OFFICE OF THE CITY MANAGER

MEMORANDUM

April 20, 2020

TO: City Council

FROM: Steve Mermell
City Manager

SUBJECT: Financial Impacts of COVID-19 Pandemic

As part of Monday's Special Council meeting, staff will be providing information as to how the COVID-19 Pandemic and response is impacting City finances. As background, Director of Finance, Matt Hawkesworth, has prepared the attached memorandum.

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04/20/2020
Item 25c

DEPARTMENT OF FINANCE
April 20, 2020

TO: Steve Mermell
City Manager

FROM: Matthew E. Hawkesworth
Director of Finance

SUBJECT: Long Term Financial Impact of COVID-19 and Financial Market Turmoil

Following up from the memo from March 20, 2020, staff is analyzing the impacts of the health pandemic and related financial market turmoil for long-term impacts. These events will have lasting impacts on the revenues and expenditures of the City and its Operating Companies.

Total General Fund revenue losses between Fiscal Year (FY) 20 and 21 are projected at $29.7 million. The losses in FY 20 will be partially offset by underspending compared to the budget, but are forecasted for a net loss of $7.6 million. Revenue losses for FY 21 are forecasted at $8.5 million and are planned to be offset by postponing all General Fund Capital Improvement projects in FY 21.

<u>General Fund Taxes</u>

Based on continued discussions with the City's property tax consultant, the revenue impacts for property tax for FY 20 and 21 are expected to be minimal. In the near term, any immediate impacts would be due to late payments beyond the April 10, 2020 deadline. Longer term impacts such as reassessments by the County could occur, but only if the real estate market contracts or collapses and there are no signs of that at this point. Furthermore, due to the annual tax assessment cycle, major downward shifts in property tax would probably not affect the City's revenues until FY 22. The growth forecast in the longer term will need to be adjusted downward if development projects currently underway are halted or postponed due to the financial market turmoil. Should the City begin to see the real estate market collapse due to business closures, bankruptcies or other issues, it would have a significant impact on the City's revenues as property tax revenue has been the strongest revenue source since the Great Recession.

Sales Tax revenue will be negatively affected in both the short and long-term. As previously reported to the City Council through the quarterly sales tax newsletters, some business sectors were already struggling prior to March 2020. That preexisting market stress combined with the current economic environment may lead to a longer recovery cycle. Following, is a table by category regarding estimates of both immediate changes along with the 12 to 24-month outlook.

Category	Jan-Mar 2020	Apr-June 2020	Fiscal Year 21
Autos/Transportation	-12.0%	-55.0%	-6.3%
Building/Construction	-7.0%	-40.0%	-0.1%
Business/Industry	-15.0%	-30.0%	-5.4%
Fuel/Service Stations	-10.0%	-50.0%	0.0%
Food/Drugs	5.0%	5.0%	2.0%
General Consumer Goods	-15.0%	-45.0%	-2.5%
Restaurants/Hotels	-10.0%	-60.0%	-6.5%
State/County Pools	15.0%	10.0%	7.3%

If Pasadena's sales tax follows these trends, FY 20 revenues will be $4.3 million less than forecasted and FY 21 will be at least $2.2 million lower than the 5-year forecast projections. However, Pasadena's heavy dependence on the Autos/Transportation, Restaurant/Hotel, and General Consumer Goods categories will provide greater volatility. We are aware of layoffs occurring in Pasadena and it is unrealistic to expect businesses will return to 100% immediately following the Safer at Home measures.

In regards to the tax generated by Measure I, the locally generated taxes should mirror the table above with FY 21 being $3.9 million lower than the 5-year forecast. The original forecast reflected strong growth above the originally forecasted $21 million; therefore the projected reduction is greater. Measure I is still forecasted to generate $22.3 million in FY 21. The primary variance will be from online sales as those retailers remit the Measure I tax directly to the City rather than through the state or county pools. Therefore, retailers such as Amazon will have increased growth similar to the County pool rather than their regular business category of General Consumer Goods.

On April 2nd Governor Newsom announced sales tax deferment measures to help small businesses with cash flow issues. The first measure is immediate and extends the payment deadline by 90 days for the first quarter of calendar year 2020 to the end of July. This extension will delay revenue received by the City for several months and may result in $3.3 million in revenue being recorded in FY 21 instead of FY 20. This payment delay may create an additional revenue shortfall in FY 20, but would help offset losses in FY 21. The second measure announced is a $50,000 tax deferment of up to 12 months for small businesses. This measure will allow small businesses to delay payment of up to $50,000 in sales tax for up to 12 months without penalty. Initial information shows that any deferments will be spread out against all tax rates and will include the City's base 1% Bradley-Burns tax and the Measure I tax. While these deferments will not be a permanent loss of revenue, it will negatively affect the City's cash flow and shift up to $2.5 million in revenues from FY 21 to FY 22. Additionally, the portion of Measure I paid to the Pasadena Unified School District will also be affected as the payments are one-third of the cash received by the City. Analysis of the financial impact is underway, but could result in a shift of several million dollars. Both of these measures should not result in a revenue loss to the City for the long-term unless a business were to file for bankruptcy during the 12-months of deferred payments; however, these measures will create annual revenue shifts that will need to be considered when preparing the City's Operating Budget.

Transient Occupancy Tax (TOT) is paid with a one-month delay and impacts are projected to be immediate with a slower recovery. The major hotels in Pasadena had been operating at occupancy levels in the low 80% range with Average Daily Rate (ADR) around $195. The week beginning March 1, 2020, occupancy and ADR at hotels in the City began to decline. By the week of March 22nd occupancy had dropped to 10-15% and ADR by 39%. Occupancy has become so low that major hotel operators around the county have begun closing for the near-term with the Langham in Pasadena closing as of April 8th. The combination of occupancy and ADR reductions will reduce TOT revenue for March by 40% and 75% or more for April and May, equating to an immediate loss of revenue of more than $1.5 million. Impacts through the end of the fiscal year could be up to $5.4 million and the impact to FY 21 revenue will likely be a reduction of $5 million or more as it will take time for both occupancy and the ADR to return to their previous levels.

Construction, Utility Users Tax (UUT), Business License Tax, and Street Light & Traffic Signal Taxes combined may come in slightly lower, but likely will not have a cumulative impact of more than $1.0 million for the current fiscal year. Looking forward, Construction Tax revenue will be dependent on the development industry and the continuation of projects in the pipeline. If the financial industry continues to suffer with liquidity and debt financing issues, the revenue impact could be significant. UUT revenue has been flat to declining for the past few years and this trend will continue. If businesses are forced to permanently close due to the current situation, UUT revenues, especially those from water and electricity, will be negatively impacted.

<u>Other General Fund Revenues</u>

At this time, it is difficult to project what the long-term financial impacts will be related to permits, programs, user fees and investment earnings. Impacts will depend on how long the Safer at Home measures are in place, if the Federal Stimulus Package provides real benefits to businesses and residents of Pasadena, and how long it takes to return to a sense of normalcy regarding behaviors and consumer confidence. The City has received requests from developers and businesses to refund building permits for projects that have not yet started. These are areas that will need to be closely monitored in the upcoming months.

Transportation Sales Tax

The City's transportation services are funded with more than $14.0 million in annual funding from various Los Angeles County sales tax measures. LA Metro announced that their total losses from COVID-19 could be at least $700 million, but at this time it is unclear how those losses will be felt through the various funding sources. Revenue losses of any size would negatively affect the City's ability to fund transit services.

Gas Tax

The City receives gas tax funding from the state's Road Maintenance and Rehabilitation Account (RMRA) and the Highway Users Tax Account (HUTA). Statewide fuel sales have dropped off significantly with the Safer at Home measures and will have an immediate impact on both RMRA and HUTA revenues. Gas Tax payments are made one month in arrears, so reductions in March will be realized in the April payments. RMRA funding is expected to be reduced by 20% ($400,000) and HUTA reduced by 30% ($1.1 million) for FY 20. Longer term revenues should not be impacted as significantly, but if it takes time for the travel industry and other large users to build back to previous levels, so the return to previous revenue levels may be drawn out. The state is expected to provide revised estimates in late May or early June for both funding sources.

Pasadena Water and Power

Revenues from retail sales of electricity and water will be negatively impacted by the closure of retail and commercial businesses throughout the City. A slight increase in revenues from residential sales is expected due to the impacts of the Safer At Home Order for both the electric and water utilities. The overall financial impact for FY 20 is difficult to project accurately because billing for services is done in arrears, so the impact of the economic decline is not fully identified at this time. However, the adverse impact on revenues is expected to be carried through FY 21. Both the electric and water utilities have performed better financially when compared to the budget for the first three quarters of the current fiscal year, so the total effect may be somewhat mitigated for FY 20.

Electric Utility

Majority of the revenues for the electric utility are generated from commercial customers, so the reduced commercial activity is expected to have significant financial impact during FY 20 and FY 21. Based on limited information available, electricity usage is lower by about 10% during the period of the Safer At Home Order. In addition, the electric utility has certain fixed price contracts in place for electricity and fuel that are commitments regardless of retail sales. Most of those contract costs are currently higher than market price due to lower demand, although low fuel costs are economically beneficial for local power plant operation.

Water Utility
Majority of revenues from the water utility are generated primarily from the residential sector, and the projected modest increase in residential revenues is expected to mitigate at least some portion of the reduction in commercial sales due to the economic downturn. Water sales and revenues are often more impacted by weather conditions and rainfall amounts than just by the economic conditions. The limited information currently available indicates that water demand was lower by about 15% during the Safer At Home period, but cooler and wetter weather conditions may have had greater negative impact on sales and revenues than the economic conditions during this period.

<u>CalPERS</u>
As discussed many times with the City Council, previous CalPERS losses stemming from the Great Recession combined with the recent decisions to lower the discount rate have driven the City's pension costs up. Despite investment policy changes by CalPERS aimed at reducing volatility, the plan has realized significant losses over the past month. The total CalPERS pension portfolio totaled $370.3 billion as of June 30, 2019. Just prior to financial market turmoil in early March, the CalPERS portfolio reached an all-time high of $404 billion. They were on target to beat their 7.0% return on investments and the outlook was optimistic. On March 23, 2020 CalPERS reported that their portfolio had a value of $335 billion. Since that time, the investment market has fluctuated greatly, but has recouped some of the initial losses. As of this memo they are still showing negative return of 4% for the year. CalPERS held a Board of Directors meeting via teleconference on March 18th and briefly discussed the investment portfolio. The Chief Investment Officer did not provide a fiscal year earnings forecast, but continued to remind the board that CalPERS investments are made with a long-term objective. While the long-term perspective is important, gains and losses for each fiscal year directly impact the City's pension costs individually on an annual basis; therefore, any losses in the current fiscal year will directly impact the City's valuation. In order to provide some scenarios, City staff used the software tool CalPERS recently made available to employers for forecasting liabilities and rates. Following is a table with various scenarios and key data points.

Fiscal Year 20 Investment Return	Plan	Funded Ratio	Total Cost of Loss over 20-year Amortization (in millions)
5.0%	Miscellaneous	71.8%	$41.38
	Safety	71.6%	$21.35
2.5%	Miscellaneous	70.45%	$86.54
	Safety	70.44%	$51.03
0.0%	Miscellaneous	68.72%	$131.71
	Safety	68.72%	$77.71
(5.0%)	Miscellaneous	65.25%	$222.02
	Safety	65.28%	$131.07
(10.0%)	Miscellaneous	61.79%	$319.88
	Safety	61.85%	$184.42

Analysis was also done to look at what would happen to future pension costs should CalPERS realize losses in the current year, but rebound the following year. If CalPERS lost 10.0% in FY 20 and then earned 20.0% in FY 21, the net impact would still be an increase in costs of $99.17 million for the Miscellaneous Plan and $53.58 million for the Safety Plan over the life of the Unfunded Accrued Liability. Therefore, CalPERS would need to sustain multiple years of excess earnings to offset one year of significant negative investment returns.

Rose Bowl Operating Company (RBOC)

The RBOC Board met on April 2, 2020 and reviewed their financial forecast. From an organizational cash perspective, the RBOC should remain positive through FY 20; however, there are several key assumptions that must come to fruition for the RBOC's cash position to remain positive through FY 21. The current financial model assumes events will be permitted to occur starting August 1st, and the golf course will re-open by July 1st. Much of RBOC's revenues for the UCLA Football season and the Rose Bowl Game come from Premium Seating. Premium seating revenue for the football season will be critical as anticipated revenue exceeds $7.8 million and traditionally is received beginning in June. Additionally, the RBOC expects significant revenue from concerts, soccer, and non-premium seating football game sales in FY 21; however, the impacts on attendance at these events post COVID-19 is uncertain. If COVID-19 impacts are felt longer than the current fiscal year and negatively affect revenues for the football season or other major events, the financial position of the RBOC could shift downward quickly.

Pasadena Center Operating Company (PCOC)

The impacts of COVID-19 on the travel and convention business have wreaked havoc all around Pasadena. PCOC clients have canceled or postponed events scheduled between March and May, possibly through June. As a result, PCOC's financial position for FY 20 has suffered significantly. Overall the operating revenue forecast through the remainder of the year is expected to decrease 16.8% ($1.8 million) with the April – June quarter assuming to have zero additional revenue. Rental income was directly and immediately impacted by cancellations and postponement of events initially through an overabundance of caution and now as a government mandate. The Ice Rink closed for most of March, and any revenue collected for classes, reservations, or registrations was refunded. As a response to the current situation, PCOC immediately suspended further non-essential and revenue-driven expenditures to offset the decrease in revenue. Expense projections include partial month actuals through March and forecast for the remainder of the year. Overall costs decreased by $1.5 million compared to the budget. Forecasted net gain from operations remains positive at $650,000 despite the decline in revenue due to very positive performance through February and the aggressive cutting of expenditures in the remainder of the year.

Summary

There are tens of millions of dollars in annual revenue at stake related to the City's General Fund and non-General Fund revenues. As the Safer at Home measures continue, banks, economists and financial news outlets are becoming less optimistic about a quick return to normal and are predicting an increased likelihood of a recession. A recession combined with the unknown regarding large or major events and if and when people will return to travelling, conferences, concerts and major sporting events could put considerable financial stress on the City, the Rose Bowl Operating Company, and the Pasadena Center Operating Company along with all of the other private and non-profit businesses in Pasadena that support these activities.

The City has done well to fully fund General Fund reserves and set-aside funds for pensions and other costs since the Great Recession. These reserves put the City in a position of strength to make intentional and calculated decisions over the coming months or years, as total losses will likely be significant and prolonged.