1400 Highland Avenue
Manhattan Beach, CA 90266

Legislation Text

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TO:
Honorable Mayor and Members of the City Council

THROUGH:
Mark Danaj, City Manager

FROM:
Bruce Moe, Finance Director
Henry Mitzner, Controller
Libby Bretthauer, Financial Analyst

SUBJECT:
FY 2016-2017 Budget Status Report; Presentation of FY 2017-2018 Operating Budget Modifications for the Second Year of the Biennial Budget (Finance Director Moe).
RECEIVE REPORT

RECOMMENDATION:
Staff recommends the City Council receive a report on the status of the Fiscal Year 2016-2017 budget, and recommended modifications for the second year (FY17-18) of the biennial budget.

(Please note that the associated PowerPoint presentation for this report will be posted on Monday, May 1, 2017)
FISCAL IMPLICATIONS:
Current trends indicate the City's FY 2016-2017 General Fund operating budget will finish the year with revenues exceeding expenditures by $832,228. Taking into account year-end projections and anticipated transfers to the Insurance, Street Lighting and Storm Water Funds, staff projects an unreserved General Fund balance of $3.4 million at fiscal year-end.

Other funds are trending within projections with the exception of the Insurance Fund. Substantial activity in Workers' Compensation continues beyond expectations. Currently, the Insurance Fund is running over budget by approximately $574,000. Staff will return to City Council later in the year with a clean-up appropriation to adjust for the excess activity. Council may recall that in FY 2015-2016, Council approved annual transfers from the General Fund to the Insurance Fund of $667,000 over three years ($2 million total) which is scheduled to end after FY 2017-2018. If not for the projected savings from the move to the new insurance pool, and the resulting $1.1 million savings, further immediate General Fund transfers would be necessary to address the Workers Compensation cost trends.

The fiscal year 2017-2018 budget as approved last year included expenditures across all funds totaling $132,963,397. The General Fund was balanced with revenues of $69,733,976 and expenditures of $69,571,459 resulting in a projected surplus of $162,517. Modifications to the plan, described later in this report, result in revenues exceeding expenditures by $468,201. Without anticipated one-time revenues and nonrecurring equipment expenditures, core (on-going) revenues exceed core expenditures by $686,786. Carry forward projects and one-time expenditures are discussed in detail below.

While the City is maintaining a balanced General Fund budget, there are significant financial issues looming which need to be proactively addressed in the near future, which will require City Council leadership and a strong commitment to the long term fiscal health of the City. Please refer to the "Financial Planning" section below.

BACKGROUND:
A new biennial budget cycle commenced in FY 2016-17. On June 21, 2016, the City Council adopted the FY 2016-17 Operating Budget and approved the FY 2017-18 Operating Budget. The FY 2016-17 Budget was adopted with a General Fund operating budget surplus of $416,425.

Revenues	$67,822,465
Expenditures	$67,406,040
FY 16-17 Adopted Surplus/(Deficit)	**$416,425**

The City's two year operating budget is on the City's website:

<http://www.citymb.info/ProposedFY17BiennialBudget>

Two Year Budget
The purpose of the two-year budget is to encourage longer range planning, and link the spending plan to that vision of the Strategic Plan, which prioritizes the City's goals for the coming years. The multi-year budget is also linked to other planning efforts such as community surveys. The advantages include a greater emphasis on management, service delivery, program evaluation and monitoring. It also improves long-term planning, reallocation of human resources to more value-added activities other than budget preparation, and reduction in staff time spent on budget development in the second budget year.

Under the two-year budget, the first year of the biennial budget (2016-2017) was adopted and the second year (2017-2018) was approved as a spending plan but not adopted - that occurs before the beginning of the second year. With that time now occurring, staff performed a review process for any critical changes to the second year spending plan, which are now presented for City Council consideration. Once determined and final direction given, City Council will formally adopt the second year spending plan (FY 2017-2018). The entire biennial budget process will commence with a new two-year budget for FY 2018-2019 and FY 2019-2020.

One of the greatest benefits to the two-year budget involves the City's Capital Improvement Plan (CIP). Previously, under the one-year budget process, the development and approval of the CIP occurred concurrently with the operating budget. This did not provide adequate time for a thorough review of one the City's major spending components - capital projects.

Now, with the two-year budget, the first year (FY 2016-2017) centered on the operating budget, with year two more closely focusing on the five year CIP. Any changes Council directs for the CIP that affect FY 2017-2018 will be incorporated into the adopted budget.

DISCUSSION:

After a thorough review of financial activity and trends to date, staff has estimated a year-end surplus of $832,228 for FY 2016-17:

Revenues	$67,743,815
Expenditures	$66,911,587
FY 16-17 Estimated Surplus/(Deficit)	**$832,228**

Overall, the fiscal year 2016-17 General Fund budget-to-actuals through March are performing near budget. Revenues are estimated to be slightly under the adjusted budget by $143,650 (-0.2%). Expenditures (including all budget adjustments subsequent to adoption) are expected to total $1,331,433 (-2.0%) under the adjusted budget (the adjusted budget includes City Council-approved amendments during the current year as well as encumbrances carried forward from the prior year).

Over half of the FY 2016-17 Estimated Surplus is a result of carryforward requests (totaling $542,008) for delayed projects and capital equipment purchases, which are now included in the FY 2017-2018 budget adjustments presented. These requests include funds set aside for previously approved City initiatives, including the ERP system upgrade ($178,585), Police Department ALPR cameras ($100,000), building permit system upgrade ($74,123), implementation of the Historic Preservation commission and program ($176,200) and the purchase of a work order management system and laptop in Public Works ($13,100). These costs already exceed the amount by which revenues exceeded expenditures in the Approved FY 2017-18 Operating Budget approved last June.

Revenues	$69,733,976
Expenditures	$69,571,459
FY 17-18 *Approved* Surplus/(Deficit)	**$162,517**

However, with the changes identified in the FY 2017-18 Proposed Budget, revenues are projected to exceed expenditures by $468,201.

General Fund Revenues

The following are highlights of several key revenues. Please see Table 1 on Attachments #1 (FY 2016-2017) and #2 (FY 2017-2018) for a list of key General Fund revenue variances.

Property Tax

Property tax is the General Fund's largest revenue source, accounting for approximately 40% of total revenue. Property Tax as a group is forecasted to come in $244,859 (0.9%) over budget and $1,722,643 (6.5%) ahead of last year. Net taxable assessed property values have grown 7.1% from fiscal year 2016, reflecting the continued strength of the Manhattan Beach housing market. This continues the trend from the prior year's growth of 8.1%.

FY 2014 Revenue:	$23,353,741
FY 2015 Revenue:	$24,435,184
FY 2016 Revenue:	$26,344,276

FY 2017 Budget:	$27,822,060
FY 2017 Full Year Estimate:	$28,066,919

Fiscal Year 2017-2018 estimates indicate a slowing in the housing market. Growth in assessed values for next fiscal year are budgeted at 5.34% as opposed to the 7.1% growth last year. However, this is still greater than the 4% estimated last year (the 4% was also calculated on a conservative year end estimate which was below final year end results).

FY 2017-2018 Budget as Approved: $28,857,000
FY 2017-2018 Recommended for Adoption: $29,511,005
Change: $654,005 (+2.3%)

Real Estate Transfer Tax
Real Estate Transfer Tax revenue is derived from a charge of fifty-five cents per $500 of sales price, split evenly between the City and the County of Los Angeles. Available data for single-family home sales indicate the sales volume in calendar year 2016 was consistent with the prior year (Source: HdL, Coren & Cone).

Residential Home Sales by Calendar Year:

2016: 427
2015: 424
2014: 486
2013: 498
2012: 489
2011: 427
2010: 393

Although the number of sales in 2016 are roughly the same as in calendar year 2015, the median single family sales price increased to $2.0 million in 2016, up just 2.8% from the prior year. Sales activity was stronger in the first half of 2016 than in July through December, which falls into the current fiscal year. Hence, transfer tax collections in FY 2016-17 are trending down from the prior fiscal year. Conservatively estimating the number and value of transfer tax collections from all properties (residential and commercial), collections are expected to be 24.3% below the prior year, and to underperform budget by $250,000 (29.4%).

FY 2014 Revenue:	$642,718
FY 2015 Revenue:	$720,826
FY 2016 Revenue:	$792,830
FY 2017 Budget:	$850,000
FY 2017 Full Year Estimate:	$600,000

For Fiscal Year 2017-2018, budgeted revenues have been lowered to reflect the most recent trend:

FY 2017-2018 Budget as Approved: $860,000
FY 2017-2018 Recommended for Adoption: $600,000

Change: -$260,000 (-30.2%)

Sales Tax

Sales Tax, the city's second largest General Fund revenue source (15% of total revenue) has not generated the same growth as seen in the past few years. Flat or declining retail "Point of Sale" returns and continued low fuel prices have contributed to the decline in growth. The FY 2016-17 budget of $9.3 million was a conservative estimate based on the year-end projection for FY 2015-16 at the time. However, with the unwinding of the "Triple Flip," the State realigned its cash flows resulting in a one-time increase to the City's sales tax receipts in FY 2015-16. New projections developed in consultation with the City's sales tax consultants (HdL) indicate Sales Tax for the current year should come in at approximately $9.0 million, $348,605 (-3.7%) below last year or 3.2% below budget. In the fourth quarter of 2016, the City's restaurants and hotels performed 1.4% better than the fourth quarter of 2015, but general consumer goods underperformed the prior year by about 1.3%. Sales tax from online sales (received through State and County Pools) increased by 3.5% over the prior year.

FY 2014 Revenue:	$9,135,807
FY 2015 Revenue:	$9,171,515
FY 2016 Revenue:	$9,348,605
FY 2017 Budget:	$9,300,000
FY 2017 Full Year Estimate:	$9,000,000

FY 2017-2018 Budget as Approved: $9,500,000
FY 2017-2018 Recommended for Adoption: $9,000,000
Change: -$500,000 (-5.3%)

Transient Occupancy Tax

Also known as the hotel bed tax, the City levies a 10% Transient Occupancy Tax (TOT) on hotel and motel rooms with 8.5% going to the General Fund. The remaining 1.5% goes to the Capital Improvement Fund to fund Police & Fire Facility debt service and future projects. Based on recent month-over-month trends, General Fund TOT revenues for the full year are expected 2.5% (-$111,666) below budget and 0.5% ($20,893) below the prior year (the budget forecasted growth at 4.5% over the prior year estimate, and 2.1% over year end results).

General Fund

FY 2014 Revenue:	$3,565,093
FY 2015 Revenue:	$3,955,209
FY 2016 Revenue:	$4,409,227
FY 2017 Budget:	$4,500,000
FY 2017 Full Year Estimate:	$4,388,334

During adoption of the FY 2016-2017 budget, Council directed that $500,000 per year be dedicated to the CIP Fund for deferred maintenance of facilities. In FY 2016-2017, that funding was accomplished through a transfer from the General Fund (and therefore did not affect the revenue-expenditure balance). For FY 2017-2018, Council directed that the deferred maintenance funding be considered part of the revenue-expenditure equation. However, staff is recommending that Council revisit that direction because the General Fund cannot afford to reduce revenues while expenditures continue to grow. This is particularly true given last year's addition of the Pension Stabilization Reserve Fund expenditure of $500,000, which staff also would like to review with the City Council. As presented, the deferred maintenance TOT has been re-directed to the General Fund, subject to Council discussion.

FY 2017-2018 Budget as Approved: $4,200,000
FY 2017-2018 Recommended for Adoption: $4,526,500
Change: $326,500 (7.8% including redirection of $500,000 from CIP Fund)

Building Permit & Plan Check Fees
With the new cost recovery fee structure approved in 2015, the City collects less for plan check services but more for permit issuance which requires more staff resources. Taken together, Building Permit and Plan Check fees collected in FY 2016-17 are anticipated to be higher than the prior year by $329,464 or 11.9%.

In the first six months of the fiscal year, the volume of plan checks is trending about the same as the prior year but the valuation of plan checks was $59 million higher this year. This spike was largely due to two large plan check submittals (Village Mall and Skechers on Sepulveda) as well as developers hurrying to submit plans before January 2017 building code changes went into effect. Taking these anomalies into account, Building Plan Check fees for the year are projected at $1,500,000, 18.4% or $233,000 over budget. On the other hand, building permit fee revenues are expected to come in 18.0% under budget (-$348,000) due to lower cost recovery charges and exclusion of permit fees anticipated from the Manhattan Village Mall remodel (when the budget was adopted last June, it was anticipated that Plan Check fees for the mall project would be collected in FY 2015-16 with Permit fees collected in FY 2016-2017). These permit fees are now anticipated in FY 2017-18.

Plan Check

FY 2014 Revenue:	$1,409,954
FY 2015 Revenue:	$1,410,028
FY 2016 Revenue:	$1,063,654
FY 2017 Budget:	$1,267,000
FY 2017 Full Year Estimate:	$1,500,000

FY 2017-2018 Budget as Approved: $1,330,400
FY 2017-2018 Recommended for Adoption: $1,400,000
Change: $69,600 (5.2%)

Although Building Permit fees from the Manhattan Village Mall project are conservatively projected to bring in an additional $100,000, fee revenue is still down from prior years due to the changes in the cost recovery model.

Building Permits

FY 2014 Revenue:	$1,031,410
FY 2015 Revenue:	$1,196,592
FY 2016 Revenue:	$1,696,882
FY 2017 Budget:	$1,938,000

FY 2017 Full Year Estimate:	$1,590,000

FY 2017-2018 Budget as Approved: $2,034,900
FY 2017-2018 Recommended for Adoption: $1,737,700
Change: -$297,200 (-14.6%)

Business License Tax
Business license tax, which is generally calculated upon a business' gross receipts, is estimated to come in slightly higher than last year's collections. This revenue showed resilience against the troubled economy and has remained level or had slight increases year over year. Analysis of previous years showed this revenue is somewhat inelastic to the ebbs and flow of the economy. Despite modest declines and increases in businesses' total gross receipts, business license tax has remained steady, likely due to the fact that around 70 businesses pay the maximum gross receipts business license, and changes in their gross receipts are unlikely to impact their total license tax.

FY 2014 Revenue:	$3,140,273
FY 2015 Revenue:	$3,376,113
FY 2016 Revenue:	$3,475,794
FY 2017 Budget:	$3,525,000
FY 2017 Full Year Estimate:	$3,525,000

FY 2017-2018 Budget as Approved: $3,600,000
FY 2017-2018 Recommended for Adoption: $3,600,000
Change: $0 (0.0%)

Interest Earnings
The City invests its idle cash in a number of instruments ranging from the state-run Local Agency Investment Fund and corporate debt, to U.S. Treasury notes, Governmental Agencies and Certificates of Deposit. During the last recession and associated economic problems, interest rates declined dramatically and have remained at very low levels. As a result, the City's maturing investments are reinvested at the current low rates. However, the portfolio was recently yielding 1.295%, up from 1.079% one year ago, and additional rate increases are predicted in 2017. This category includes interest income as well as an offset for investment amortization.

FY 2014 Revenue:	$379,576
FY 2015 Revenue:	$329,148
FY 2016 Revenue:	$483,737
FY 2017 Budget:	$418,590
FY 2017 Full Year Estimate:	$477,040

Given the health of the U.S. economy, the Federal Reserve Open Market Committee has raised interest rates twice in the past six months, with more rate increases expected in the coming months. As a result, staff expects the yield on the City's portfolio to increase as maturing investments are re-invested at higher rates than previously received. The City Treasurer and staff work closely to monitor markets for opportunities to invest idle funds with the goals of Safety, Liquidity and Yield in that order.

FY 2017-2018 Budget as Approved: $444,631

FY 2017-2018 Recommended for Adoption: $544,631
Change: $100,000 (22.5%)

<u>*Other General Fund Revenues*</u>
Other revenues worth mentioning include:

Miscellaneous Revenues
The Miscellaneous Revenue category includes Workers' Compensation Salary Continuation, which is a reimbursement to the General Fund for wages paid to injured employees receiving benefits. Based on recent workers' compensation claim activity in FY 2016-17, reimbursement revenue has exceeded budget ($400,000) by $212,706 through the end of March. Workers' Compensation Salary Continuation revenue is projected to be over budget by $250,000 or 62.5% at year-end. The source of this revenue is the Insurance Fund which reimburses the General Fund for salary continuation.

Risk Management and Finance staff are collaborating on funding methodology alternatives that will stabilize the effects of claims volatility in Workers Compensation funding. Risk Management is also in the planning stages for development of Workers' Compensation program elements designed to gain control over medical provider protocols as allowed under the Labor Code. The intended outcomes of these efforts are: 1) reduction in medical costs; 2) reduction in temporary disability expenditures; and 3) improved medical outcomes for injured employees. Program development and any required labor discussions will proceed through FY17/18.

Parking Citations
In July 2015, parking citation fees were increased by $5 in alignment with other comparable cities. However, downtown parking revenues and citations were also impacted by the streetscape project occurring in the fall of 2015. Several meters had to be temporarily removed for concrete sidewalk replacement during the project, which took away both meter revenue and the expired meter citations. Parking conditions have since normalized and the number of citations is on par with earlier years before the construction. General Fund citation revenue is projected to end the year at $2.6 million, which exceeds FY 2015-16 revenue by $263,953 or 11.3% and exceeds budget by $14,000.

While a General Fund revenue source, a portion of the revenue from Parking Citations ($4 of all citations except expired meters) goes to the CIP Fund. The CIP fund utilizes the moneys to pay debt service on the Police/Fire facility and to fund other general CIP projects.

General Fund Expenditures
For Fiscal Year 2016-2017, within the Salary and Wages category, regular salaries are projected to be over budget by $74,756, or 0.6%, and sworn salaries (Police and Fire) are trending over budget by $498,787 or 3.9%. As in previous years, a vacancy factor of 4% ($1.4 million in the General Fund) was built into the budget to recognize the salary savings achieved from vacancies naturally occurring throughout the year due to attrition and retirements. Regular and sworn overtime costs are projected to remain within budget. Current trends indicate ending the year under budget by $24,362 or 0.6%. Part-time salaries are estimated to end the year under budget by $53,515 or 2.6%.

Employee Benefits are estimated at 3.2% or $448,854 under budget for the full year, mainly due to the “superfunded” status of the City’s other postemployment benefits (OPEB) liability thus eliminating the need for a contribution. Although a medical retirement contribution of $238,512 was budgeted in FY 2016-17, a payment has not been required since FY 2014-15. All other employee benefits are projected to end the year $210,342 or 1.5% under budget. In addition to vacancies, this change can be attributed to Group Medical Insurance trending $79,774 (2.3%) under budget due to medical premium increases rising at a lower rate than budgeted.

Regular and Sworn employee pension costs are estimated under budget by 3.0% ($172,766) totaling $5,597,648 in the General Fund ($6,038,292 across all funds) in FY 2016-17. In addition to vacancies, prepaying the unfunded liability contribution in July added to the savings by about $61,000. CalPERS payments in FY 2016-17 include the normal cost portion ($1,321,466 for Regular and $2,154,197 Sworn) as well as $2,562,629 toward paying down the City’s Unfunded Liability.

Contract and Professional Services is estimated under budget by $287,830 or 3.3%. A significant part of this savings is due to the Historic Preservation program and commission originally scheduled for implementation in FY 2016-17. Budgeted funds totaling $176,200 will not be spent this fiscal year, but staff has incorporated this amount in the requested budget amendments for implementation in FY 2017-18. Computer contract services will also end the year under budget due to the re-evaluation of the building permit system implementation. About $74,000 in funding related to this project will also be recommended for re-budgeting in FY 2017-18. Offsetting these savings, legal services is trending over budget by about $143,000 (30.8%) due to unanticipated legal proceedings.

Utility costs and Internal Service Charges are both anticipated to end the year under budget. Cost increases assumed during the development of utility budgets have not materialized, thus causing the lower trend in actual expenditures to date. In addition, fleet maintenance costs are also trending lower.

Property and Equipment will not be fully expended by year end, and is expected to come in under budget by $375,747. Much of these costs are related to Information Systems Master Plan projects which are not expected to be completed by year end (e.g. Financial and Human Resources software system upgrades). Remaining unspent budgets for these projects are included in the budget amendments (carry forwards) proposed for FY 2017-18.

In 2016, the City refinanced variable rate bond debt on Marine Avenue Park to fixed rate Certificates of Participation. Interest payments on the variable rate debt had been budgeted at an artificially high interest rate in line with bond covenants. Because actual interest rates were always lower than the budgeted rate, budgetary savings were realized every year. In addition, administrative fees/letter of credit fees on the variable rate debt cost the City about $80,000 per year. By refinancing with fixed rate bonds, the City is realizing significant budget savings. The revised full-year estimate for debt service in FY 2016-17 is $141,376 under budget and the proposed budget for FY 2017-18 was reduced by $122,431.

Overall, General Fund expenditures are trending 2.0% or $1,331,433 under the adjusted budget in FY 2016-17.

Other Funds

Worth noting are other Funds receiving subsidies from the General Fund, which diverts resources from Police, Fire and other general governmental services. Over the next five years, General Fund subsidies to the Storm Water and Street Lighting & Landscape District Funds are projected between $1 million and $2 million per fiscal year.

The Street Lighting and Landscaping Fund currently has no fund balance and assessments are inadequate to fund operations or provide for future capital needs. As a result, the General Fund subsidizes this fund every year, estimated at $206,903 in FY 2016-17.

The General Fund's subsidy to the Storm Water Fund is estimated at $1,263,233 in FY 2016-17, which includes the addition of $221,415 for emergency Stormwater repairs approved by City Council on March 21, 2017 (if the City's claim to recover the moneys is successful, the General Fund will be reimbursed). The General Fund transferred $841,286 in FY 2015-16. Stormwater operations will continue to encounter higher operating costs due to legislative action to clean storm water runoff and limits, which reduces funds for highly needed capital improvement projects. Capital projects such as the storm drain debris filters therefore continue to be underfunded and must be paid for out of the General Fund.

In addition to Street Lighting and Stormwater Fund transfers, the City Council approved a phased transfer plan from the General Fund Unreserved Fund Balance to the Insurance Fund on November 17, 2015. Transfers in the amount of $667,000 were approved for fiscal years 2015-16, 2016-17, and 2017-18 to correct a fund imbalance that was a result of higher than expected claims activity during FY 2014-15 (the transfers in FY 2015-16 and 2016-17 have been made and are reflected in fund balance estimates stated in this report).

Workers' compensation claims activity resulted in $4,057,854 in claims paid in FY 2015-16. Based on workers' compensation claims activity through March 2017, paid claims for the fiscal year are projected to total $3.8 million for the year ($1,020,000 over budget).

FY 2014-15	$3,779,780
FY 2015-16	$4,057,854
FY 2016-17 Estimate	$3,800,000

Liability claims activity is anticipated to be under budget by $500,000, which will help offset the higher costs due to workers' compensation. As a result, an appropriation of approximately $600,000 will be needed so that total fund expenditures do not exceed total fund appropriations. A budget adjustment will be requested in the coming weeks once the amount if finalized.

As previously stated, Risk Management and Finance staff are collaborating on funding methodology alternatives that will stabilize the effects of claims volatility in Workers Compensation funding. Risk Management is also in the planning stages for development of Workers' Compensation program elements designed to gain control over medical provider protocols as allowed under the Labor Code. The intended outcomes of these efforts are: 1) reduction in medical costs; 2) reduction in temporary disability expenditures; and 3) improved medical outcomes for injured employees. Program development and any required labor discussions will proceed through FY17/18.

On the basis of actual results in FY 2015-16 and projected results in FY 2016-17, a budget amendment for claims paid is included in FY 2017-18 to conservatively align the budget with prior years. Although workers' compensation claims paid is increasing by $960,000, liability claims are being reduced by $400,000. In addition, premium costs have been adjusted down by $1.1 million to reflect recent estimates received from the City's new risk sharing pool, the California State Association of Counties-Excess Insurance Authority (CSAC-EIA). Overall, these changes reduce projected expenditures in FY 2017-18 by $537,728.

Fiscal Year 2017-2018 Budget Highlights

While the FY17-18 budget was approved by the City Council last year, the actual adoption and appropriation of funds must take place now, before the commencement of the new fiscal year. The budget as presented with amendments is as follows:

Revenues	$71,013,648
Expenditures	$70,545,447
FY 17-18 Proposed Surplus/(Deficit)	**$468,201**

Policy Changes vs. Technical Changes

Staff is recommending a number of modifications to the approved FY 17-18 budget to be incorporated into the adopted spending plan. The changes are listed on Attachment #4 and have been placed into two categories: 1) **policy-related changes** requiring direction from the City Council, and 2) **technical changes** that staff recommends as routine mid-course adjustments. These technical changes mainly include adjustments to revenues to reflect recent trends both positive and negative, as well as expenditure adjustments necessary to meet operational needs. All recommended changes are expected to result in revenues exceeding expenditures by $468,201 in the General Fund.

The following policy changes for Council direction have been included in the proposed budget modifications for FY 2017-2018. All involve the General Fund unless otherwise noted:

Addition of four Senior Civil Engineers

At the April 10th Capital Improvement Projects study session, City Council gave tentative approval to add four Senior Civil Engineers in order to provide resources for the timely execution of the CIP plan. The CIP plan as presented is contingent upon those resources. The cost of the four positions is $674,950. The funding for these positions is derived from Water, Wastewater, CIP and Special Revenue Funds (Proposition C, Measure R, etc.) and has no net impact on the General Fund.

Reallocation of Specific Purpose Funds

Last year, the City Council allocated funds to two purposes: 1) $500,000 to establish a Pension Stabilization Reserve Fund to address rapidly rising pension costs, and 2) $500,000 to be dedicated to the CIP Fund for deferred maintenance at City facilities. The pension funding was added as an expenditure to the FY 2016-2017 budget (and included in all future years). The deferred maintenance contribution was treated as a transfer from the General Fund to the CIP Fund in FY 2016-2017, while in FY 2017-2018 TOT revenues were reduced by $500,000 in the General Fund and dedicated as revenue to the CIP. The net impact on the General Fund of these allocations is a reduction of available General Fund resources of $1 million.

Upon review of the second year of the biennial budget, it became apparent that General Fund structural deficits would be incurred given the reduction of $1 million in resources. In an effort to balance the FY 2017-2018 budget and the future years, staff has recommended reducing the pension stabilization reserve allocation from $500,000 to $250,000 per year, and discontinuing the $500,000 allocation of TOT from the General Fund to the CIP fund for deferred maintenance. These reallocations increase General Fund resources by $750,000, and eliminate the structural deficits.

The reduction in allocation to CIP will not have a significant impact on addressing deferred maintenance. Sufficient resources are already budgeted and are aligned with staffing resources proposed.

The five year forecast (Attachment #5) has been updated for FY 2017-18 through FY 2021-22, and includes the reallocations described above. As presented, the General Fund has surpluses ranging from a low of $110,144 to a high of $665,639 over the five-year period. It is important to note that while the deficits are addressed, the subsidies from the General Fund to Storm Water, and Street Lighting and Landscaping Districts, continue to draw down General Fund balances. This includes the use of Economic Uncertainty reserves beginning in FY 18/19 (which are depleted by FY 21/22), and draws against the City Council policy designation of 20% of expenditures starting in FY 21/22.

<u>Ambulance Operator Program</u>
Also included in this budget is expansion of the Fire Department ambulance operator program with no net effect on the budget. Expenditure increases of $115,720 are offset by revenues of $115,720, the latter of which is a conservative estimate.

The program is in the process of being revamped to provide consistent, reliable basic life support ambulance transportation services utilizing paid part time staffing. This replaces the prior method of utilizing Fire Department reserves which, due to the nature of the work and limited shifts, did not provide the staffing stability needed to successfully run the program. This is a revenue-generating program that relies on staffing availability to operate.

Using Ambulance Operators to transport residents with non-acute medical needs to a local hospital keeps paramedic resources available for life threating emergencies. Using a basic life support ambulance to transport a person to the nearest emergency room can, at a minimum, tie-up the ambulance for 2 hours. Not only will the paramedics be available for advanced life support medical emergencies, but are part of our effective firefighting resources for non-medical emergencies. Lastly, with the potential for Hermosa Beach contracting services to Los Angeles County Fire Department, this is a resource that will be necessary to maintain current service levels.

<u>Crossing Guards</u>
The City received a request for two additional crossing guards. The City Traffic Engineer reviewed the request and opined that the additions are justified based on a ranking system and statewide crossing guard guidelines. On March 23, 2017, the PPIC recommended approval of two additional adult crossing guards at the intersections of Pacific Avenue/17th Street and Rowell Avenue/Gates Avenue. The cost of the added guards is $36,000 per year through an existing contract.

<u>Reinstatement of Equipment Mechanic Position (Fleet Fund)</u>
The Public Works Department previously had three full time Equipment Mechanics. One of the positions was held by an employee who was out on a long term work-related injury. During that time the department utilized a temporary employee to maintain service levels. After the injured employee retired, the City eliminated the third full time position in FY11-12. However, the need for additional

mechanic services did not dissipate as the equipment/fleet count/work load was not reduced. As a result, the department consistently used long term temporary employees to help meet the needs of the Fleet Division. In order to meet federal and state regulations, including CalPERS, as well as meet workload, staff is recommending that the contract employee be converted/reinstated to a full time employee.

The estimated budget adjustment necessary to effect this change is $33,438 in the Fleet Fund. However, the new rate from the temporary agency for 2017 indicates that the actual difference between continuing with temporary labor versus a full time employee is $16,700 annually.

The balance of the adjustments, which are considered technical in nature, are listed on Attachment #4. These include adjustments to revenues and expenditures based on trends, additional one time capital purchases, carryforwards (re-budgeting) of prior year projects yet to be completed, and changes to the CIP Plan as proposed by the Public Works department.

Other notable proposed budget adjustments:

- A one-time assessment from the South Bay Regional Public Communications Authority to replace the 9-1-1 dispatch software system ($238,648)
- The addition of revenue from Measure M transportation funding from a voter approved sales tax increase ($415,899)
- A reduction in contributions to the City's Other Post Employment Benefits (OPEB) trust fund ($264,660 across all funds) due to the overfunded (160%) status. No contributions are required at this time.
- The one-time purchase of a replacement kiln for the Parks and Recreation ceramics program for $45,000

Pension Costs

Chief among the issues for the City are retirement system costs. For FY 2016-2017, the City budgeted $6.2 million (an increase of $662,044 from FY 15-16) to provide employees with defined benefit pension plans through the California Public Employees' Retirement System (CalPERS). In the second year (FY 17-18), the budget increases by $673,934 to $6.9 million for these benefits.

In FY 2014-2015 the City hired an independent actuary to review and project rates beyond what CalPERS provides. This is a distinctive and progressive action to take as most agencies simply rely on the more dated and short-term analysis regularly provided by CalPERS. Using long-term actuarial analysis results in more accurate planning farther on the horizon.

Recently, the actuary updated projections given recent CalPERS phased reductions in the discount rate (the assumed rate of return on invested funds) from 7.5% to 7% over three years, investment policy changes, and the less-than-adequate investment returns achieved the last two years. Please note that these new projections have been incorporated into the revised five year forecast provided with this report. The actuary, John Bartel, will present information on the new rate projections at the May 4th City Council Budget Study Session.

Investment returns in FY 2014-2015 (2.4%) and FY 2015-2016 (0.61%) fall well below the current assumed 7.5% rate of return, further exacerbating the funding of pensions. Coupled with the policy changes above, City contributions will be increasing dramatically. For Manhattan Beach, contributions are expected to rise from $6.9 million in FY 2017-2018 to up to $12.0 million by FY 2021-2022. Fortunately, our five year forecast indicates the ability to absorb these increases, however, clearly these additional costs crowd-out the ability to enhance service levels or fund other priorities.

Street Lighting and Landscaping Districts
At the April 4th City Council meeting, in response to the commencement of annual renewal of the Street Lighting and Landscaping District assessments for FY 2017-2018, Councilmember Napolitano requested that staff review costs of the districts to ensure that they are as low as possible, this in advance of any possible discussion on raising assessments which have remained unchanged since 1996. A review of the data from FY 2016-2017 indicates the following:

- Revenues across all districts total $396,139 from assessments
- Expenditures total $619,794
    - Energy costs alone from electricity and gas total $404,154 (102% of total revenue)
    - 63% of district costs are for electricity and natural gas used to power the lighting
    - Contract Services make up 23% of total costs (mainly in the Downtown Streetscape zone) and include:
        - Power washing the downtown district - $60,900
        - Landscape maintenance downtown - $61,660
        - Contract electrician for maintenance and repairs ($8,200)
        - The annual assessment report required to renew the districts ($7,000)
    - City overhead costs (admin fee and fleet costs) total $58,339 (9% of total district costs). Please note that the most recent cost allocation plan from 2015 reduced the administrative fee by $34,097.

The districts as a whole have run a deficit since 2007. Once available fund balances were depleted in 2009, the General Fund began subsidizing the activities, which now cumulatively total $1.76 million. Broken out by district, the FY 2016-2017 subsidies total $207,408:

General Street Lighting - $84,471
Downtown Streetscape - $54,558
Gas Lamp - $38,042
Strand Lighting - $20,733
Arbolado Tract - $5,175
Walkstreets - $4,429

As the City reviews cost associated with these districts, staff believes there is limited ability to reduce costs without affecting service levels. However, one opportunity that is being pursued is an audit of energy costs. Earlier this year, staff issued an RFP and contracted with a utility audit firm to ensure that the City is charged appropriate electricity, natural gas and other utility rates, not just in the lighting districts, but for all City paid utility bills. This may result in further changes in the costing structure of the districts. The audit is scheduled to be completed by August 2017.

Asset Forfeiture
Last year's approval of the FY 2017-2018 budget included the lease/purchase of new mobile radios for the Police and Fire Departments in order to take advantage of new interoperability features being deployed through the RCC. The Police Department's share of the radios are to be purchased mainly through Asset Forfeiture funds.

The budget assumed a certain revenue stream from forfeitures to support the lease/purchase. However, for budgeting purposes, the City may not assume such revenues. As a result, the Asset Forfeiture Fund is presented as having a negative fund balance starting in FY 18-19 in the five year forecast. Staff is searching for grant opportunities for these radios (including the Fire Department portion). Any purchase of radios is predicated upon sufficient funding sources, budgeted or otherwise.

Five Year Forecast
Each year as the budget is prepared, staff updates the Five Year Forecast for all funds. This document is invaluable in determining affordability of programs and services, and in spotting the effects of developing trends.

The FY 2017-2018 to FY 2021-2022 forecast includes certain assumptions on revenue and expenditure growth as determined on a line item by line item basis. The current forecast assumptions are included with Attachment #5.

The forecast presented with this report illustrates:

- The General Fund is balanced over the next five years with surpluses ranging from $432,202 to $3,854
- The General Fund balance is reduced by $7,431,791 million over the next five years due to subsidies and transfers
- Those subsidies and transfers will result in the Economic Uncertainty Reserve being depleted by FY 2021-2022, with the Financial Policy reserve being tapped into that same year
- The Storm Water Fund is being subsidized by the General Fund for $6,609,582 million from 2017-2018 through 2021-2022
- Street Lighting and Landscaping will receive $1,165,765 from the General Fund over that same timeframe
- CalPERS contributions, while funded from on-going revenues, will nearly double to $12 million by FY 2021-2022
- The City's ability to fund any significant general capital improvements is limited by year-end General Fund surpluses (which historically were transferred to the CIP Fund) and lack of available General Funds
- The Parking Fund generates only enough revenue to pay for operational expenses and debt service; there is insufficient funding for any capital improvements or major maintenance projects
- With significant progress on water and wastewater projects expected, and the concomitant use of fund balances to effect the construction, the current rate structures (adopted in 2009) need to be reviewed for sufficiency vis-à-vis the next round of system maintenance and improvements
- Workers Compensation costs continue to grow. While recent cost reductions from changing

risk pools are beneficial, further General Fund support to the Insurance Fund may be necessary to ensure sufficient funding if claims trends continue

These issues and trends point to the need for a comprehensive long range financial plan.

FINANCIAL PLANNING
The City has enjoyed a long history of fiscal stability. General Fund budgets have been balanced with year-end surpluses. Reserves have been retained and grown. Debt levels are low, and the City continues to maintain its Triple-A credit rating, which was recently reaffirmed by Standard & Poor's in 2016 under new, more stringent criteria. At the same time, the City has been able to support programs and services to meet the needs of the community while controlling costs. The City's positive fiscal position is a direct result of thoughtful and deliberate actions of past and present City Council's to support the City's financial wellbeing.

However, the City's fiscal future is in need of immediate and proactive City Council action. A list of the funding issues to be addressed include:

- Pension Costs
- General Fund Subsidies of the Storm Water (Enterprise Fund)
- General Fund Subsidies of Street Lighting and Landscape District (Special Revenue Fund)
- Parking Operations and Facilities
- General Infrastructure and Capital Improvements
- Water and Wastewater Rates
- Measure R Support of Proposition A
- School District Support
- Workers Compensation/Insurance Fund

Staff understands that solutions to these issues may come from identifying acceptable cost savings as a first step. In fact, searching and identifying efficiencies and cost savings is standard protocol for all departments (Attachment #10 is a list of recent efficiency measures by department). Cost savings must also be weighed against service level reductions to determine the desirability of the outcome.

Solutions may also include the need to seek new revenues. For example, as described above, Street Lighting rates have not increased since 1996. The revenues in all districts are insufficient to cover even the energy costs associated with the lighting. Cutting costs may result in unacceptable service levels, and will likely not be sufficient to correct the imbalance. As a result, additional resources may be necessary to maintain acceptable service levels.

This list of issues requires crafting a coordinated and comprehensive financial plan that fully identifies and vets the issues, presents potential solutions (on both the expenditure and revenue sides) and remedial processes, and assigns a timetable for completion. To that end, staff recommends that the City Council consider adding a comprehensive long range financial plan as a work plan item for the coming year. Further consideration may be given to assigning oversight of the development of the plan to the Finance Subcommittee, with a final report being provided to the full City Council.

Historical Staffing Levels

Attachments #8 and #9 to this report provide a 12-year perspective on the General Fund budget by department. It includes salaries and benefits information as well as headcount by department. A listing of the positions added and deleted is also included. This will be reviewed at the May 4th City Council meeting.

PUBLIC OUTREACH/INTEREST:
After analysis, staff determined that public outreach was not required for this issue.

ENVIRONMENTAL REVIEW
Not applicable.

LEGAL REVIEW
The City Attorney has reviewed this report and determined that no additional legal analysis is necessary.

Attachments:
1. FY 2016-17 General Fund Year-End Estimates
2. FY 2017-18 General Fund Proposed Budget
3. FY 2017-18 All Funds Comparison
4. FY 2017-18 Budget Amendment Requests
5. Five Year Forecast
6. P&R Profit and Loss Estimates for FY 2017-2018
7. General Fund Budget History
8. General Fund History - Salaries & Benefits
9. History of Position Changes
10. Departmental Efficiencies
11. City Council Staff Report (Due to the large number of pages for this particular staff report, this is an alternative option to review the complete staff report. This attachment is only available online.)