June 12, 2018

Honorable Mayor and Councilmembers:

FINANCIAL PLAN / 5 YEAR FORECAST

Note: This plan was presented to the City Council on June 6, 2018 and all recommendations were approved except for increases to restaurant encroachment fees and parking citation fines which will come back separately for more review.

PURPOSE

The financial plan is intended to incorporate analysis, forecasting, strategies, policies, and recommendations into one document that provides guidelines and goals for the financial management of the city.

COMPONENTS OF THE PLAN

Components of the plan are:

- Analysis of Economic and Financial Environment
- Five Year Forecast
- Debt Analysis
- Financial Strategies
- Financial Policies
- Recommendations

Financial indicators will be added to the plan in the future.

ANALYSIS OF ECONOMIC AND FINANCIAL ENVIRONMENT

As reflected in the following chart of economic measures, median home prices continue the upward trend across the board at the national, state, and city levels. Southern California median home prices hit an all-time high of $519,999 in March 2018 according to the Los Angeles Times. Unemployment is at historical lows, with the U.S. unemployment rate at its lowest level since December 2000 and California at a record low since 1976 (when the state started tracking data consistently). Hotel occupancy continues to remain strong, with occupancy rates through January 2018 consistent with the prior year. The economic expansion has lasted 95 months and is the third longest in U.S. history. According to Goldman Sachs, there is a two-thirds chance that this recovery will be the longest on record.

Comparative Economic Measures

Measure	U.S. 2018	U.S. 2017	Los Angeles 2018	Los Angeles 2017	Hermosa Beach 2018	Hermosa Beach 2017
Unemployment March	4.1% [1]	4.5% [1]	4.3% [1]	4.7% [1]	1.9% [1]	2.1% [1]
Median Home Price - Thru March	$252,100 [2]	$238,000 [2]	$585,000 [3]	$549,000 [4]	$1,927,000 [3]	$1,390,000 [4]
Hotel Occupancy Rate (Jul Thru Jan)			81% [5]	82% [5]	80% [6]	80% [6]
Consumer Price Index - All Urban Consumers - March	2.4 [7]	2.4 [8]	3.8 [7]	2.7 [8]		

A brief overview of the 2018-19 Preliminary Budget for the General Fund is included for context within this document.

The 2018-19 budget reflects the policy of maintaining a contingency or “rainy day fund” of 16% of operating expenditures, or $6.1 million. This is a best practice recommended by the Government Finance Officers Association (GFOA) and an adopted city financial policy.

The 2018-19 Budget reflects the first full year of providing a higher level of Fire Service with the conversion to Los Angeles County Fire. The 2017-18 Forecast predicted a tight year for 2018-19 which does turn out to be the case, with a slight increase in revenue and some increases in expenditures which are noted hereafter.

Revenue. Revenue in the General Fund shows an increase of less than 1%. The change in budget estimates for some of the largest revenue sources are shown below:

Largest Revenue Source
2018-19

Revenue	Change
Secured Property Tax	5%
Sales Tax	2.5%
Utility User Tax	-2%
Transient Occupancy Tax	0%
Property Tax In Lieu of VLF	5%
Licenses and Permits	-10%*
Fines and Forfeitures	3%
Service Charges	-6%

* Due to anticipated decline in building and plumbing permits and uncertainty in taxi franchise revenue.

Expenditures. Expenditures in the General Fund increased by 1.7%, or 6.4% without Capital Improvements. Personnel costs represent 57% of expenditures in the General Fund. While there appears to be a 4% decrease in personnel costs, this is a result of transitioning the sworn Fire personnel from City to Los Angeles County employment that took place December 30, 2017. The Fire Department personnel costs were replaced with ongoing contract services and legacy City Fire Department costs, including California Public Employees’ Retirement System (CalPERS) and Other Post-Employment Benefits (OPEB) unfunded liabilities.

The 2018-19 Budget converted the full-time temporary Public Works Inspector to full-time permanent and is cost neutral. The part-time temporary Code Enforcement Officer was removed and consulting services to augment planning staff was funded instead. Salary increases of 2 or 2.5% are included for all salary groups as a part of the final year of 3-year Memorandums of Understanding (MOUs) with all labor groups. Additionally, step increases for employees with less than five years of service are also included.

Employee benefit estimates include a conservative 12% increase in health insurance effective January 1, 2019. Retirement costs increase by 11% without Fire primarily due to the December 2016 CalPERS Board decision to change the discount rate from 7.50% to 7% over 3 years. Further information regarding these factors will be provided later in the forecast.

Recommendation

CalPERS allows for the prepayment of the annual unfunded liability payment each year. The City took advantage of the 3.55% savings ($116,610) in 2017-18 by paying the unfunded liability in one lump sum payment for the Police and Miscellaneous plans, instead of making monthly payments. The City will also save 3.5% ($146,926) by prepaying in 2018-19 which is reflected in the amount budgeted. It is recommended that the practice of evaluating prepayment of retirement contributions annually to determine if there are savings be added to our Financial Policies.

Private contract services increase 5% due to additional porter and scrubbing services for downtown and a full year of the ambulance services contract (services with McCormick commenced December 30, 2017).

Capital Improvements. New capital funding of $200,000 is set aside for Capital Improvement Projects.

FIVE-YEAR FORECAST
2019-20 THROUGH 2023-24

Forecast Assumptions
Largest Revenue Sources
2019-20 Through 2023-24

Revenue	Change
Secured Property Tax	3.7%
Sales Tax	2%
Utility User Tax	0%
Transient Occupancy Tax	1%
Property Tax In Lieu of VLF	3.7%
Licenses and Permits	-23.2%*
Fines and Forfeitures	0%
Service Charges	1.5%*

* Due to the fluctuation in building permits and plan check fees, a 5 year average was used in place of the 2018-19 budgeted revenue.

The five-year forecast focuses on the General Fund since the majority of the city's operating expenses are paid from this fund.

Secured Property tax and Property Tax in Lieu of Vehicle License Fees are assumed to increase at the 3.7% per year in the five year forecast. Since transient occupancy tax and sales tax are projected at the highest revenue level ever, a conservative 1% and 2% increase respectively is assumed in the forecast for those sources. Licenses and Permits and Service Charges were adjusted to reflect a 5 year average for building permit revenue and plan check fees due to the varying fluctuations that occur from year to year due to projects. These assumptions result in a conservative revenue forecast of 1.7% average growth per year.

Expenditure Assumptions used in the forecast:

- Salaries include the 2 to 2.5% salary increases negotiated for 2018-19 as a part of the 3-year MOUs ending 6/30/2019. For illustrative purposes, 2% is included for 2019-20 through 2023-204.

- Employee benefits include a projected 10% annual increase. Annual rate increases have historically been lower.

- Contract services - A 3% annual COLA is assumed for contracts, with the exception of the following contracts:

    - McCormick Ambulance services contract is increased according to the annual per transport costs in the contract (assuming 620 transports a year).

    - LA County Fire contract is assumed at a 4% annual increase, which is the annual fee limitation for the first 5 years of the contract.

    - The South Bay Regional Public Communications Authority contract for Police dispatching increased by 56% overall. The increase is spread over 5 years at $78,837 per year for years 1-4 of the forecast and capped at 5% thereafter.

- Election costs of $60,000 were included for years 2019-20 and 2022-23, when the City transitions to holding its elections on a statewide election date.

- No Retirement Stabilization funds were used to balance any of the forecast years. The balance is $1,000,000. A recommendation for these funds to be put into a Retirement Trust is included later in the financial plan.

- Our goal of setting aside 16% of operating expenditures in the General Fund for Contingencies is included for each year. This contingency amount serves as the City's "Rainy Day Fund" and is a best practice.

- The transfer from the General Fund of utility user tax revenue to the Storm Drain Fund is constant at $700,000, to be used to cover ongoing needs. The transfer of almost $800,000 to the debt service fund for the 2015 Lease Revenue Bond payments is also budgeted annually.

- Hermosa Beach implemented second tier retirement plans as of July 2011. The City also has a third tier which resulted from the Public Employees' Pension Reform Act (PEPRA) effective 1/1/13.

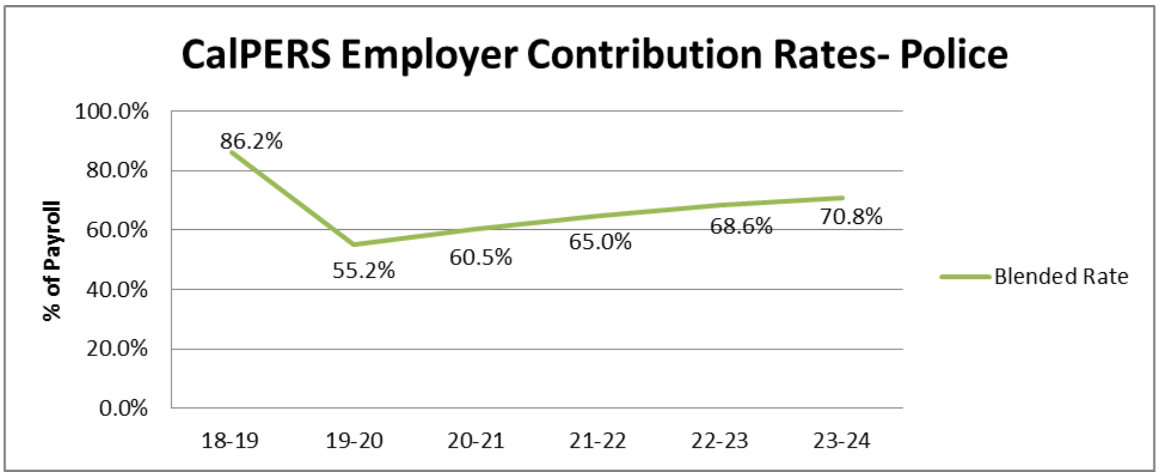
RETIREMENT PLANS

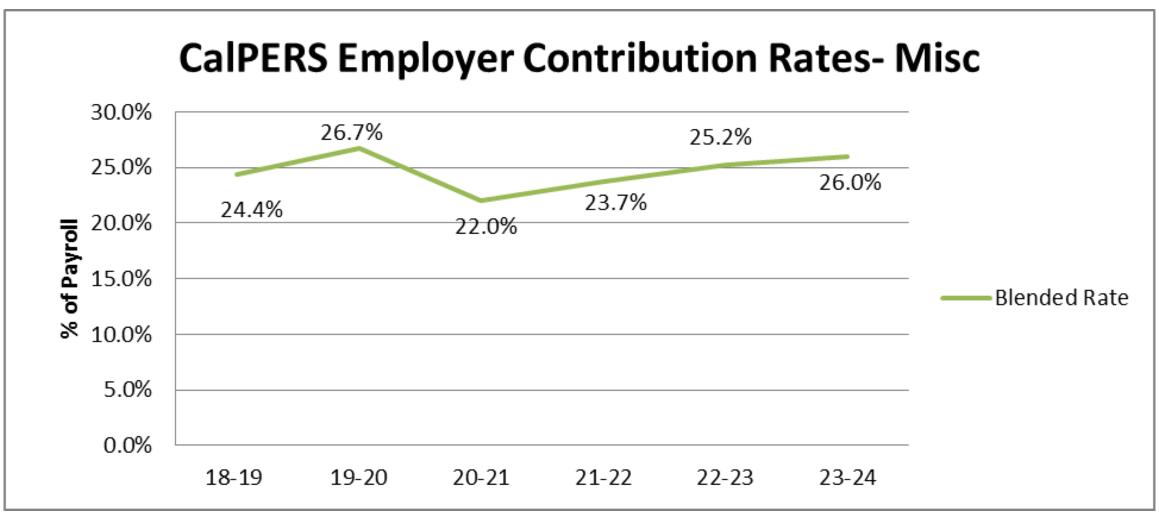
Group	Tier 1 Plan	Tier 2 Plan	PEPRA Plan
Police	3% @ 50	2% @ 50	2.7% @ 57
Fire	3% @ 55	2% @ 50	2.7% @ 57
Miscellaneous	2% @ 55	2% @ 60	2% @ 62

The CalPERS Board voted to lower the discount rate from 7.50% to 7% in December 2016. The change will be implemented over a 3 year period beginning in 2018-19. Lowering the discount rate (also known as the assumed rate of investment return) means that employers will see increases in the contribution rates and higher payment for unfunded liabilities. The City of Hermosa Beach is fortunate in that our rates will actually be decreasing in the short term as will be explained below.

The contribution rate charts on the next page shows the blended rates for all tiers. The expected rates for the forecast were projected by an independent actuary in April 2018 since CalPERS only provide rates for 2018-19 and projected rates for two years thereafter.

The drop in 2019-20 shown in the following graphs for Police and Miscellaneous reflects the payoff of the Police Group Side Fund (which is the liability that existed in 2003 when CalPERS "pooled" our plans with other cities of similar size). After the Police Side Fund pays off in 2018-19, there is a projected drop in rates of 31 percentage points. The Miscellaneous Group Side Fund also pays off in 2019-20, resulting in a projected drop of 4.7 percentage points in 2020-21. A recommendation regarding the utilization of the savings from this drop in rates follows later in this plan.

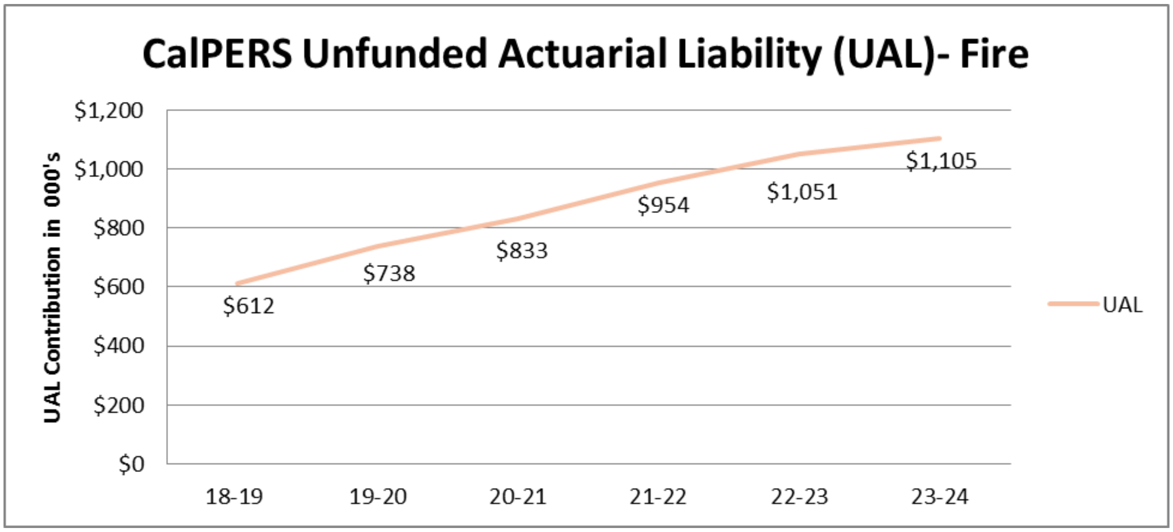




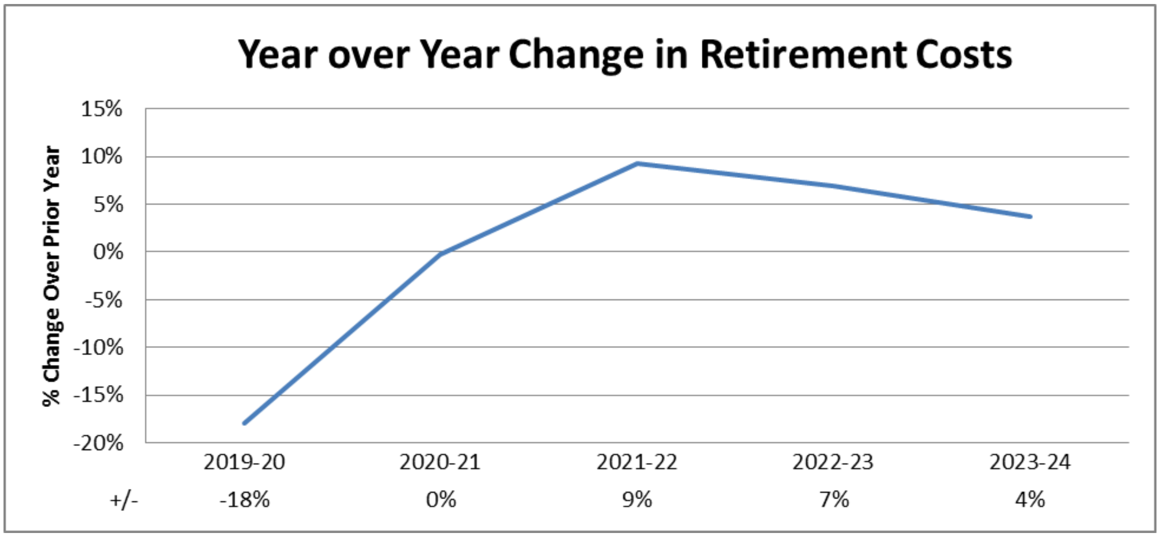
Now that the Fire Department has transitioned to the County, the City will only be responsible for paying the Fire Department's retirement costs related to the value of past service benefits, referred to as the unfunded actuarial liability (UAL). The "normal cost" portion of the retirement costs, which relate to the current service benefits, ended as of 12/30/17. CalPERS requires inactive plans to amortize the unfunded liability as a level dollar payment rather than as a percentage of payroll, which the City will request to start early in 2018-19. The following graph

Correction

assumes that the UAL for Fire is converted to level dollar payments starting in 2018-19, which is an update from the preliminary budget. The preliminary budget assumed paying the unfunded liability of $466,772 and setting aside $200,000 for a retirement trust contribution. The actuary recommended moving to a level dollar payment of $612,000 in 18-19. The difference of $54,772 will be placed in Prospective Expenditures. This is a change that will be made in the Final Budget. Payments will still be impacted by other assumptions, such as the lowering of the discount rate referenced earlier. This means that even though it is called "level dollar amount" the amount will fluctuate due to CalPERS investment earnings and other changes.



Based on the actuarial report referenced earlier, the overall decrease in retirement costs as shown below is 18% for the first year of the forecast due to the Police Side Fund payoff. Year 2 shows a decrease of less than 1% over Year 1 due to the Miscellaneous Side Fund payoff. Years 3, 4, and 5 show increases of 9%, 7%, and 4% respectively. The City is very fortunate that the side funds are paying off (thereby reducing our rates) at the same time as CalPERS is lowering their discount rate (which increases rates).



DEBT ANALYSIS

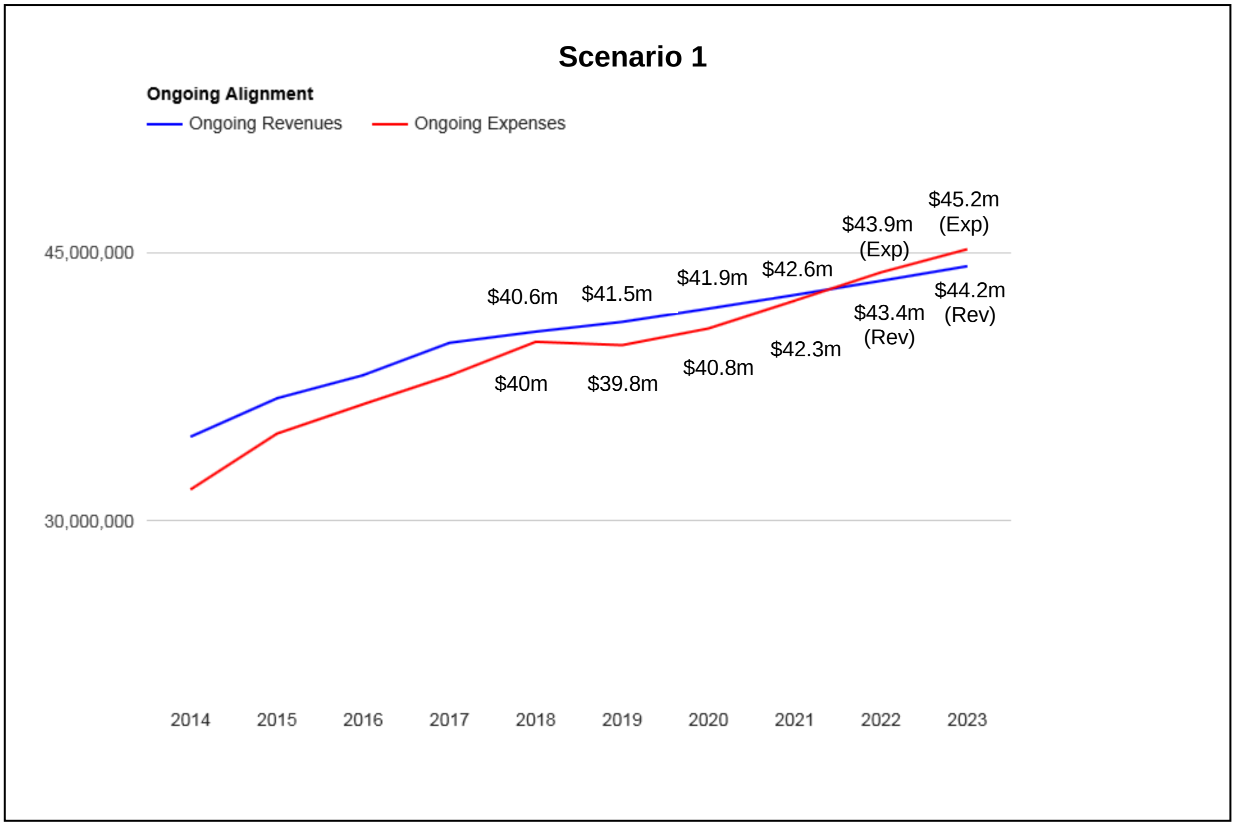
The City's legal debt margin according to State law and City policy is shown below. The State Government Code provides for a legal debt limit of 15% of gross assessed valuation. The City's adopted policy reflects a more conservative margin of 2%. This limit is a policy adopted by the City Council and may be changed by the City Council based on the ability to support debt payments.

With issuance of the revenue bonds in 2015 for the Oil Settlement, debt is at 35% of the adopted policy. Even though it appears that we have reasonable margin for issuance of debt, with our revenue and expenses as tight as they are right now, it would not be advisable to issue debt at this time.

Legal Debt Margin Fiscal Year Ended 6/30/17	
Assessed Valuation	$6,593,783,921
Conversion Percentage[9]	25%
Adjusted Assessed Valuation	$1,648,445,980
Legal Debt Limit Percentage	15%
Legal Debt Limit	$247,266,897
City's Established Debt Limit Percentage	2%
City's Debt Limit Margin	$32,968,919
Issued Debt	$11,600,000
Total Debt as Percentage of Debt Limit	35%
Remaining Debt Limit Margin	$21,368,919
Total Remaining Debt Limit as Percentage	65%

Fiscal Health Model

The following graphs were generated using the Fiscal Health Model from the International City/County Management Association's (ICMA) Center for Performance Based Budgeting. In this system, the year listed is the start of the fiscal year. For example, 2018 is 2018-19 (we typically refer to this fiscal year as 2019, not 2018). Actual (historic) revenue and expenditures are used for years 2012-2016. Year 2017 uses the midyear budget numbers and year 2018 uses the preliminary budget for 2018-19. Years 2019-2022 are projections based on the preliminary budget and assumptions outlined in the 5-Year Forecast earlier.



Scenario 1. The model is used to generate various scenarios, building upon the 2018-19 Budget which includes the previously outlined assumptions. Scenario 1 depicts the revenue and expense assumptions with the exception that the Fiscal Health Model sorts ongoing from one time revenue and expenses and includes only ongoing in the model. The average expenditure growth of 2.5% outpaces the revenue growth of 1.7%, resulting in expenditures above revenue of almost $500,000 and $1 million respectively in years 4 and 5 of the forecast.

FINANCIAL STRATEGIES

Master Plans for Sewer, Storm Water and Pavement Management. Master plans for sewer, storm water and pavement management (streets) were presented to Council in October 2017.

Sewer. With adoption of a sewer fee, effective 7/1/15, the City now has a stable funding source available for sewer improvements. The Master Plan provided an estimated cost analysis of $14,439,500 to address sewer line and manhole rehabilitation. $1,260,000 is budgeted for 2018-19, with the same amount shown annually in the 3-Year CIP Plan. Projects will be designed following the highest priorities identified in the master plan and in coordination with planned street projects.

Storm Drain. Prior to adoption of the sewer fee, $700,000 was transferred annually from Utility User Tax (UUT) revenue in the General Fund to the Sewer Fund. Those funds are now transferred to the Storm Drain Fund and are the only source of revenue for this purpose. The Master Plan identifies $2,530,000 in high priority storm drain capital improvements. $645,090 is budgeted in 2018-19, with $640,000 shown annually in the 3-Year CIP Plan.

Pavement Management Plan (Streets). The Pavement Management Plan (PMP) concluded that the average citywide street network Pavement Condition Index (PCI) for Hermosa Beach is 70 and the average PCI for neighborhood streets is 64. The target

PCI adopted by City Council is 81. The PMP estimated a 10 year period to achieve the PCI level of 81. $2,300,000 is budgeted for 2018-19 from a variety of funding sources, with $1,340,000 shown annually in the 3-Year CIP Plan.

Public Works is able to calculate and track improvement in the PCI after street projects are complete so progress toward the target CPI of 81 will be known.

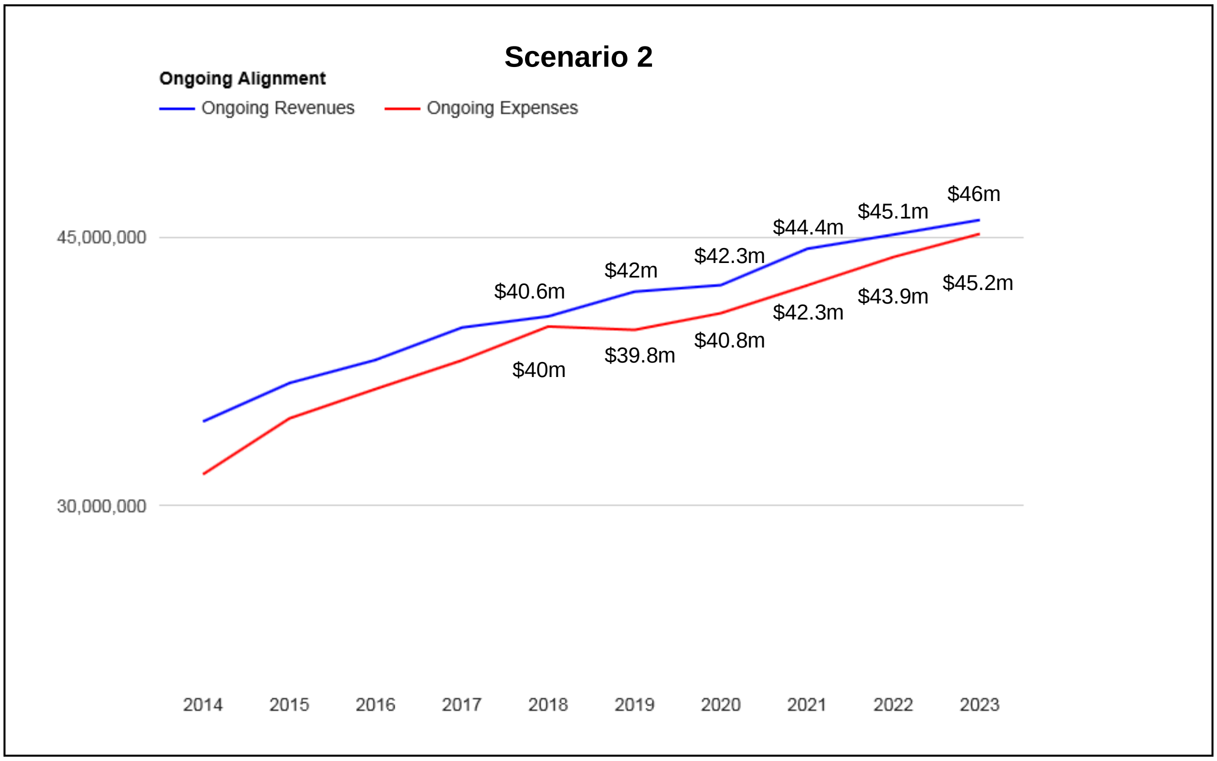
Review of Potential New Developments. New developments in progress or on the drawing board are shown in the table below. The revenue estimates are very conservative and timeframes for completion are tentative. The inclusion of new developments is intended to show the potential of opportunities that are on the near and longer term horizon. The inclusion is not intended to suggest that funds should be allocated at this time.

REVENUE FROM POTENTIAL FUTURE DEVELOPMENTS

Potential Developments	1 year 2019-20	2 years 2020-21	3 years 2021-22	4 years 2022-23	5 years 2023-24
Skechers			$100,000	$100,000	$100,000
Undersea Cable - RTI					
Annual Payment -2nd Cable	$264,000	$72,000	$72,000	$72,000	$72,000
Annual Payment - 3rd Cable	$253,000	$69,000	$69,000	$69,000	$69,000
H_2O Hotel					
TOT	$274,955	$274,955	$274,955	$274,955	$274,955
Property Tax	$42,630	$42,630	$42,630	$42,630	$42,630
Pier/Strand Hotel					
TOT/Sales Tax			$1,067,625	$1,067,625	$1,067,625
Property Tax			$101,500	$101,500	$101,500
Total	**$834,585**	**$458,585**	**$1,727,710**	**$1,727,710**	**$1,727,710**

Assumptions:

- **Skechers**- $100,000, based on developer estimates, moved out to 2020-21.
- **Undersea Cable-** 2nd Cable Q1 2020 and 3rd Cable Q3 2020.
- **H_2O-** Hotel with 30 rooms, rates less than Beach House. 24 months to completion. TOT (30 rooms x $279 room rate x 12% TOT x 365 days x 75% occupancy). Property tax on estimated improvements of $21 million- $42,630.
- **Pier/Strand Hotel**- Hotel with 100 rooms, rates higher than Beach House. 3 years to completion. TOT (100 rooms x $325 room rate x 12% TOT x 365 days x 75% occupancy). Property tax on estimated improvements of $50 million- $101,500. Property tax on estimated improvements of $50 million- $101,500



Scenario 2 builds on Scenario 1 and illustrates the possible impact of the future development assumptions listed above. With the future development assumptions, revenue exceeds expenditures for all 5 years of the forecast.

Potential Revenue Increases

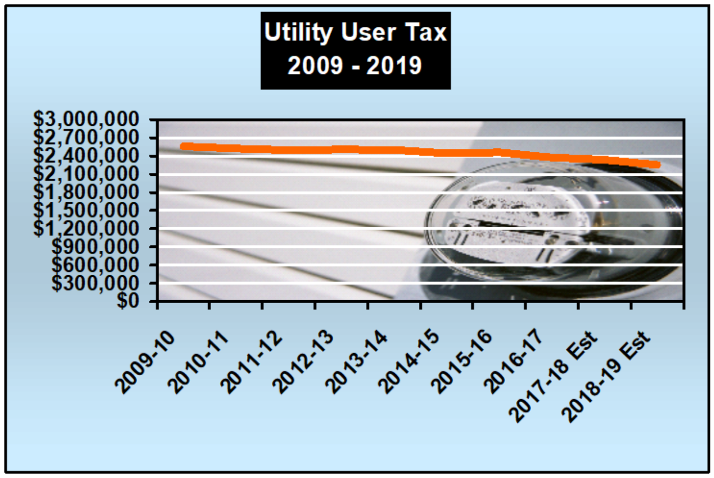
Short Term Vacation Rentals. Community Development Staff intends to return to City Council with options for allowing/regulating short term vacation rentals in existing non-conforming residential uses located in commercial zones.

Parking. Through our Coastal Zone Parking Study, the City and consultant team is taking a holistic look at how we efficiently manage parking resources in the City to serve the needs of the community. The scope of the policy/program is beyond simply looking at rates/revenues, but to look at a range of recommendations related to the following topics:

- Residential Parking Permits
- Employee Parking Permits
- Downtown/Coastal Street Meters (including parking meter upgrades and demand-based pricing)
- Coastal Zone Non-Metered
- Public Parking Lots/Structures (including parking meter upgrades and demand-based pricing)
- Off-Street Parking Requirements for Commercial Development
- Off-Street Parking Requirements for Residential Development
- Other Mobility Initiatives/Technology Disruptors

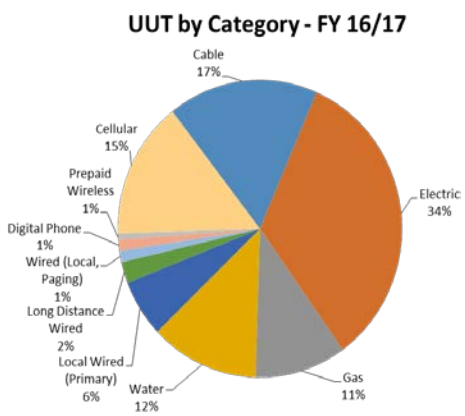
Staff is still in the early phases of data analysis, and there will be thorough community engagement before we bring forward recommendations to any of the City's commissions and City Council. We anticipate engagement happening in the summer/early fall, with some initial draft recommendations coming forward before the end of the calendar year.

UUT Erosion. The erosion in the UUT has been gradual at -4%, -2%, 0%, -2%, 0% for the past five years. In discussing the erosion with our UUT consultant, MuniServices, short of increasing the tax rate, there is not much that can be done to stop the erosion for telecom and cable. Telecom is largely driven by increased competition among providers which is driving down rates. On the cable side, cord-cutting and newer technologies is driving down the number of subscribers and driving down rates. Tax on electric, water and gas fluctuate with rate increases and conservation efforts. Hermosa Beach's experience is shared by most cities that have a UUT. In a year over year analysis for 2016-17 provided by MuniServices, Hermosa Beach shows similar and sometimes better results as compared to the 32 cities in the analysis. (Their analysis does not include water.)



Year over Year Results
Hermosa Beach vs. 32 Client Cities

UUT Category	Average of 32 Cities	Hermosa Beach
Video (Cable)	-1.49%	9.23%
Wireless Telecom	-2.08%	-8.45%
Wired Telecom	-5.48%	-9.91%
Electricity	-5.15%	-4.70%
Gas	8.70%	13.04%



TOT, Online Travel Companies. Our TOT consulting firm, MuniServices, is conducting an audit of five of our nine hotels. As part of the audit, they will be specifically reviewing revenue and bookings from online travel companies associated with each hotel. Staff expects to receive their findings in June.

Restaurant Encroachments. Fees for restaurant encroachments located on Pier Plaza that are open after midnight were increased to $3/square foot in September 2007, with fees increasing to $4 in 2008 and $5 in 2009. Fees for restaurants located on Pier Plaza that close before midnight or restaurants that are not on Pier Plaza. remained at $2. Fees for snack shops are $1/per square foot. A few businesses use the encroachments less than full time and a few are open after midnight only during certain months.

Through an appraisal, the market value of the restaurant encroachments is determined based on land value by location (on Pier Plaza or not), and whether the encroachment area is fenced or not. The conclusion was that fenced areas are fairly permanent and benefit only the lessee while non-fenced areas lack privacy and have some public access.

Market value encroachment fees from the appraisal are:

Fenced Encroachment Area	
Pier Plaza	$5.63
Non-Pier Plaza	$4.50

Non-Fenced Encroachment Area	
Pier Plaza	$1.97
Non-Pier Plaza	$1.58

Recommendation

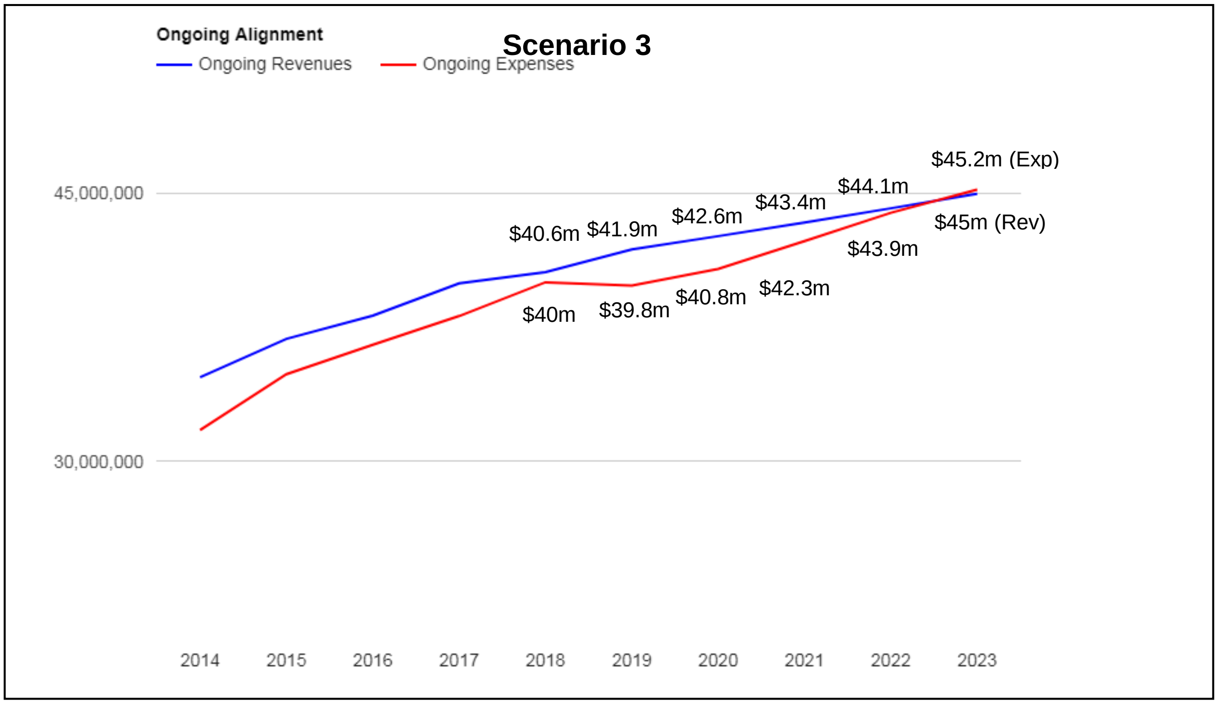
No allowance is made for hours of operation. If the rates are moved to the market rates shown, revenue will be increased by approximately $270,436. Council would have the option to spread the increase over more than one year if desired. A spreadsheet showing existing encroachments rates on the left and appraisal rates on the right is attached.

Recommendation

Parking Citations. A survey of neighboring and other cities that issue parking citations is attached. The survey shows that the fine for street sweeping in Hermosa Beach is low compared with other cities. The average of the cities' fine is $60 while Hermosa Beach is $38. The City of Hermosa Beach issued 13,688 citations for street sweeping in 2016-17. If the Hermosa Beach fine was increased to the same amount as Manhattan Beach, $53, increased revenue would be $205,320. Of course, revenue could be less due to increased compliance, which is the point of the citation.

The survey also includes late fees on parking citations charged by other cities. The late fee for Hermosa Beach has always been $30 and is applied two weeks after a late notice is mailed (typically 35 days). The attached survey shows only one other city, Manhattan Beach, has a similar late fee of $31. The other cities either double the citation amount ($50+) or have more than one late fee. For example, Redondo Beach adds $30 after 40 days, another $30 after another 14 days and another $25 after 20 days. If the late fee for Hermosa Beach was increased by $15, increased revenue would be $230,790. Of course, if citations are paid timely, no increase in revenue would be recognized.

Electric Charging Station Fees. Staff plans to look at cost and usage of charging stations in order to consider developing a fee. This item will come back at a later date.



Scenario 3 builds on Scenario 1 leaving out the impact of new development and illustrates the possible impact of revenue enhancement options: increase to restaurant encroachments, street sweeping violations, and parking citation late fees. Under this scenario, expenditures are short of revenue by only about $200,000 in year 5 of the forecast.

City Facilities Strategic Plan. All city facilities are deficient in terms of space and are in need of renovation. A high-level city facilities strategic plan was presented to City Council in 2016 with an order of magnitude cost model that ranged from $90 million to $135 million, which is unattainable. Plans for the two facilities with the most urgent need are the Corporate Yard and the Fire Station. Funds are reserved in the 2018-19 Preliminary Budget for a new Corporate Yard Facility and Los Angeles County will be renovating the fire station, with costs spread over five years. Funds are available for most of the first two year's payments from the 2% increase in the transient occupancy tax. Recommendations below address a plan to reserve funds on a go-forward basis. Additional revenue sources may need to be considered to fund improvements or replacements to other facilities.

Unspent General Fund at Year End. The City currently has a policy that any funds remaining unspent at year-end in the General Fund transfer equally to the Contingency Fund, Insurance Fund, Equipment Replacement Fund and the Capital Improvement Fund. Transfers may be redirected as the need arises. Funds are typically left at year end in the General Fund due to personnel vacancies/absences/injuries and conservative revenue estimates.

Recommendation

For the past 2 years, funds were transferred to the Insurance Fund to build the balance back to the goal amount of $3 million after payments for the oil settlement and settlement of some long term claims. Previous to that funds transferred to the Capital Improvement Fund. It is recommended that a new Reserve for Capital Facilities be added to the list above with the intent being that if funds are not needed in the Contingency, Insurance Fund or Equipment Replacement Fund, unspent funds would transfer equally to the Capital Improvement Fund and Reserve for Capital Facilities. This would be a start toward putting funds aside for facilities needs.

Historic General Fund Year End Surplus

2012-13	2013-14	2014-15	2015-16	2016-17		Average
$2,805,490	$2,499,592	$2,610,442	$1,457,687	$414,736	*	$1,957,589

* The 2016-17 year end surplus was reduced by $806,472 due to the need to record accured leave payable for Fire Personnel transferring to the County.

History of Transfers from General Fund to Capital Improvement Fund

Transfer	2013-14	2014-15	2015-16	2016-17	2017-18
Year End	$ 2,499,592	$ 2,629,192	$ 1,457,687	$ -	$ -
Mid-Year(Unused Debt Service/Unspecified Contingency)	$ -	$ -	$ 2,160,000	$ -	$ -
Total	$ 2,499,592	$ 2,629,192	$ 3,617,687	$ - [1]	$ - [2]

[1] The 2016-17 year end transfer was directed to the Insurance Fund in order to bring the fund balance to the funding goal.

[2] The 2017-18 year end transfer is recommended to transfer first to the Insurance Fund, then any remaining funds transferred to the Capital Improvement Fund.

Retirement Savings

As discussed earlier, the City has an upcoming opportunity for retirement savings due to the payoff of our side funds for Fire, Police and Miscellaneous employees (as defined by CalPERS). The side fund accounts were created when CalPERS made the decision to pool small cities in the 2003 actuarial valuation. The City's unfunded liability at that time was put into a separate account, with amounts owed amortized over approximately 15 years. The amount has been paid over that time as part of our retirement contribution which is expressed as a % of payroll. The chart below shows projected rates for each group as well as the rate after the side fund pays off. When the rates drop after the side fund is paid off, savings will occur. The city could just pay the lower rates and absorb the savings into the annual budgeting process. The better option, in staff's opinion, is to put the savings toward stabilizing retirement rates since the savings is a one-time occurrence (even though it will occur over a number of years).

PERS Side Fund Payoff and Trust Contribution			
	Misc	**Police**	**Fire***
Last FY with Side Fund Payment	2019-20	2018-19	2017-18
Projected PERS Contribution	26.7%	86.2%	$ 1,080
1st FY without Sidefund	2020-21	2019-20	2018-19
Projected PERS Contribution	22.0%	55.2%	$ 612
Savings Fom Side Fund Pay Off	**4.7%**	**31.0%**	**N/A**
$ Savings From SideFund Pay Off	**$ 330,068**	**$ 1,298,069**	**$ 468,000**
With Supplemental Trust			
Target Contribution Rate	27.5%	73.0%	N/A
Year	2022-23 [1]	2019-20	2022-23 [2]

* Payments are no longer reflected as percentage of payroll due to contracting out fire services. Payments will transition to level dollar payments in 2018-19.

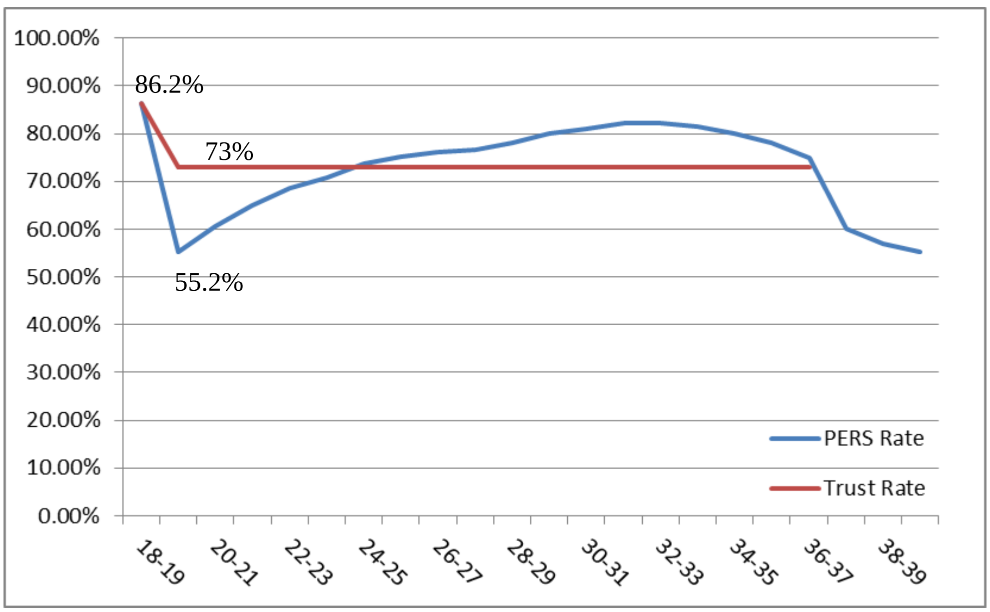
[1] Make additional contribution of 3% years 2020-21 and 2021-22.

[2] Make additional contribution of $200k from years 2019-20 to 2021-22.

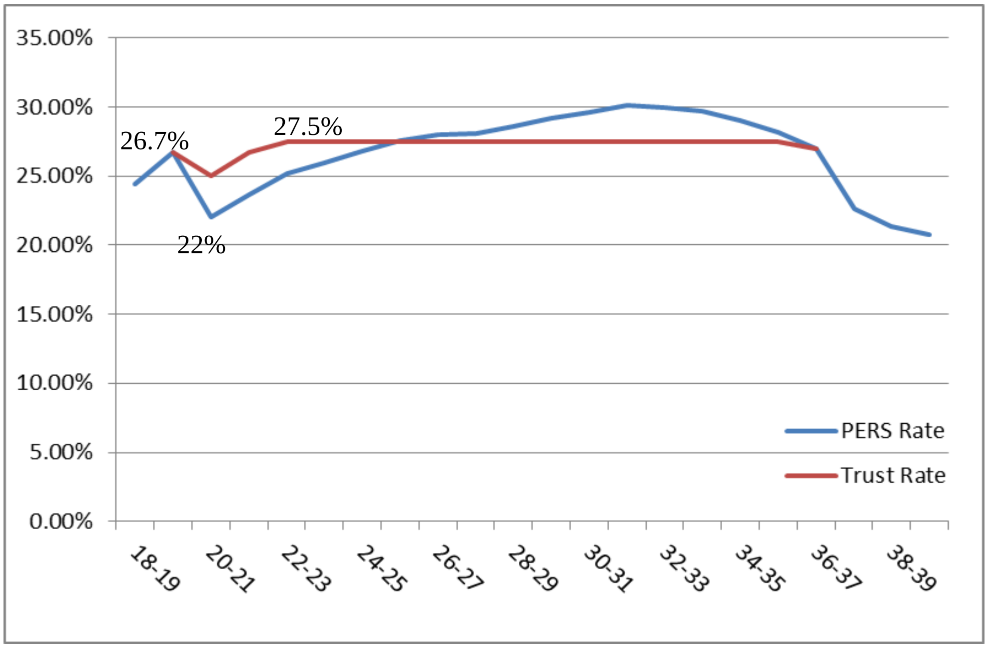
Recommendation

Staff recommends that the City Council approve utilizing the savings toward stabilizing our rates and depositing the funds to a retirement trust. We would accomplish this by continuing to fund our retirement at a higher "target" rate represented by the red line in the following three charts even though our rates have dropped. The table on the previous page and the graphs below show our projected rates at the time the side fund pays off and the target rate that is projected to stabilize our rates. In the graphs below, when contributions rise above the target rate, funds could be withdrawn from the trust to assist in making payments, thereby stabilizing the amount required for retirement. For example, looking at the Police graph below, the rate is 86.2%. Our side fund pays off the next year and the rate drops to 55.2%. Instead of using all that savings for budget purposes, staff is suggesting that we use the target rate of 73% (leaving our contribution rate at 73%) and putting that savings into the trust for use when rates rise. Since we receive actual rates from CalPERS prior to adopting the budget each year, we will know the amount of savings or additional contributions at the time using the actual rates for the upcoming year.

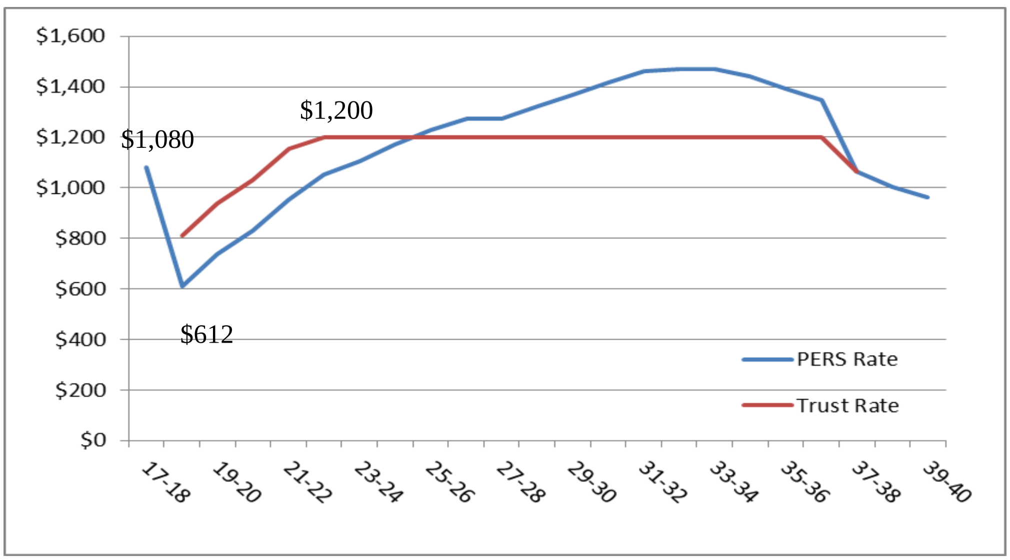
Police Plan Rate Stabilization



Miscellaneous Plan Rate Stabilization



Fire Plan Rate Stabilization



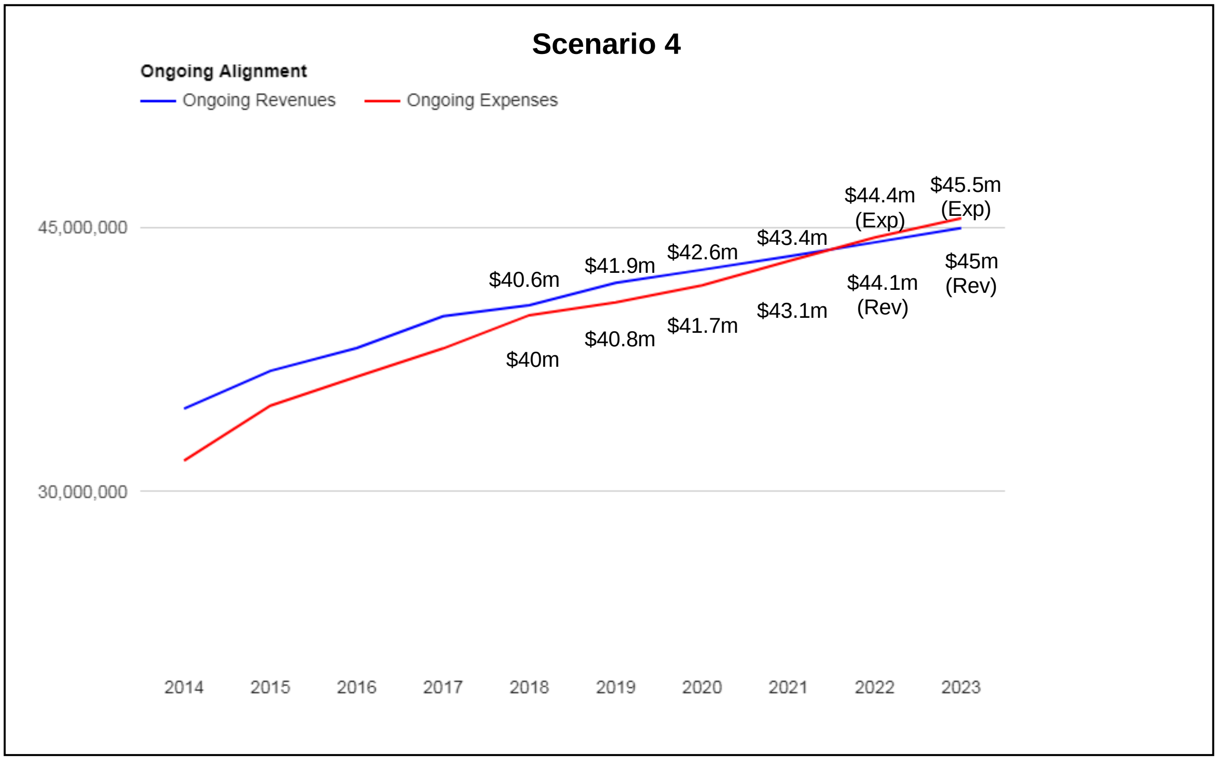
The retirement trust is recommended to give the city more stable CalPERS contribution rates and greater flexibility. We already have a trust to fund our retiree health benefits and the retirement trust is the same type of trust. Benefits of the trust are:

- Ability to earn a higher rate of return on this type of trust than on other city funds
- Flexibility to leave funds in trust to use for retirement contributions, in the case of an economic downturn or large rate increases

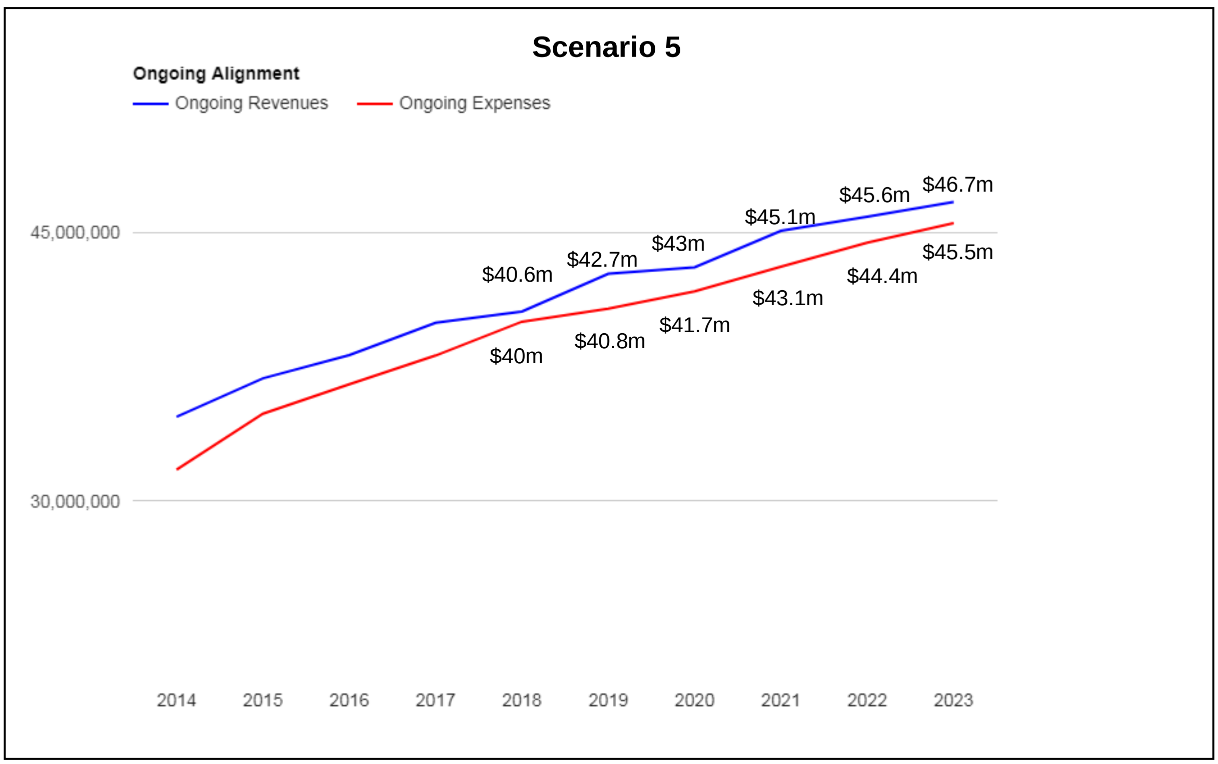
Recommendation

If funds are given to CalPERS, they are subject to more volatile earnings and once given to CalPERS cannot be used to pay contributions other than the unfunded liability.

$1 million Retirement Stabilization Funds. The City has $1 million of assigned funds set aside in the General Fund for retirement stabilization. It is recommended that these funds be placed in the retirement trust by 6/30/18 to earn a greater return and to stipulate that funds may only be used for retirement.



Scenario 4 builds on Scenarios 3 above and shows the impact setting aside part of the side fund savings into a retirement trust stabilize retirement costs would have. This scenario illustrates that while utilizing a retirement trust will stabilize our retirement costs long-term, additional revenue is still needed to offset rising costs in years 4 and 5 of the forecast.



Scenario 5 builds on Scenario 4 above and shows the impact of having both revenue enhancements and future development revenue available while utilizing a retirement trust to stabilize retirement costs.

FINANCIAL POLICIES

The following existing city policies will be changed to reflect any changes made in the financial plan.

Fund Balance Policies

The City Council has adopted policies for specific fund balances or reserve funds:

New

General Fund	Any funds remaining unspent at year-end in the General Fund transfer equally to the Contingency Reserve, Insurance Fund, Equipment Replacement Fund, Capital Improvement Fund, and Capital Facility Reserve. The Capital Facility Reserve will be established in the Capital Improvement Fund. Transfers may be redirected as the need arises.
Contingencies*	The adopted goal is to maintain fund balance equal to 16% of the General Fund appropriations for economic uncertainties and unforeseen emergencies.
Compensated Absences	The adopted goal is to maintain fund balance equal to 25% funding for accrued liabilities for employee vacation, sick and compensatory time.
Retirement Stabilization	These funds are set aside for use during periods of unstable rates.
Insurance Fund	The adopted goal is to maintain $3,000,000 in net assets for unanticipated claims and catastrophic losses. Claims liabilities are recorded at the 56% probability level.
Equipment Replacement Fund	The adopted goal is to maintain net assets equal to the accumulated amount calculated for all equipment, based on replacement cost and useful life of equipment.

*The Contingencies balance in the General Fund is intended to serve as a hedge against uncertainty in the estimates used in the budget and multi-year forecast and as a reserve in the event of an emergency. Risks associated with estimates include the following:

Revenue risks: Revenues falling short of budget estimates may cause deficits. Transitional funding may be necessary to respond to reductions in major revenues due to local, regional, and national economic downturns (which could range from one year to several years).

State budget risks: In the past, the State has implemented budget solutions that legislatively reallocate intergovernmental revenues from local jurisdictions to the State (in the absence of guarantees or constitutional protection of these revenues). These include property taxes, sales taxes, gas taxes, grants, and reimbursements.

Uncontrollable costs: Fluctuations in retirement costs due to market conditions and pension system investment performance. The City does also have funds set aside for Retirement Stabilization. In addition, there may be other cost increases that are beyond the City's control (e.g., fuel, utility charges).

Accounting and Reporting Policies

The City's accounting and financial reporting systems will be maintained in conformance with all state and federal laws, generally accepted accounting principles (GAAP) and standards of the Governmental Accounting Standards Board (GASB) and the Government Finance Officers Association (GFOA). Further, the City will make every attempt to implement all changes to governmental accounting practices at the earliest practicable time.

An annual audit will be performed by an independent public accounting firm with an audit opinion to be included with the City's published Comprehensive Annual Financial Report (CAFR).

The City's CAFR will present budgetary comparisons as part of audited basic financial statements.

The City's CAFR will be submitted to the GFOA Certification of Achievement for Excellence in Financial Reporting Program. The financial report should be in conformity with GAAP, demonstrate compliance with finance related, legal and contractual provisions, disclose thoroughness and detail sufficiency, and minimize ambiguities and potentials for misleading inference.

The City's CAFR will also be submitted to the California Society of Municipal Finance Officers (CSMFO) Awards Program and to national repositories identified by the City's bond trust agent in compliance with continuing disclosure requirements and to enable investors to make informed decisions.

Internal Controls

A system of effective internal controls will be maintained that assures only properly authorized expenditures, recordings of financial transactions, and accounting entries are executed and provides for the physical security of City funds and assets.

The City's independent auditor conducts annual reviews of the City's internal controls in conjunction with the annual audit to assure that adequate internal controls exist, at a reasonable cost, and that fiscal practices are in compliance with federal, state and city rules and regulations.

The City's cash handling practices are also reviewed in conjunction with the independent audit.

Classification of Fund Balance

In accordance with the Governmental Accounting Standards Board (GASB) Statement No. 54, classifications of fund balance used are as follows:

Non-spendable fund balances include amounts that cannot be spent because they are either (a) not in spendable form, or (b) legally or contractually required to be maintained intact. Examples are inventory, prepaid items, long-term notes receivable

Restricted fund balances are the portion of fund balance that have externally enforceable limitations on their usage through legislation or limitations imposed by creditors, grantors, laws and regulations of other governments or enabling legislation.

Committed fund balances are self-imposed limitations by the highest level of decision-making authority, namely the City Council, prior to the end of the reporting period. City Council approval is required to commit resources or to rescind the commitment.

Assigned fund balances are limitations imposed by management based on the intended use of the funds. Modifications or rescissions of the constraints can be removed by the same type of action that limited the use of the funds

Unassigned fund balances represent funds that have not been restricted, committed or assigned to specific purposes with the general fund.

Pension and Other Post Employment Benefit (OPEB) Funding

Pension

The City's retirement plan for full time employees is provided through California Public Employees Retirement System (CalPERS). The City's contributions to the plan fluctuate each year based on an annual actuarial plan valuation. This variable rate employer contribution includes the normal cost of providing contracted benefits plus or minus an amortization of plan changes and net actuarial gains and losses since the last valuation period.

It is the City's policy to make contributions to the plan equaling 100% of the actuarially required contribution (ARC). Because the City pays the entire actuarially required contribution each year, by definition, its net pension obligation at the end of the each is $0. Any unfunded actuarial liability is amortized and paid in accordance with the actuary's funding recommendations.

OPEB

The City participates in a post- retirement health care plan trust administered by Public Agency Retirement Service's (PARS). Varying benefits are provided according to the City's Memorandums of Understanding (MOU's) with each employee group.

It is the City's policy to make contributions to the plan equaling 100% of the actuarially required contribution (ARC). Because the City pays the entire actuarially required contribution each year, by definition, its net pension obligation at the end of the each is $0. Any unfunded actuarial liability is amortized and paid in accordance with the actuary's funding recommendations. An actuarial study is performed every three years in accordance with Governmental Accounting Board Standards. (GASB).

Internal Service Funds

The City uses internal service funds to account for equipment replacement costs, insurance costs, building maintenance costs and information technology costs and to account for the financing of goods and services provided by one department or agency to other departments or agencies of the City through user service charges.

Internal Service Funds shall be used to equitably distribute facility, vehicle and equipment replacement and maintenance costs among City user departments and to assure that adequate funding is on hand to replace/maintain assets and pay liabilities.

Internal Service Funds are maintained to account for insurance payments and claims liabilities and to provide a mechanism to fully fund such costs and liabilities.

Budget Policies

When both restricted and unrestricted resources are available for use, it is the City's policy to use restricted resources first, then unrestricted (committed, assigned and unassigned) as they are needed when expenditures are incurred.

One-time revenue will be reserved or used for one-time expenditures or capital improvements. Conversely, on-going revenues will be used to fund on-going expenditures.

The City will prepare a five- year forecast annually to emphasize and facilitate long range financial planning as well as a three-year capital improvement plan.

The City will prepare a budget summary or a budget in brief to summarize financial factors, provide financial summaries and identify keys issues affecting the budget as a tool to educate and involve the public.

It is the City's policy to adopt a balanced General Fund budget where operating revenue is equal to, or exceeds, operating expenditures. In the event a balanced budget is not adopted, a specific plan will be presented to the City Council for returning the budget to a balanced position.

The City Council and Department Heads will be provided with periodic summary financial reports, by fund, comparing actual revenues and expenditures to budgeted amounts.

New

The City Council adopted a target Pavement Condition Index (PCI) of 81 from the Management Plan (PMP). The plan concluded that the average citywide street network Pavement Condition Index (PCI) for Hermosa Beach is 70 and the average PCI for neighborhood streets is 64. The PMP estimated a 10 year period to achieve the PCI level of 81. $2,300,000 is budgeted for 2018-19 from a variety of funding sources, with $1,340,000 shown annually in the 3-Year CIP Plan. The plan will be used to guide selection of streets for improvement since they are prioritized in the plan. Public Works will calculate progress toward the PCI goal annually after completion of street projects.

New

The City supports consideration of collaboration with other agencies and use of alternatives for service delivery when practicable. Existing examples are shared dispatching services through the South Bay Regional Communication Authority and Fire services contracted with the County of Los Angeles.

New

The City supports development of private/public partnerships where opportunities exist.

New

An analysis of potential savings for prepayment of retirement contributions will be conducted on an annual basis to determine if prepayment would be beneficial.

Budget Process

The budget process begins each year in February with a Pre-Budget Policy meeting with the City Council, City Manager and Department Heads. The meeting is an early opportunity to review City Council goals, identify upcoming issues that may affect the budget and a chance for the City Council to discuss policy issues that may impact budget preparation. Department Heads prepare estimates of revenues and departmental expenditures for submission to the Finance Director. The City Manager and Finance Director meet with each department to review the estimates and discuss requests. From these meetings, the preliminary budget is developed. The Capital Improvement Budget, which is part of the same document, follows the same process.

The City Manager is required to submit a preliminary budget to the City Council on or before May 15th of each year. One or two public workshops are held in May and June to review the budget and receive public input. One formal public hearing is held in June, prior to budget adoption. The City Council must adopt an annual budget, by resolution, on or before June 30 for the coming fiscal year (July 1 – June 30). If the budget is not adopted by that date, the preliminary budget, except for capital outlays, goes into effect until the budget is adopted.

The budget may be amended during the year as necessary. A Midyear Budget Review is conducted in February, at which time adjustments to revenue estimates and appropriations are made. Expenditures may not exceed appropriations at the fund level. The City Manager may approve transfers of appropriation within funds; transfers of appropriations from one fund to another require City Council approval.

Budgets are adopted for all governmental and proprietary funds on a basis consistent with generally accepted accounting principles.

Appropriation Limitation

The City Council annually adopts a resolution establishing the City's appropriation limit in accordance with Article XIII-B of the Constitution of the State of California, Section 7900 of the State of California Government Code. The resolution is considered in conjunction with adoption of the annual budget. The limit is reviewed by the City's independent auditors as required by law.

Revenue Policies

The City will estimate annual revenues using an objective, analytical process; specific assumptions will be documented and maintained. Budgeted revenues will be estimated conservatively using accepted standards, trends and estimates provided by the state, other governmental agencies, reliable economic forecasters and/or consultants when available.

The City plans to conduct a user fee study at least every five years to ensure cost recovery and subsidy levels are correct and to ensure that service delivery methods are represented accurately in the study. The study will determine the full cost of providing services and identify subsidy levels so that the appropriate recovery level may be set. The latest user fee study was conducted in 2016.

New

The city supports exploring grant opportunities and will seek to apply for all grants that may practically be implemented and that align with the city's goals and strategies.

Debt Service

The City will typically consider the use of debt (bonds, certificates of participation or capital leases) only for one-time capital improvement projects. The project's useful life will not exceed the term of the financing. Debt financing will not be used for current operations. Even though California Government Code Section 43605 provides for a legal debt limit of 15% of gross assessed valuation, the City uses a limit of 2%. (Because this provision was enacted when assessed valuation was based on 25% of market value, the valuation will be calculated at 25% before the debt limit is applied).

The City will seek to obtain the highest possible bond rating and to maintain or improve the rating in order to minimize borrowing costs and preserve access to credit.

The City will generally conduct financings on a competitive basis; however, negotiated financings may be used where market volatility or the use of an unusual or complex financing or security structure is a concern with regard to marketability.

Investment Policies

Investments are governed by a separate investment policy that is adopted by resolution every year.

Website Presentation of Financial Documents

The City will use its website to present official financial documents of the City and other financial documents that may be of interest to the public and as an important investor relations tool.

List of Recommendations

City Council will not be taking action at the workshop however items may be discussed to see if there is consensus on the following recommendations:

1. It is recommended that the practice of evaluating prepayment of retirement contributions annually to determine if there are savings be added to our Financial Policies.
2. It is recommended that a new Reserve for Capital Facilities be added to the list for year- end fund transfers in addition to the Capital Improvement, Contingency, Equipment Replacement, and Insurance Funds.
3. It is recommended that the City Council approve utilizing the CalPERS side fund payoff savings toward stabilizing our rates and depositing the funds into a retirement trust.
4. It is recommended that the $1 million Retirement Stabilization Funds be placed in the retirement trust to earn a greater return and stipulate that funds may only be used for retirement.
5. It is recommended that level dollar retirement payment for Fire in 2018-19 be selected (approximately $612,000) instead of paying the unfunded liability of $466,772 and setting aside $200,000 for a retirement trust contribution, as reflected in the preliminary budget. The difference of approximately $54,772 will increase Prospective Expenditures. This will be a correction made in the Final Budget.
6. It is recommended that City Council approve the new Financial Policies.
7. It is recommended that City Council consider increases to restaurant encroachment fees, street sweeping violations, and parking citation late fees.

Respectfully submitted,

Viki Copeland

Viki Copeland
Finance Director

[1] Employment Development Department
[2] National Association of Realtors
[3] Data Quick News- Core Logic, March 2018 prices
[4] Data Quick News- Core Logic, March 2017 prices
[5] Los Angeles Economic Development
[6] Hermosa Beach Finance Department
[7] U.S. Bureau of Labor Statistics, March 2018
[8] U.S. Bureau of Labor Statistics, March 2017
[9] California Government Code section 43605 provides for a legal debt limit of 15% of gross assessed valuation. This provision was enacted when assessed valuation was based on 25% of market value. Effective fiscal year 1981-82, each parcel was assessed based on 100% of market value as of the most recent change in ownership. The computations shown in the Legal Debt Margin schedule convert the assessed valuation data for each fiscal year from the full valuation perspective to the 25% level that was in effect at the time that the legal debt margin was enacted.