



MEMORANDUM

TO: CITY COUNCIL

FROM: MICHAEL STEVENS, ADMINISTRATIVE SERVICES DIRECTOR

SUBJECT: CONSIDERATION OF REVENUE IMPACTS DUE TO CORONAVIRUS (COVID-19)

DATE: APRIL 14, 2020

SUMMARY OF ACTION:

Review and discuss estimated fiscal impacts as a result of reduced revenue associated with the Coronavirus (COVID-19) pandemic.

IMPACT ON FINANCIAL AND PERSONNEL RESOURCES:

There is no direct fiscal impact other than the staff time to prepare the update; however, based on the forecast, significant fiscal impacts are projected for the remainder of the fiscal year.

RECOMMENDATION:

It is recommended the City Council receive, discuss, and file the update.

BACKGROUND:

On March 24, 2020, the City Council adopted a Resolution ratifying the existence of a local emergency in response to the Coronavirus Pandemic. In an effort to slow the spread of the disease, the Centers for Disease Control and Prevention, the California Department of Health, and County of San Luis Obispo have issued shelter at home directives to enforce physical distancing, prohibited group events, and taken other precautions to protect health and prevent transmission of this highly communicable virus. As a result of the public health emergency and shelter at home directives, many City residents and local businesses will experience income loss, ultimately impacting the City's ability to generate revenue.

The City's Administrative Services Department is in the process of developing a one-year budget for Fiscal Year 2020-21; however, given the recent circumstances and the need to focus on financial impacts of Coronavirus in the current fiscal year, efforts have been diverted briefly from the annual budget process and focused on a high level revenue forecast, taking into consideration the impact of the various orders and actions needed to slow the spread of the Coronavirus and the impact this will have on current City revenue estimates within the current fiscal year.

**CITY COUNCIL
DISCUSSION AND CONSIDERATION OF REVENUE IMPACTS DUE TO
CORONAVIRUS (COVID-19)
APRIL 14, 2020
PAGE 2**

ANALYSIS OF ISSUES:

The City's three largest General Fund revenue sources are property tax, sales tax and transient occupancy tax (TOT). These three sources comprise roughly 65% of the City's General Fund revenues. Service fee revenue including recreation, planning, and building plan checks also contribute to the City's General Fund revenue, but to a lesser degree. The health measures put in place to ensure public safety and limit the spread of the virus have already had a significant and immediate impact on City revenues including sales tax, TOT, recreation services and could potentially impact property taxes, if these measures inadvertently result in widespread foreclosures and small business closures. The following discussion will address each of these important revenue sources and attempt to quantify the impact of the Coronavirus on each revenue sources.

Transient Occupancy Tax (TOT) – Shortfall of (\$300K)

Tourism plays an important role in the financial vitality of the City. Lodging establishments in the City provide not only a place for visitors to stay while in the City, but also generate additional income in the form of TOT revenue. Transient Occupancy Tax makes up roughly 6% of the City's revenues. Prior to the Coronavirus, TOT revenues on an annual basis were running 11% over the prior year's actuals. However, as a result of health measures to ensure public safety and limit the spread of Coronavirus, lodging occupancy has significantly been reduced and TOT revenue is expected to decline by 19% compared to the prior year. Transient Occupancy Tax is also expected to decline 36%, or \$300K, versus the current budget, with just under three months remaining in the fiscal year. Transient Occupancy Tax revenue is seasonal with the majority of revenue collected in the months from June through September.

Lodging occupancy rates started to decline in mid-March and are expected to remain lower for the remaining months in this fiscal year. Our current forecast assumes a 50% reduction in TOT revenue for the month of March and is based on March actuals from the prior year. For the remaining months of April through June, we forecasted a more aggressive reduction in TOT revenues of 80%, based on the final quarter of the prior year. These TOT revenue projections are preliminary and may change depending on when shelter at home directives begin to be lifted and subsequent tourism rebounds.

Sales Tax – Shortfall of (\$550K)

Sales tax collections are the second largest revenue source for the City and accounts for \$4.1 million dollars of General Fund revenue. Sales tax revenue is approximately 22% of total City revenue. Currently, sales tax revenues are forecasted to be 13% lower compared to the current budget, or a shortfall of \$550K in the current year. As is the case with TOT revenue, a portion of sales tax revenue is directly impacted by tourism and the sales tax dollars generated from visitors' purchases at local restaurants and stores. In addition, local businesses are scrambling to stay solvent in the face of closures, quarantines, and physical distancing rules which have impacted their overall sales.

**CITY COUNCIL
DISCUSSION AND CONSIDERATION OF REVENUE IMPACTS DUE TO
CORONAVIRUS (COVID-19)
APRIL 14, 2020
PAGE 3**

As a note, the forecast does not reflect the impact of the Governor’s announcement on April 2nd that the State is considering allowing small businesses (less than \$5 million in taxable annual sales) to defer payment of sales and use taxes of up to \$50,000 for 12 months. We will be continuing to track this proposal and its impact in the coming weeks when more details from the State are provided.

Our sales tax forecast is based on the City’s top 13 business and their generation of sales tax. These 13 local businesses combine to make up 49.5% of all sales tax revenue. The remaining 50.5% is attributed to a number of smaller businesses that collectively make up the remaining sales tax balance. The table below is a listing of sales tax generated by business, prior to the Coronavirus, and reflects the most recent sales tax data available to us.

	Cumulative		Sales Tax	
	% of total	%	Impact	Discount
Wal Mart	14.03%	14.03%	100%	14.03%
Mullahey Ford	8.07%	22.10%	0%	0.00%
AG Chevrolet	4.30%	26.40%	0%	0.00%
Marshalls	3.48%	29.88%	0%	0.00%
Kath GO	3.25%	33.13%	50%	1.63%
Burke & Pace Lumber	3.05%	36.18%	100%	3.05%
Arco	2.88%	39.06%	50%	1.44%
Chevron	2.68%	41.74%	50%	1.34%
Ace Hardware	2.19%	43.93%	100%	2.19%
Smart & Final	1.70%	45.63%	100%	1.70%
Mobil	1.68%	47.31%	50%	0.84%
In n Out	1.67%	48.98%	50%	0.84%
AG Valero	1.51%	50.49%	50%	0.76%
Remaining sales tax	49.51%	49.51%	50%	24.76%

52.56% Discounted sales tax collections based on impact
of COVID-19 on local businesses

In mid-March, directives limiting residents’ movement and closing of nonessential businesses had a significant impact on sales tax revenues. Certain businesses were deemed essential and remained open for business; however, most with physical distancing limitations. Businesses deemed essential included grocery, hardware, gas stations, discount, and big-box stores. For forecasting purposes, many of these essential businesses were not impacted to the extent that other local businesses have been. Walmart, at the top of the list, and grocery and hardware stores were included in this category and sales tax was forecasted to remain stable. Other businesses also determined to be essential, like food establishments, are currently restricted by physical distancing guidelines and are not open for dining but rather only takeout. For forecasting purposes, these businesses were assumed to generate 50% of normal sales tax revenue. Similarly, sales tax collected by fuel and service stations also considered essential are impacted by both a decrease in the demand for fuel, due to stay at home orders, coupled with an increase in supply from Russia and OPEC, further decreasing the price of fuel

**CITY COUNCIL
DISCUSSION AND CONSIDERATION OF REVENUE IMPACTS DUE TO
CORONAVIRUS (COVID-19)
APRIL 14, 2020
PAGE 4**

and the associated sales tax. Both food service and fuel related businesses, as shown in the table, are forecasted at a discounted sales tax rate of 50% over the final quarter of this fiscal year. Lastly, the second and third ranked sales tax contributors on the list (12%) are the two local car dealerships, both of which we took the conservative approach and assumed that vehicle sales would be significantly reduced during the final quarter.

The year-end forecast of sales tax is calculated by taking an average of monthly sales tax and multiplying this by the discounted rate of 53% for the remaining three months of the fiscal year. When combined with actuals through March, you get a total sales tax estimate of \$3.6 million. The shortfall of \$550K in sales tax revenue represents the difference between the FY 2019-20 budgeted amount and this new forecasted amount. Unfortunately, we don't have current sales tax receipt data by business for the month of March. However, when more current sales tax information is available we will update our assumptions and revise our forecast accordingly.

Property Tax – Shortfall of (\$200K)

Property tax is the single largest revenue source at \$7 million, or 38% of revenue. The impacts of Coronavirus on property taxes are unknown at this time. Property tax revenues could be impacted in the long term by extensive home foreclosures and business closures.

The forecasted property tax shortfall of \$200K, while not a result of the Coronavirus per se, is due to the difference between our original budget, which included a property tax growth rate of 6% for the year and now our revised forecast of growth at 3%. Our current estimate for the year was based on discussions and information provided by the County Auditor's office.

Recreation Fees – Shortfall of (\$183K)

Lastly, recreation fees will be significantly impacted in the months of April through June as staff and City residents adhere to the sheltering at home directives. Many recreation programs like Children in Motion and special interest classes are temporarily closed, as are sports leagues. Recreation fees were trending favorable prior to the Coronavirus, but taking a conservative approach we did not assume any additional recreation revenue for the months from April through June.

Salary Savings – Savings of \$415K

While most of the discussion has focused thus far on the revenue impacts of Coronavirus, a full forecast including expenditures was developed. Salary and benefit costs make up approximately 55% of budgeted expenditures. We are forecasting \$415K in salary savings by year's end. This salary savings will play an important part in offsetting revenue shortfalls.

**CITY COUNCIL
DISCUSSION AND CONSIDERATION OF REVENUE IMPACTS DUE TO
CORONAVIRUS (COVID-19)
APRIL 14, 2020
PAGE 5**

Summary

The table below summarizes the discussion above and the impacts of the Coronavirus on revenue estimates. The Department will be working on developing a list of strategies to address the forecasted shortfall and will be looking to discuss those strategies at an upcoming City Council meeting.

General Fund Revenue Estimates Affected by COVID-19
Estimated As of 3/2020

(In thousands)

	CURRENT YEAR			
	Year to Date 03/31/20	Budgeted FY 2019-20	Forecasted FY 2019-20	Variance Fav/(unfav)
REVENUES:				
Taxes				
Sales Tax	2,437	4,143	3,595	(548)
Transient Occupancy Tax	724	1,142	839	(303)
Property Tax	4,545	7,071	6,872	(199)
Service Fees				
Recreation Fees	612	795	612	(183)
Other Revenue	3,610	5,688	5,743	55
Total Estimated Affected Revenues	11,928	18,839	17,661	(1,178)
EXPENSE:				
Salary & Benefits	7,534	11,297	10,882	415
			Forecasted Shortfall	<u><u>(763)</u></u>

ALTERNATIVES:

1. Receive and file the update; or
2. Direct staff to provide more specific information at a later date.

ADVANTAGES:

Receiving this report will facilitate discussions regarding the City's current revenue projections in response to the impacts brought on by the Coronavirus. Communication to the community, City Council, and staff regarding these impacts is transparent and contributes to the organizational values of the City.

DISADVANTAGES:

There are no disadvantages.

ENVIRONMENTAL REVIEW:

No environmental review is required for this item.

PUBLIC NOTIFICATION AND COMMENTS:

The Agenda was posted at City Hall and on the City's website in accordance with Government Code Section 54954.2.

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