



# City of Hermosa Beach

## Information Item

**DATE:** June 29, 2020  
**TO:** Honorable Mayor and Members of the City Council  
**FROM:** Viki Copeland, Finance Director  
**SUBJECT:** 2020-21 Budget Hearing Follow Up

### Introduction

At the 2020-21 Budget Hearing, Councilman Fangary raised a question about the \$3 million transfer from the Sewer Fund to the General Fund. He recalled that when the sewer fee was passed there was a discussion about taking \$3 million from the General Fund and putting it into the Sewer Fund and that it would reduce the per parcel fee that the City was going to charge the residents. He also recalled the fee as somewhere between \$90 and \$120 and if the \$3 million was not put in from the General Fund, the parcel fee would be \$120. Councilmember Fangary asked if taking the \$3 million would cause the City to be short that much for the budget for sewer and if the City would have to raise additional money to finish sewer projects that were authorized back to 2017.

Staff did not recall the relationship of the \$3 million specific to the options presented for rate setting, perhaps because the initial idea of using the \$3 million in cash and issuing bonds did not happen. Staff indicated that it would be researched and the information provided to the City Council. In researching the development of the fee, staff thought it would be beneficial to provide some more information about the history. This follow-up item is intended to provide that information relating to the transfer of the \$3 million from the Insurance Fund to the General Fund in 2015 and the information regarding the sewer service fee as it relates to the \$3 million.

### Background

At the meeting of June 10, 2014, the City Council considered a plan to either annex into Los Angeles County's Sewer Maintenance District or continue to own and operate the City's own sewer system. Necessary capital improvements to the sewer system were projected to cost approximately \$11 million. The City Council elected to continue ownership and operation of the City's sewer system. The Council also directed staff to return with scenarios on how to fund both operations and maintenance, alongside critical capital improvements to both the sewer and storm drain system.

During the 2014-15 Budget Hearing, at the same meeting of June 10, 2014, action was taken to continue the current policy of maintaining a balance of \$3 million in the insurance fund,



# City of Hermosa Beach

## Information Item

with direction to staff to return at the mid-year budget evaluation with a proposal for earmarking money in excess of that target amount for sewer repairs at the discretion of the Council.

The City held a study session in September 2014 to review staff's findings and discuss the funding mechanism for operation and maintenance as well as necessary improvements to the City's sewer system. Council discussed various types of sewer service charges for both residential and commercial units. Council directed staff to return with a proposed sewer fee structure that will fund sewer operations and maintenance.

On February 24, 2015, the 2014-15 Midyear Budget Review reported the following: During 2014-15 budget deliberations, City Council directed staff to transfer any balance over the goal amount of \$3 million at year end 2013-14 to the Sewer Fund. The goal of \$3 million is in addition to the \$6 million previously set aside as contingency for the oil settlement. The amount transferred was \$3,063,903.

At the April 14, 2015 Council meeting, staff and the City's sewer fee consultant, Penco Engineering, Inc. (Penco) proposed a sewer charge formula for determining each property owner's sewage charge. Staff recommended that the City Council choose a sewer fee structure that is substantial enough to fund all operations, maintenance and improvements to the sewer system at an estimated cost of \$11 million without the use of other sources outside of the charge rates. Staff also recommended that the \$3 million be transferred from the Sewer Fund to the Capital Improvement Fund with the use to be determined in the future.

The City Council was presented with several fee options to fund necessary capital improvements and annual operation and maintenance costs as shown below.

	<b>Option 1</b>	<b>Option 2</b>	<b>Option 3</b>
<b>Cash</b>	\$3 Million	\$1.5 Million	0
<b>Finance</b>	\$8 Million	\$9.5 Million	\$11 Million
<b>O &amp; M</b>	\$250,000/year	\$250,000/year	\$250,000/year
<b>\$ Fee/1 ESU* (Single Family Resident)</b>	\$112.50/year	\$118.75/year	\$125/year

\*Equivalent Service Unit



# City of Hermosa Beach

## Information Item

There was much discussion at the meeting which was ascertained from listening to the video:

Councilmember Fangary preferred “Option 3”, which would not use the \$3 million since the difference between using the \$3 million and not using it amounted to a difference of \$12.50/year. He said he would rather discuss it with budget and potentially use it for the oil settlement to give more flexibility for the current debt situation. Councilmember Petty was glad that Councilmember Fangary pointed out the cost difference. She wanted to keep the money in the Sewer Fund. She didn’t want to deplete reserves for sewers. Councilmember Tucker wanted to use \$3 million for the sewer improvements because he felt like they had committed to the community that they would put that money there. Councilmember DiVirgilio saw the \$3 million as savings for the incredible bill and sends a sign to the community that the City had been responsible to save 30% of the funds towards the cost of the repairs. Councilmember Tucker clarified that he thought the funds just showed that we were under budget the prior year and not that we had been initially saving this for the sewers. Councilmember Barragan wanted to put in more than \$3 million if possible.

Council selected to use \$3 million in cash from the Sewer Fund and finance the remaining \$8 million for the expenditure of \$11 million dollars in necessary capital improvements on the City’s sewer system over the next ten years, with a minimum annual operation and maintenance budget of \$250,000.

Council directed staff to return with a proposed sewer fee structure to fund the \$8 million over 20 or 30 years for comparison of the bond term.

At the April 28, 2015 Council meeting, staff recommended that Council set a fee of \$92, which included annual operation and maintenance (O&M) costs of \$250,000. The City Council set the level of proposed charge at \$115 per ESU and directed staff to proceed with securing a 15 or 20-year bond. The proposed charge would include the range of annual O&M costs from \$250,000/year to \$450,000/year, to be determined based on the bond terms selected. This range will pay for all anticipated O&M expenditures for the year as well as allow for a gradual buildup of reserves to be spent on future sewer capital projects after the initial ten-year program, estimated at a cost of approximately \$11 million, is completed. The staff report included a letter dated April 22, 2015 from MBF Consulting which updated the Sewer Master Plan that was last revised March 2011 and included a construction cost estimate of \$11 million for the rehabilitation of the sewer system in the next ten years. Staff informed Council that the bond term would be reviewed, and options brought back to Council after the June 23, 2015 protest hearing.



# City of Hermosa Beach

## Information Item

At the April 28, 2015 Council meeting, Council adopted the Engineer's Report, setting the majority protest hearing for June 23, 2015 and directed the City Clerk to mail all notices required under Proposition 218. Staff was directed to proceed with securing a 15 to 20-year bond and to increase the annual tax for single family residences to \$115.

On June 23, 2015, the City Council held the majority protest hearing and adopted the \$115 annual sewer service charge and authorized the charge for 2015-16 to fund maintenance, operation, servicing and improvements to the city's sewer collection system.

The wording of the notice for the hearing was as follows:

The City of Hermosa Beach proposes to collect funds to cover the expenses for the overall operation, maintenance and servicing of the city-owned sewer system as well as the funds deemed appropriate and necessary to pay for capital improvements and reserves for the next ten years. The City estimates that \$11 million worth of capital improvements to the sewer system will be needed over the next ten years (including rehabilitation and reconstructing pipes and manholes). The charge will also cover annual operation and maintenance costs for the sewer system. The proposed sewer service charge is based on the direct cost of providing the service, which includes staff, rent, utilities and other costs. The baseline for calculating the charge per parcel is a single--family residential lot. If approved, the proposed charge will appear on your annual property tax bill.

On October 10, 2017 the Sewer Master Plan was presented with a total estimated cost of \$14.4 million. There was a discussion between the City Council and City Manager regarding the increase in cost over the initial estimate of \$11 million and how that impacted the sewer service charge. City Manager Gonzalez indicated that the City would be okay for the next few years with projects, keeping in mind the City's capacity. He indicated that the City wouldn't be able to do more than \$2 million dollars a year in sewer projects anyway, so the fund would continue to be replenished every year. Progress would need to be assessed and fee modification considered.

### **Fiscal Impact**

The City has not issued bonds for sewer improvements and the \$3 million is still in the Sewer Fund after six years. The City's Public Works Directors, including the incumbent at the time the service charge was established, did not support large sewer projects that would disrupt the entire City. Proceeding on a pay-as you-go basis rather than issuing bonds saves a lot in



# City of Hermosa Beach

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## Information Item

interest charges that may be spent on projects, albeit at a slower pace. Based on the bond analysis at the time, the interest would have been \$5.5 million over 20 years.

Staff made the recommendation to transfer the \$3 million from the Sewer Fund to the General Fund to assist with closing the deficit as a good solution in these unforeseen, unprecedented times. Transferring these funds does not prompt a need to increase the sewer service charge.

Since there is over \$2.7 million in sewer capital improvements almost completed in 2019-20 and almost \$2.5 million budgeted in 2020–21, sufficient funds are available for the current CIP program. It is likely that future projects will diminish in size as more work is done and progress is made. Review of where the City is with sewer repairs and the funds available would be merited after the next big project is completed, including an analysis of the fee.

The City Council always has the authority to consider allocating unspent funds from the General Fund at year end in better times or transferring funds from the Capital Improvement Fund to the Sewer fund based upon an analysis of the needs in the future.