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Supplemental 2
ITEM 40/41
JUNE 30, 2020
Vice Mayor Hahn

SUPPLEMENTAL AGENDA MATERIAL

for Supplemental Packet 2

Meeting Date: June 30, 2020

Item Number: 40/41

Item Description: Council Item Budget Shortfall

Submitted by: Vice Mayor Sophie Hahn & Councilmembers Kate Harrison & Ben Bartlett

Revise items to allocate all remaining FY2020 unassigned General Fund Balance to General Fund Reserves, with 55% going to the Stabilization Reserve Fund and 45% to the Catastrophic Reserve Fund, simultaneous with adoption of the FY2021 Budget, to increase reserves available to address the current COVID-19 related crisis and any future Catastrophic events and/or Economic Downturns.



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JUNE 30, 2020
SUPPLEMENTAL MATERIALS FOR ITEMS 40/41

To: Honorable Members of the City Council
From: Vice Mayor Sophie Hahn & Councilmembers Kate Harrison & Ben Bartlett

The following is a recommendation for the Council to implement as a means to immediately increase the City's General Fund Reserves, simultaneous with adoption of the FY2021 Budget:

Allocate all remaining FY2020 unassigned General Fund Balance to General Fund Reserves, with 55% going to the Stabilization Reserve Fund and 45% to the Catastrophic Reserve Fund, simultaneous with adoption of the FY2021 Budget, to increase reserves available to address the current COVID-19 related crisis and any future Catastrophic events and/or Economic Downturns.

BACKGROUND

Due to the COVID-19 pandemic and the effects of necessary Shelter-In-Place orders that have shut down much of the local, state and national economies, the City of Berkeley is simultaneously managing a major health crisis and facing an unprecedented financial shock, expected to lead to a short- or longer-term economic downturn or depression.

These conditions are exactly what the Council had in mind when the City's first formally designated General Fund Catastrophic and Stability Reserves were created in 2017. Assigned General Fund Reserves were first funded at 13.8% of adopted 2017 General Fund Revenues and have increased every year since. At the end of FY2019, the City had approximately \$36.6M in assigned General Fund Reserves, representing approximately 18.2% of adopted FY2019 General Fund revenues.

The City has instituted a hiring freeze and is looking at other measures to address an estimated \$38M shortfall as compared to revenues adopted in the existing 2021 Budget. Addressing this shortfall will likely require applying a portion of both Catastrophic and Stability Reserves as well as reducing previously adopted FY2021 expenditures through a hiring freeze and deferrals.

To support the City's recovery from COVID-19 and its impacts on the health and economy of the community, this recommendation proposes to additionally fund General Fund Reserves with the remainder of FY2020 unassigned General Fund Balance simultaneous with adoption of the FY2021 Budget.

Berkeley bases its annual budgets on estimated income and expenditures over the same year. Over the past 8+ years, Berkeley's estimated income has far surpassed estimates, while expenses have fallen below budgeted expenditures, leading the build-up of very large "General Fund Balances." These "balances" represent savings/equity the City accumulates over the course of the year through savings and extra income. Traditionally, the vast majority of General Fund Balance was unassigned; when the City Council created a formal Reserves policy, a portion of General Fund Balance was assigned to Reserves.

Equity/Savings accumulated has risen dramatically over the past few years. In 2014, for example, the City's General Fund Balance was approximately \$45M. In 2015 it grew to approximately \$52M, and in 2016 it jumped to approximately \$65M. In 2018, the City Council allocated a portion of that year's General Fund Balance to General Fund Reserves, effectively restricting use of that portion of General Fund Balance to the purposes outlined in the Reserves Policy. Reserves are now shown as "assigned" General Fund Balance. By 2019, the General Fund Balance was a total of over \$95M; approximately \$42M assigned (mostly to General Fund Reserves) and about \$46M remaining unassigned. These numbers represented a blockbuster economy that pumped out more revenues than were anticipated year after year, as well as, among other things, savings realized through vacancies/salary savings, reflecting a tight labor market, and some positions that remained unfilled over many years. Ultimately, "General Fund Balance" during these boom years (savings/equity) equaled yearly sums equal to approximately one quarter of General Fund budgeted revenues.

Unassigned General Fund Balance accumulated over the full 12 months of 2020 has not yet been formally reported, but assuming the first three quarters were as good as, or better than 2019, Berkeley was on track to accumulate somewhere in the neighborhood of \$100M in General Fund Balance, with a little less than a half likely "assigned" (most to General Fund Reserves), and the other portion "unassigned." Even with weaker FY2020 fourth quarter revenues due to the COVID-19 economic shock, it is likely that the City will have accumulated \$40-\$45M in unassigned General Fund Balance in FY2020.

Traditionally the remainder of the City's end-of-year equity/savings/unassigned balances are presented to Council for final allocation in the November AAO adjustment – with most of the excess funds already programmed or recommended for allocation by the City Manager or through Council action on City Manager or Council proposals introduced during the course of the year. Many small and medium-sized allocations consume these positive balances, including the Council's allocations of additional amounts to Reserves.

In FY2020, savings and extra income accumulated as unassigned General Fund Balance can be applied to backfill reduced income in the fourth quarter if actual income during the fourth quarter was not adequate to cover fourth quarter expenses; it is possible that even reduced fourth quarter income was adequate to cover fourth quarter expenses, because salary and other

savings continued to be significant. There may even be fourth quarter surpluses; but if so, much less than would have been generated in each of the first three quarters of FY2020. The Finance Director reports that the City will have a positive revenue balance of \$9.8M for FY2020 and an additional \$2.2M is forthcoming from the County for further property tax adjustments. There is a significant amount of FY2020 unassigned General Fund Balance still available to be allocated – estimated at \$12.6M. This sum (whatever the exact amount will be – this suggestion is to allocate “all” remaining unassigned General Fund Balance to reserves) would traditionally be allocated at the November AAO.

Given the urgency of the City’s projected FY2021 revenue shortfalls and the likelihood of similar or even more dramatic shortfalls in the coming years, all remaining FY2020 savings/equity/ unassigned General Fund Balance should be directed to General Fund Reserves immediately, to make more reserves funds available to be allocated towards, at the Council’s discretion, to the City’s anticipated General Fund revenue shortfalls for FY2021 and subsequent years. *Leaving remaining General Fund Balance to be allocated to a variety of small and medium-sized Council and City Manager “add-ons” may have been possible in good times, but is no longer appropriate when the City is facing the kind of economic outlook we are facing at this time.*

FY2020 positive General Fund Balance is our last “bonus” from the boom years that preceded the current crisis. There likely won’t be another of similar size, if any, for many years to come. Allocating the full remainder of FY2020 unassigned General Fund Balance to General Fund Reserves, estimated to be approximately \$12.6M, simultaneous with adoption of the FY2021 Budget (even without knowing the exact dollar amount of the remainder) is the most prudent course the City can take to make additional reserves funds available for Council to potentially allocate to support projected revenue shortfalls related to the COVID-19 economic downturn.