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## City Manager's Message

### FY 2022 City Manager's Budget Letter

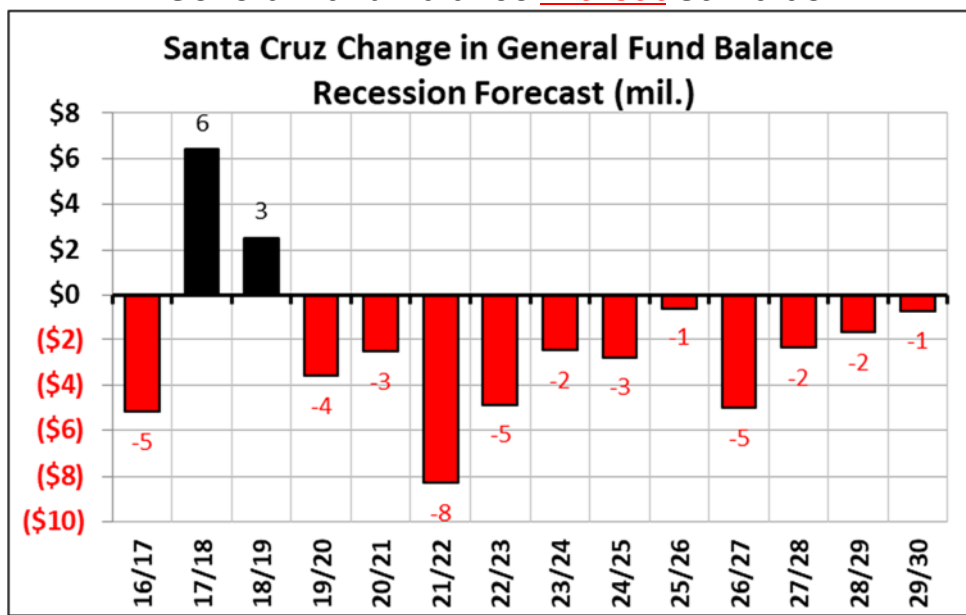
Dear Mayor and Members of the City Council,

I write this message as we complete an unparalleled year of change and impacts to our City. Not only has the COVID-19 pandemic had sweeping effects on our fiscal position, our work, and our personal lives, but our region also experienced the collective trauma of the CZU Lightning Complex Fire. Never before has the City been required to act more swiftly and nimbly in the face of mounting challenges. This is also my eleventh and final budget message after twenty-four years of service to the City of Santa Cruz. It has been an honor and privilege to serve the City.

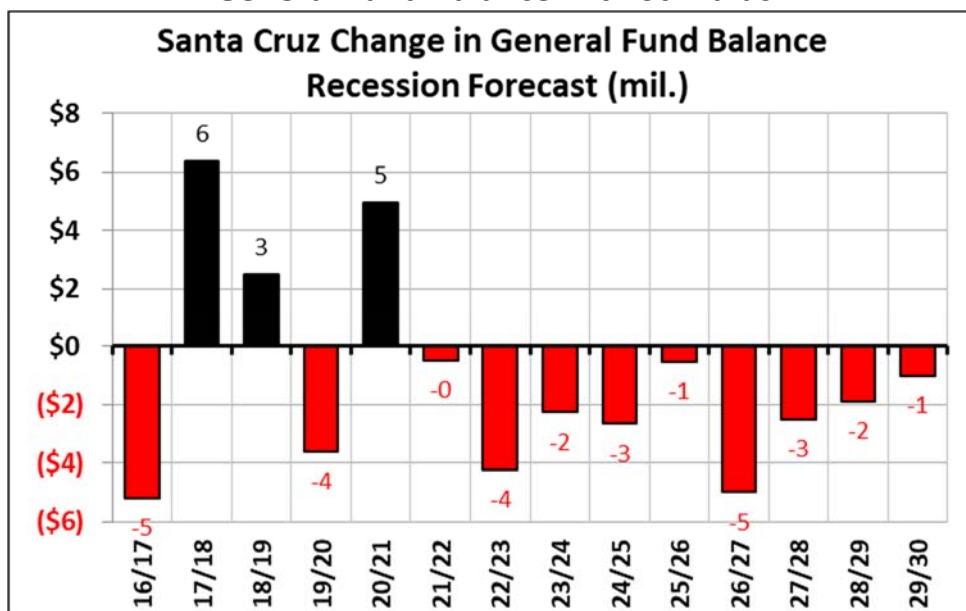
The fiscal impact of the COVID-19 pandemic is the most significant in the modern history of the City of Santa Cruz, even greater than the Great Recession of 2007. We have never faced such a dramatic and drastic reduction in revenues while at the same time having to respond to public emergencies and maintain essential services. Fortunately, the City has a strong record of prudent fiscal practices, including setting aside reserves to address unforeseen events and disasters. With respect to the General Fund, the City saw a loss of \$10 million in Fiscal Year 2020 and a loss of \$11 million for Fiscal Year 2021. This budget projects that revenues will begin to recover, but remain approximately \$6 million less than previously estimated. Tourism/visitor-related revenues saw a sharp reduction. Transient Occupancy Tax revenue dropped by 33% over the two-year period, and our Admission Tax revenue plunged an incredible 97%. The City was forced to immediately rely on reserves to maintain solvency.

Just as important, each and every City employee stepped up to these challenges over the past year. The City froze hiring, encouraged early retirements, and for Fiscal Year 2021 most employee groups took a 10% salary reduction through furloughs. These sacrifices resulted in approximately \$7 million in savings. As the effects of the pandemic continued, in October the City Council adopted a revised budget that resulted in another \$5 million in cuts. Most severe was the elimination of the City's Park Ranger program. Even still, our General Fund reserves decreased 32% from Fiscal Year 2019 to 2021 (not including American Rescue Plan funding).

### General Fund Balance without Stimulus



### General Fund Balance with Stimulus

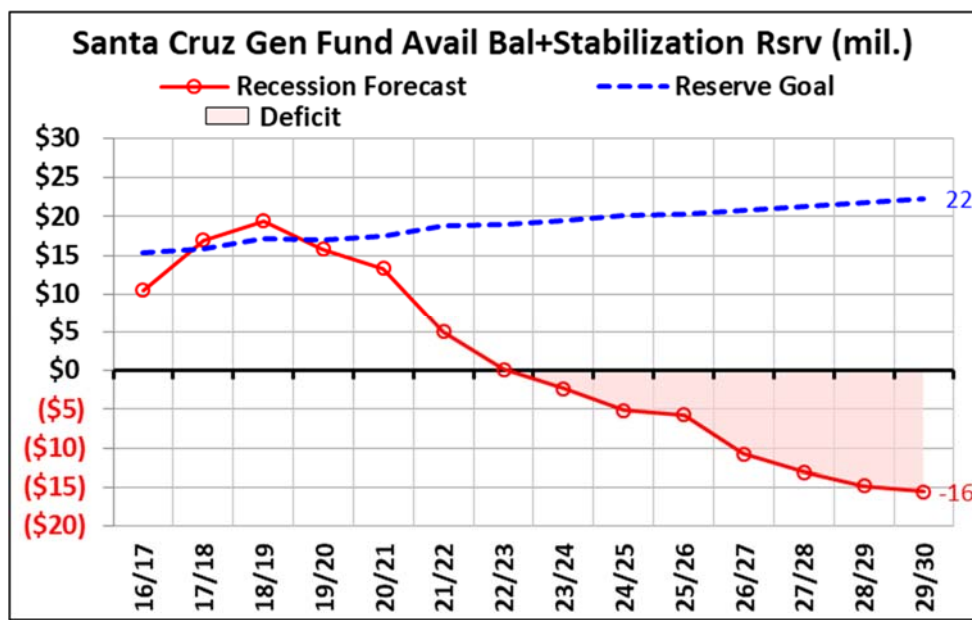


Our residents, community organizations, and businesses personally felt the effects of the pandemic as well. In 2020, unemployment skyrocketed in the City to a high of nearly 14% and ended the year averaging almost 8%. Comparing Fiscal Years 2019 and 2021, we saw the number of business licenses issued drop 35%. Our Finance team estimates that the City will experience a revenue deficit of \$27 million through the end of the upcoming fiscal year.

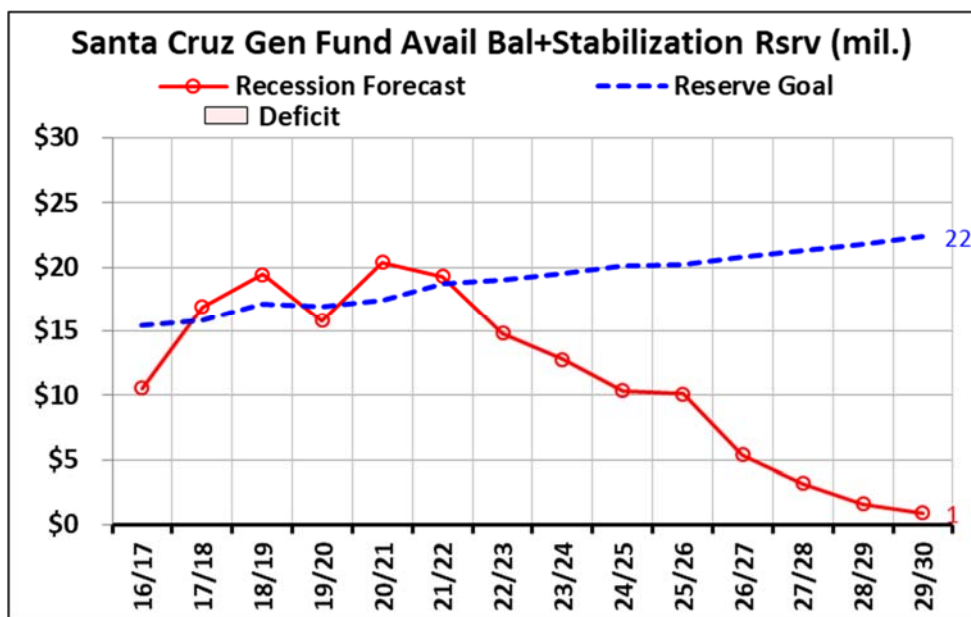
With respect to Enterprise Funds, the COVID-19 pandemic also had an effect. Most significantly impacted was the Parking Fund, which saw a loss of \$4.5 million. The Parking Fund will be able to weather the loss due to prudent reserves, the ability to adjust rates, and the return of parking demand in the Parking District. Interestingly, the Golf Course Fund, while not technically an Enterprise Fund, experienced a boon such that it no longer requires a subsidy from the General Fund.

Still, looking ahead to Fiscal Year 2022, we see some signs that our recovery has begun. We have started to move through less restrictive COVID-19 tiers and more people are accessing vaccines, which have allowed the local economy and tourism to begin to reopen and rebound. As of March 2021, the unemployment rate in the City fell to 4.5%, and, in May, we lifted the City employee furloughs six weeks ahead of schedule. The City also received Federal relief funding. The first round of stimulus funding was allocated in December 2020. The approximately \$784,000 was used to address the added costs of responding to the pandemic. It was a wholly inadequate amount for a City like Santa Cruz to respond to the impact of the pandemic. The City is set to receive approximately \$14 million in one-time Federal American Rescue Plan stimulus funds to help stabilize the budget. Being one-time funding, it will provide interim stability to the City, allowing the deferral of additional reductions; replenishing reserves; and, essentially, allowing the City the time to develop and implement a longer-range fiscal sustainability plan. It will not close our significant structural deficit or fully restore the massive revenue gaps brought on by the pandemic. The bottom line is that the City is facing a structural budget deficit. The City faces a range of \$1 to \$5 million annual deficits with stimulus (\$1 to \$8 million without stimulus) for the next ten fiscal years, with revenue increasing from 2.2% to 5.3% over the same period. Additionally, the General Fund Capital Improvement Program has been unfunded for the previous two fiscal years and is projected to remain unfunded. The project deficits are shown in the forecast chart below.

### General Fund Forecast without Stimulus



### General Fund Forecast with Stimulus



At the start of 2021, the City Council launched Re-Envision Santa Cruz, an interim recovery plan to carry us through a 12–18 month recovery period. We will execute a bold vision that centers on the priorities of long-term fiscal sustainability, downtown and business revitalization, and building out much-needed infrastructure. We will explore ways to inject our local economy with new jobs, green businesses, affordable housing, and resilient green infrastructure. We will bolster what makes Santa Cruz special by supporting our businesses; advocating for new and improved funding sources; and reinvesting in the downtown and infrastructure from roads and water to parks, facilities, and open spaces.

Our focus during the 2022 budget year will be on not only recovery, but also ongoing resilience. Because of the scale of the structural deficit, the City will continue to identify areas for expenditure reductions and explore the potential for a new revenue measure. Robust new revenue sources are needed to maintain existing essential services and address increased needs for business recovery, health and public safety, and infrastructure maintenance. To that end, several actions have already been taken. As noted above, immediately was the draw down of reserves, followed by budget cuts and furloughs. The City Council also established a Revenue Committee, which is developing a recommendation on whether to proceed with a revenue ballot measure at an upcoming election. The Revenue Committee is expected to bring forward its final recommendations in June after outreach and a public opinion poll is conducted.

I would like to thank our budget development team, including our new Finance Director Kim Krause and Budget Manager Lupita Alamos. We are so fortunate for this team’s incredible leadership during the most challenging financial years of my thirty-plus years serving in local government. I also want to thank the executive leadership and the more than 800 employees of the City of Santa Cruz for their sacrifice over the past year. They have truly demonstrated their unwavering dedication to serving the community.

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As I prepare for my transition to retirement and I reflect on my time as City Manager, I am confident that the City will emerge from the pandemic stronger and more focused than ever before. I tend to focus on our fiscal challenges in my budget messages, but I want to take the opportunity in my final message to comment on the long-term picture and positive outlook for the City of Santa Cruz, fiscally and otherwise. As public officials we tend to primarily hear the complaints and focus on the challenges, but it is important to reflect on how blessed and fortunate we are in Santa Cruz. The signs of recovery are significant, as evidenced by the amount of investment that is taking place in our City, particularly in the downtown. We also have a supportive and involved community, who supports its local governments and appreciates the extensive service levels that we are able to provide. The economic recovery will be strong, and I am confident that the community will support the high level of services and public amenities that we enjoy and that make Santa Cruz what it is today, a truly world-class city. We are incredibly fortunate to have highly capable leadership, both at the staff level and political level. The level of collaboration and teamwork amongst and between staff, the City Council, and the community is high, and, more importantly, on the upswing, which is critical to our ability to address challenges and to progress as a community.

I am grateful for the opportunity to have served the City of Santa Cruz over the past eleven years as City Manager and for my twenty-four years at the City. During that time, with the collaboration of the many dedicated leaders of the City Council and staff, we have weathered the Great Recession and responded to a global pandemic. Our shared legacy will be one of resiliency in the City of Santa Cruz.

Sincerely,

Martín Bernal  
City Manager