face downside risk as the pandemic's impact continues, but cannot be quantified at this time.

Any deviations from planned revenue receipts are reported in Financial Status Reports (FSRs) along with deviations in the appropriations budget. Surpluses or deficits that are projected for year-end are typically addressed during the development of the following fiscal year's budget, at which time revenue estimates are revised. This year, this Office anticipates recommending changes to the current year budget at mid-year to recognize significant shortfalls that require immediate budget action.

See below for greater detail on known and anticipated variances from the 2020-21 Budget.

202-21 General Fund Revenue and Variance through August
(Thousand dollars)

	2020-21 Budget	Plan Through August	Receipts Through August	Receipts as Percent of Budget	Variance of Receipts from Plan
Property Tax	\$2,297,080	\$94,158	\$84,627	3.7%	(\$9,531)
Property Tax Ex-CRA Inc.	95,900	-	-	0.0%	-
Utility Users' Tax	614,620	112,960	108,975	17.7%	(3,985)
Department receipts	1,335,289	99,682	87,077	6.5%	(12,605)
Business Tax	686,540	70,454	45,855	6.7%	(24,599)
Sales Tax	557,055	89,475	81,125	14.6%	(8,350)
Documentary Transfer Tax	215,835	34,215	28,450	13.2%	(5,765)
Power Revenue Transfer	224,100	-	-	0.0%	-
Transient Occupancy Tax	244,860	22,889	13,851	5.7%	(9,038)
Parking Fines	140,477	28,467	9,924	7.1%	(18,543)
Parking Occupancy Tax	102,000	8,072	9,459	9.3%	1,387
Franchise Income	81,226	18,690	18,208	22.4%	(481)
State Motor Vehicle License Fees	3,198	-	-	0.0%	-
Grant Receipts	12,521	1,204	1,057	8.4%	(147)
Tobacco Settlement	10,615	0	0	0.0%	-
Residential Development Tax	3,693	393	684	18.5%	291
Special Parking Revenue	27,721	-	-	0.0%	-
Transfer					
Interest Income	34,613	15,403	20,205	58.4%	4,802
Total General Fund	\$6,687,342	\$596,061	\$509,497	7.6%	\$(86,564)

Property taxes, including remittances from the former CRA/LA: The current \$9.5 million shortfall are in secured and unsecured receipts and will not be recovered. The total secured shortfall for the prior tax period (December 2019 through August 2020) was \$28.2 million, which the County has since attributed to delinquencies, despite previously reporting that delinquencies were consistent with prior years. Additionally there is significant downside risk as the City's budgeted growth of 6.6 percent exceeds that forecasted for the County (5.25 percent). While the City's growth has typically outpaced countywide growth, the budgeted rate is above the typical variance. The CRA/LA June 2020 remittance was \$10.9 million short of the April estimate provided by the County. Assuming this shortfall may be due to increased delinquencies, there is downside risk to current year tax increment receipts.

Utility users tax: The net \$4.0 million shortfall is attributed to lower electric users tax (EUT) revenue. There is downside risk to EUT, should receipts end closer to DWP's low range estimate. No significant shortfall, however, is currently anticipated for EUT or the communication or gas users tax receipts.

Department receipts: Receipts from licenses, permits, fees and fines (LPFF), direct and related costs reimbursements through August are \$87.1 million, which is \$12.6 below plan due to lower reimbursements from related costs, ambulance billings and police services to LA Metro. Additional identified shortfalls include reduced reimbursements due to audit findings and billing disputes; the inability to recover prior year receipts anticipated for the current year budget; and the continuing impact of the pandemic on service levels and the resulting reduction to related fees, fines, and reimbursements.

Business tax: August receipts are \$24.6 million below plan. This shortfall will increase since prior year receipts anticipated for the current year will not be realized, as these receipts were recorded in 2019-20 as originally budgeted. There is significant downside risk to the 2021 tax renewal period based on the Office of Finance's estimates for the pandemic's impacts to business activity and gross receipts.

Sales tax: Sales tax revenue through August is \$8.4 million below plan. The State adjusted its methodology to accelerate allocations to local jurisdictions, without which this shortfall would be higher. There is an approximate 3-month lag between economic activity and City tax receipts. Based on the most recent projections from the City's sales tax consultant, there is significant downside risk to the City's General Fund and special fund tax receipts.

Documentary transfer tax: Receipts through August are \$5.7 million below plan due to a larger-than-anticipated drop in deed transfers (analogous to sales activity) from the pandemic's continuing impact on home buying. Receipts exhibited some recovery in August with receipts-to-date at 60 percent of last year's level. The budget assumed flat sales and minimal price appreciation. Zillow's current forecast predicts a small decline in home value. The downside risk increases if both fall below these estimates.

Power Revenue Transfer: After the adoption of the budget, the DWP board approved a lower transfer estimate of \$217.8 million equating to a \$6.3 million year-end shortfall. There is additional downside risk as the final amount approved for transfer in recent years has been below the amount assumed in the budget.

Transient occupancy tax (TOT): Receipts through August are \$9.0 million below budget for both hotel and short-term rental activity. This current shortfall will not be recovered and will increase with next month's tax collection. Receipts-to-date are at 23 percent of last year's level. There are significant downside risks based on industry projections for a long recovery for the hotel sector and the increasing enforcement of short-term rental restrictions.

Parking fines: Parking fine revenue is \$18.5 million below plan. This current shortfall will not be recovered and will increase through October with the extension of relaxed parking enforcement. Receipts-to-date are at 44 percent of last year's level.

Parking occupancy tax: Receipts for parking occupancy tax through August are \$1.4 million above plan, exceeding the forecasted impact of social distancing policies and slowing economy. Based on monthly receipts impacted by the pandemic-related business closures and recession, however, there is downside risk as the pandemic continues past the point of the assumed recovery

in receipts.

Special Parking Revenue Fund Transfer: There is significant downside risk as the decline in special parking fund revenues are likely to mirror decline in parking occupancy tax thereby reducing the year-end transfer.

Interest Earnings: Finance reports significant downside risk to interest earnings due to aggressive emergency cuts by the Federal Reserve Bank that subsequently resulted in a decrease in forward interest rates.

Expenditures

Key Findings

- *The number of furlough days anticipated to be taken by most civilian employees has been reduced from 26 day to 18 days resulting in a reduced savings target.*
- *There are risks to the City's ability to achieve \$42 million in savings from a hard hiring freeze across most civilian positions.*
- *The 2020-21 savings of up to \$14 million from the SIP requires the Los Angeles City Employee's Retirement System to move aggressively to process the unusually high number of retirements on an accelerated schedule. If it cannot do so, actual savings will fall below this estimate.*

This Office will report on its assessment of City spending through August in the First FSR in late October. While it is premature to present an analysis of spending data to date, we do not expect to project significant savings in that report. There are several risks to spending, especially related to salary accounts.

The 2020-21 Budget included 26 civilian furlough days at a savings of \$150 million. The reduced number of 18 furloughs recently approved and set to be implemented beginning on October 11, 2020 will generate less. This Office expects that the \$40 million that the City Council added to the Unappropriated Balance from the LAPD for furlough relief largely will offset the savings forgone by reducing the number of furlough days from 26 to 18.

The 2020-21 Budget included \$42 million in savings from a hard hiring freeze across most civilian positions. There are risks to the City's ability to achieve these savings. First, there have been several exemptions to this hiring freeze. Further, the Budget based hiring freeze savings on the assumption that employees would leave the City in a number and at a pace consistent with the past year. The process of negotiating the SIP has delayed typical retirement separations likely reducing the savings that a hiring freeze will generate.

Finally, this Office has reported 2020-21 savings of up to \$14 million from the SIP. This level of savings, however, requires the Los Angeles City Employee's Retirement System to move

aggressively to process the unusually high number of retirements on an accelerated schedule. If it cannot do so, actual savings will fall below these estimates in 2020-21. The list of participants, which will not be final until the end of September 2020, will also impact the level of savings. This Office will continue to report periodically on the savings that this program actually generates, although it will not be sufficient to offset furloughs or make up for the projected revenue shortfall.

Mayor's Fiscal Restraint Memorandum

In light of the imbalance between revenues and expenditures that is likely to occur in 2020-21, on September 11, 2020, the Mayor released a memorandum directing the City to take several actions to address the anticipated 2020-21 budget shortfalls. This Office intends to work with all City departments to take steps to implement each of these actions. We will report in subsequent Financial Status Reports with recommendations for actions that can only go forward with City Council approval. The development of these proposals may require this Office and other departments to take a number of steps including gathering historical data, evaluating existing projects and contracts, establishing reduction targets, and working on staffing plans. The specific instruction in the Mayor's memo include the following:

- The Personnel Department and CAO initiate a layoff evaluation process.
- The CAO, with all departments, propose specific reductions of three percent of each department's 2020-21 Budget in an upcoming Financial Status Report including reductions related to the layoff evaluation.
- The CAO, in conjunction with the Mayor and the Executive Employee Relations Committee, work with the City's labor partners to develop cost savings proposals including, but not limited to, the deferral of previously negotiated salary increases.
- The CAO, with all departments, evaluate savings associated with insourcing work that the City currently provides through contracts.
- The CAO, with all departments, evaluate all proposed contracts with fiscal impacts in this and next fiscal year, restrict new contracts, and seek cost reductions in current contracts.
- The CAO, with the General Services Department and other relevant departments, evaluate potential savings or earnings from leasing City assets.
- All departments limit their requests for exemption from the hiring freeze.
- The CAO, with all departments, identify opportunities to update fees for service and pursue revenue enhancement opportunities.
- All department suspend non-emergency, non-reimbursed overtime.
- The Controller and CAO, with all departments, expedite grant and bond reimbursements and Reserve Fund loan repayments.
- The CAO, with the Bureau of Engineering and the General Services Department evaluate construction projects and identify those that the City can defer or cancel.
- The CAO and Controller identify MICLA savings that can be swept to generate General Fund savings.
- The CAO, with relevant departments, identify potential savings in non-departmental accounts including General City Purposes and Water and Electricity.

- The CAO evaluate special funds to determine which, if any, can accept transfers of employees currently paid by the General Fund or subsidized special funds.

We will report in the next FSR on these proposals and present other actions required to achieve savings in order to mitigate the estimated revenue shortfall.

FISCAL IMPACT STATEMENT

There is no fiscal impact to the recommendation in this report. The recommendation in this report will initiate a budget reduction exercise that, if enacted, will reduce expenditures to match revenues that are expected to fall short of 2020-21 Budget levels.

FINANCIAL POLICIES STATEMENT

This report complies with the City's Financial Policy that this Office prepare periodic reports regarding the condition of the current year's budget, and insofar as it presents the need for current appropriations be limited to revenues estimated to be received in the current budget year.