City of Modesto
Long-Range Forecast with COVID-19 Pandemic/Recession

Management Partners

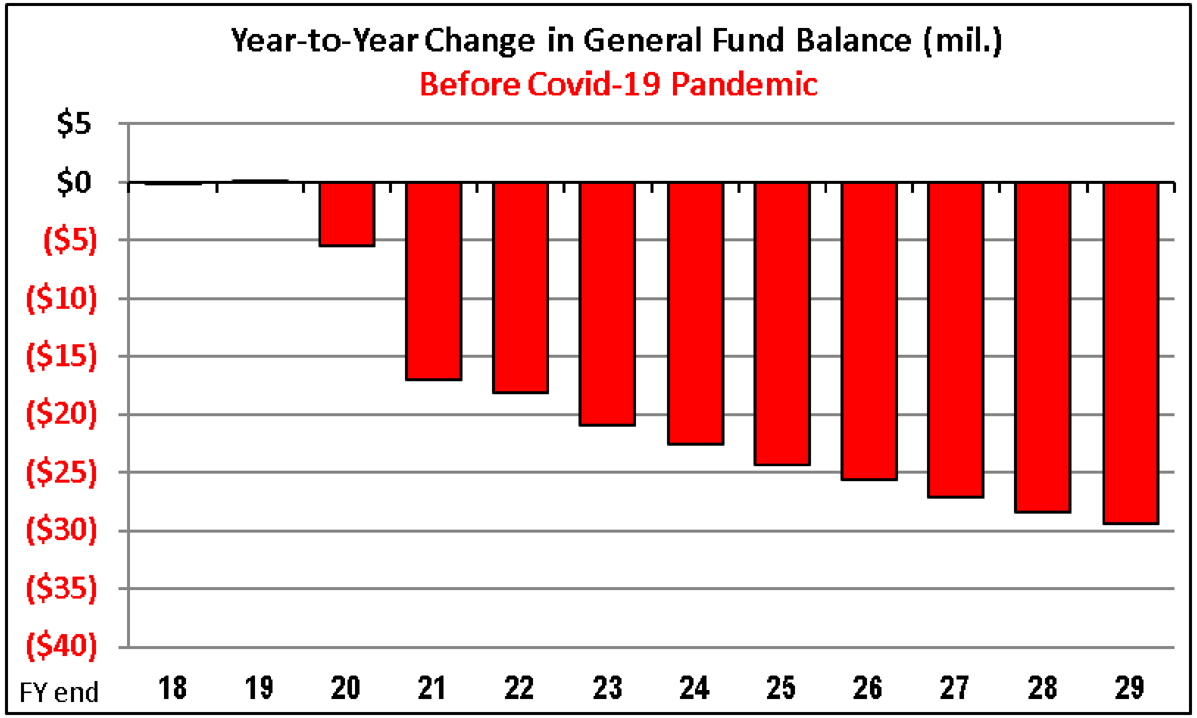
Finance Committee Meeting
May 19, 2020

CITY OF MODESTO CALIFORNIA

General Fund Headed for Deficit Within a Year

- Revenue losses due to COVID-19 pandemic
  - Scenario 1: Quicker recovery
    - Moderate revenue losses in FY20, FY21 and FY22, and no losses thereafter (total $10M in revenue losses); results in average annual shortfall of $24M
  - Scenario 2: Slower recovery
    - Uses Management Partners (MP) estimate of revenue losses (severe in final quarter of FY20 and in FY21, high in FY22), phase-in to pre-recession revenue level by FY26 (total $43M in revenue losses); results in average annual shortfall of $28M
- Under either scenario, the General Fund (GF) faces a deficit balance by the end of FY21 without implementation of budget strategies to close an ongoing average annual budget shortfall of $24-28M
- Federal assistance legislation has been introduced but remains an uncertainty at this point

Modesto Had a Pre-Existing Structural Deficit



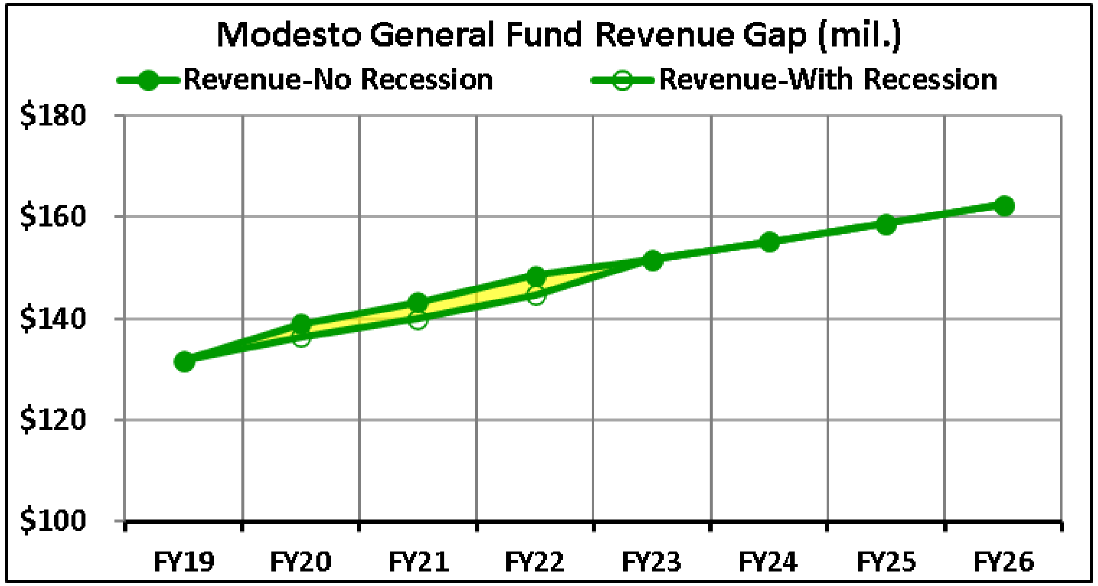
- Even <u>before</u> the pandemic, Modesto had a growing annual shortfall
- Primary causes were:
  - Unsustainable staffing levels
  - Higher pension costs
- Helping delay the inevitable was a high vacancy rate and lower O&M spending than budgeted
- Absent budget corrections, reserves would have been depleted by end of FY21 absent the COVID-19 recession

Enter the COVID-19 Pandemic

- State economic activity largely shut down for last two months
  - 36.5 million unemployed nationally; CA unemployment rate likely to hit 18%
  - Projections vary widely as to how fast economy will recover given potential for resurgence of virus, continued new social distancing and buying habits that have formed, impact of federal stimulus spending; V-shaped vs. L-shaped
- Local agencies hardest hit are those with highly elastic tax bases
  - Sales Tax, TOT, fee-based programs: losses are in "real time" and exacerbated by sales tax payment delays allowed by the State (31% of Modesto's GF revenue)
  - Business/Mill tax: impact won't show up until next year (10% of GF revenue)
  - Property tax: relatively steady, and any value declines will not hit until FY22 (25% of GF revenue)
  - Intergovernmental, internal charges, other revenue: no or limited impact in near-term (34% of GF revenue)
- CalPERS losses from FY20 will increase employer rates, but not until FY23

Large Range of Potential Revenue Loss

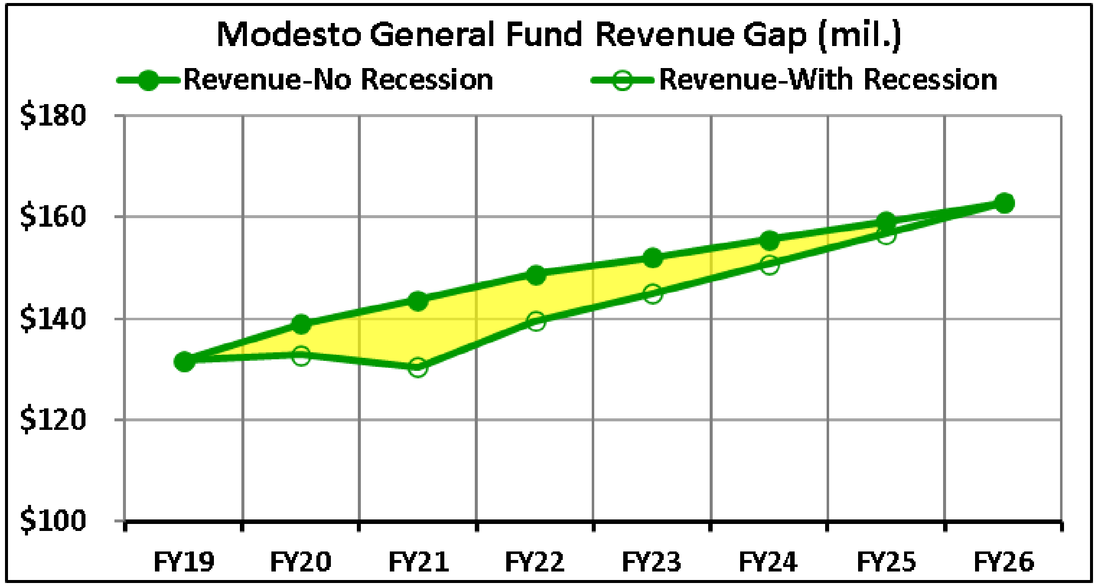
Quicker Recovery - Lower Revenue Loss



Revenue Reduction from No-Recession Forecast (S in Mil.)

	FY19	FY20	FY21	FY22	FY23	FY24	FY25	FY26
Prop Tax	0.0	0.8	0.1	(0.5)	0.0	0.0	0.0	0.0
Sales Tax	0.0	(1.7)	(3.6)	(1.3)	0.0	0.0	0.0	0.0
UUT	0.0	0.1	0.1	0.0	0.0	0.0	0.0	0.0
BLT	0.0	(0.6)	(0.8)	(1.0)	0.0	0.0	0.0	0.0
TOT	0.0	(0.7)	(1.1)	(0.2)	0.0	0.0	0.0	0.0
Other	0.0	(0.5)	1.8	(0.7)	0.0	0.0	0.0	0.0
Total	0.0	(2.6)	(3.4)	(3.7)	0.0	0.0	0.0	0.0

Slower Recovery - Higher Revenue Loss



Revenue Reduction from No-Recession Forecast (S in Mil.)

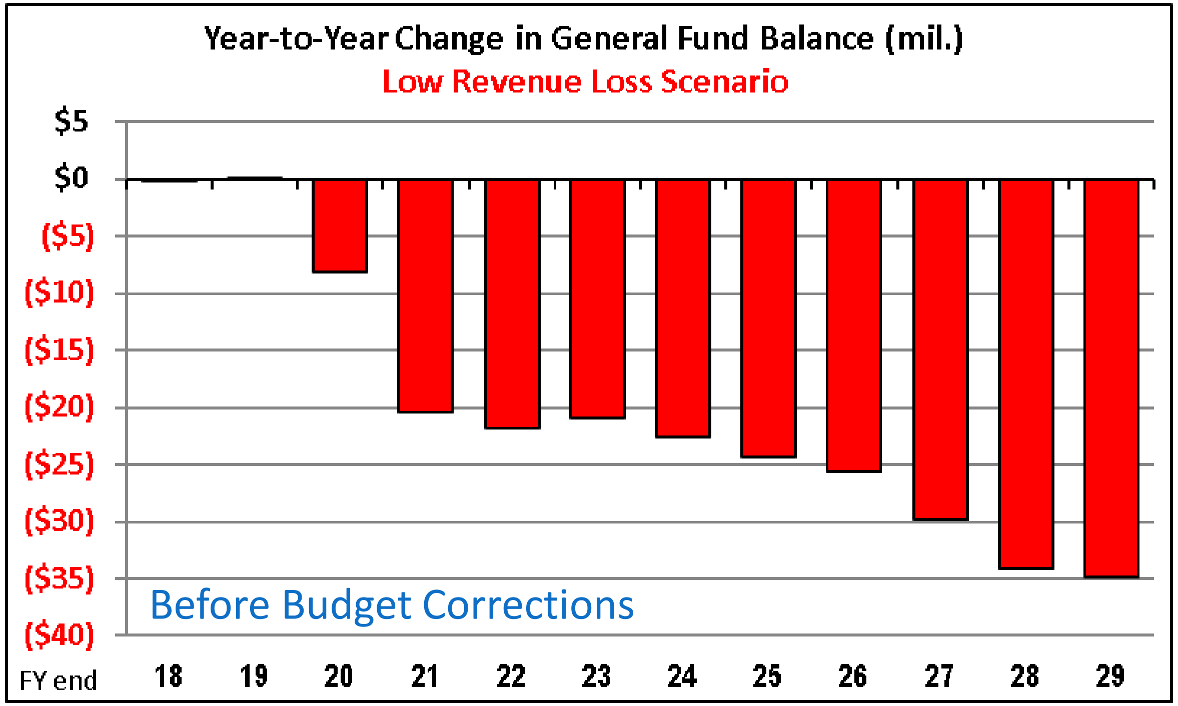
	FY19	FY20	FY21	FY22	FY23	FY24	FY25	FY26
Prop Tax	0.0	0.0	(0.2)	(1.2)	(1.0)	(0.7)	(0.3)	0.0
Sales Tax	0.0	(3.3)	(5.1)	(3.1)	(2.4)	(1.6)	(0.8)	0.0
UUT	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
BLT	0.0	0.0	(4.1)	(2.5)	(1.9)	(1.3)	(0.7)	0.0
TOT	0.0	(0.6)	(0.9)	(0.6)	(0.4)	(0.3)	(0.2)	0.0
Other	0.0	(2.2)	(3.0)	(1.8)	(1.4)	(1.0)	(0.5)	0.0
Total	0.0	(6.1)	(13.3)	(9.3)	(7.2)	(4.9)	(2.5)	0.0

Other Major Forecast Assumptions

- FY20 expenses use City estimates
- FY21 expenses use City payroll model and preliminary budget (includes 5% vacancy savings rate)
- FY22 assumes:
  - no FTE growth and no CIP contribution
  - 2% COLAs (or current MOU if higher), but no market adjustments
  - Police/Fire pension cost-sharing
  - lower pension discount rate and investment performance
  - inflation growth for O&M expenses
- Forecast is *before* impact of budget strategies

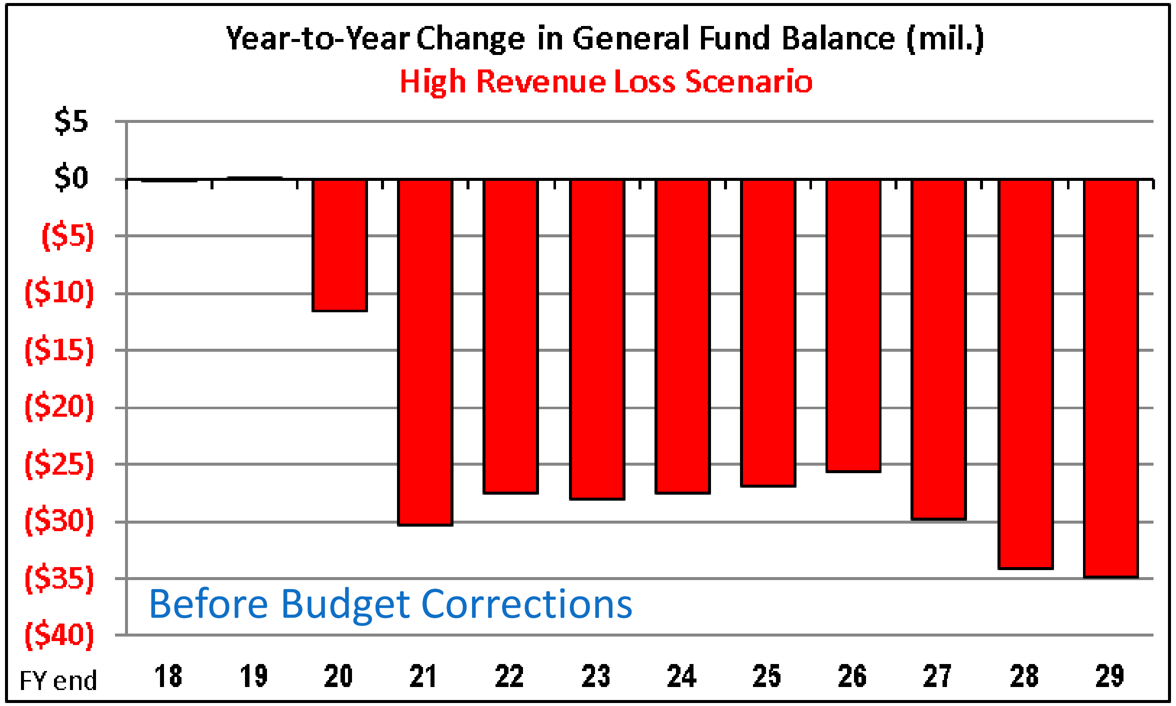
Structural Shortfall High Under Both Revenue Loss Scenarios

Quicker Recovery - Lower Revenue Loss



- $24M average shortfall, growing over time
- Reserves depleted by end of FY21

Slower Recovery - Higher Revenue Loss



- $28M average shortfall, but worse in near-term
- Reserves still depleted by end of FY21

Even Under Optimistic Revenue Loss Scenario, City Reserves Are Rapidly Being Depleted

	FY 2016	FY 2017	FY 2018	FY 2019	FY 2020	FY 2021	FY 2022
Beginning Total Fund Balance	$27.07M	$29.65M	$26.75M	$25.58M	$17.48M	-$2.93M	-$24.77M
Nonspendable	$2.65M	$2.52M	$2.88M	$2.72M	$2.72M	$2.72M	$2.72M
Restricted	$2.09M	$1.97M	$2.67M	$2.21M	$2.21M	$2.21M	$2.21M
Assigned	$6.50M	$4.85M	$1.10M	$0.51M	$0.51M	$0.51M	$0.51M
Emergency Reserve	$3.00M	$15.80M	$18.40M	$18.40M	$21.30M	$25.18M	$27.77M
Unassigned	$12.82M	$4.51M	$1.70M	$1.74M	-$9.26M	-$33.55M	-$57.98M
Total Emergency+Unassigned	$15.82M	$20.31M	$20.09M	$20.14M	$12.04M	-$8.37M	-$30.22M
Change in Emergency+Unassigned	-$1.76M	$4.49M	-$0.22M	$0.05M	-$8.11M	-$20.41M	-$21.84M

- Assumes growth in Emergency Reserve to goal of 16.7% of total expense by FY22, but is undermined by annual shortfalls that pull down Unassigned Balance
- Emergency Reserve plus Unassigned Balance projected to be in net deficit by FY21 (before impact of budget strategies)
- This leaves limited time to implement budget solutions, assuming lack of federal assistance

Current Staffing Level is Unsustainable

	$ in 2020 Dollars	
Total GF Expense	**$144.51M**	
Total Personnel Cost	**$103.82M**	
Personnel % of Total	**71.8%**	
Total GF FTE	**695.25**	
Average Cost per FTE	**$149,328**	
Avg Annual Shortfall-Low	**$24.00M**	
Personnel Share of Shortfall	**$17.24M**	
Equivalent to Cutting this FTE	**115.5**	**-16.6%**
Avg Annual Shortfall-High	**$28.00M**	
Personnel Share of Shortfall	**$20.12M**	
Equivalent to Cutting this FTE	**134.7**	**-19.4%**

- Average shortfall ranges from $24-28M from FY20 through FY29
- Assuming personnel costs comprise 72% of shortfall solution, then 115-135 FTE would have to be cut (reduction of 16.6% to 19.4% of workforce)
- Remaining 28% would have to come from reducing O&M expenses

Vacancies and Other Personnel Cost Savings Options

- General Fund vacancies continually changing, but are currently:
  - Police: 19.0
  - Fire: 13.0
  - Misc: 23.5
  - Total: 55.5
- City has had difficulty filling positions
- But also can't afford to have the positions filled
- Authorized staffing level is a budgetary decision

- Other cost reduction options involving personnel:
  - Furloughs (unpaid leave)
  - Defer COLAs or market adjustments
  - Reduce pay levels
  - Added employee pension cost sharing
- Requires time and consensus through meet & confer negotiating process with bargaining units
- Furloughs and COLA deferrals are typically limited-term in nature, and City's structural shortfall is on-going

HEROES Act: $3 Trillion Coronavirus Relief Bill

- Bill provides $915 billion in aid to state and local governments facing budget pressures as tax revenues fall
- Although passed by the House, these provisions may be significantly reduced by the Senate, altered in eligibility, or defeated altogether
- Relief that may ultimately be received by Modesto has to be eligible to cover revenue losses, not just COVID-19 related expenses
- Aid likely to be limited to one or two years, while City faces ongoing shortfalls
- What federal aid would buy is time to craft and implement long-term budget strategies

Contact Information

Bob Leland
Senior Advisor
Management Partners
rleland@managementpartners.com
(530) 219-5812