

**CITY OF PALOS VERDES ESTATES
FISCAL HEALTH REPORT
FY 2004-2014**



**January 27, 2015
Finance**



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Mayor and Members of City Council:

The Fiscal Health Report illustrates results for fiscal year 2004-14. It serves also to supplement the mid-year budget report. Information within this report is derived from the City's Comprehensive Annual Financial Report (CAFR) and provides a graphic representation of the City's fiscal condition.

The Fiscal Health Report includes a number of financial factors and compares the results over time. It is a timely recap of internal financial reporting to help identify early warning trends on a proactive basis. The report is based on systems developed by local agency and finance professional organizations using factors for our City.

How this Report Works

Financial factors are calculated and trends graphed from 2004 through the fiscal year ended June 30, 2014. The focus of the reporting is on the General Fund, the City's major operating source.

Color-coded factors and their trends are generally judged as favorable (green), stable (yellow), watch (brown) or unfavorable (red). The "watch" designation indicates that a rating could tip to either a favorable or unfavorable position and/or extra oversight is recommended. Like the City Council and its approach to budgeting during this time period, the staff was especially cautious about the City's financial assumptions and took a very conservative approach to factor ratings.

Findings

Because the City's revenue base is based materially upon property tax, and not diverse, cost control and close fiscal monitoring remains ever important. Certainly the annual budget process and updates are foundational to fiscal stewardship, as are annual audits and internal fiscal reporting. The mid-year budget report, a document on tonight's agenda, gives credence to this point. The City remains diligent in identifying and assessing risk factors. Several on the horizon to be addressed include: outdated facilities in need of replacement/repair, the continued incidence of rising pension rates, the coming expiration of the paramedic/parcel tax, emerging changes in healthcare reform, addressing State storm drain mandates and the ever present concern with the California state budget cycles.

"Growth in Assessed Values" (AV) is favorable in FY 2014. AV increased 5.1 %, as opposed to 2.64% last year. Future trends indicate an additional 5% increase in 2014-15. AV changes reflect stable trends

over the next several years with averages over the past ten years at 4%. Factor 1 increased to a status of favorable given the strength and direction of this revenue source. Likewise, Factor 3 “General Fund Revenue Per Capita” received a favorable trend rating – mostly influenced by Property tax.

Factor 4 “General Fund Expenditures Per Capita” achieved a status of watch with a clear rise in relative expenditure levels. That said, factors 4a and 4b are now included in the summary chart to provide an important sense of context – most notably factor 4b. This factor, rated as favorable, recognizes that the higher expenditures noted in 2014, addressing past deferred maintenance, equipment, training and strategic staffing needs, were done within budget plans and in the framework of an overall fiscal surplus.

The City operates with lean staffing and deploys contract staffing where most appropriate, effective and efficient. Fire, solid waste, planning & building, animal control and large scale landscaping services are delivered via contract. City personnel costs are closely monitored, as they represent over 60% of the City’s general fund budget. In FY 2014, the City rounded out final negotiations with both the Police and Professional Services bargaining groups. Negotiations were completed on time and in good form. Modest increases resulted ranging in the 2 to 3% range. All city staff, both represented and unrepresented, commendably agreed to begin a phased-in shared cost pension model for the employee portion of the CalPERS rates. This will benefit the organization as a whole for some time given the clear direction of increasing costs that CalPERS has and continues to advise us of.

Factor 6, “Benefits as a % Personnel Costs” is once again classified as “watch” with uncertainty in the direction of pension rates as CalPERS develops its new actuarial methods. Small changes in pension rates have a large impact on City expenditures. This is also true for health care costs.

Factors (# 8 & # 9) related to budgeting and operating position are favorable. The City has a long track record of conservative budgeting. Factor #7, “General Fund Balance”, reflects a “favorable” rating given a steadfast Council policy of maintaining a strong fiscal policy reserve balance - 50% and greater in the General Fund. The biennial budget underscores the maintenance of favorable reserve balances. In fact, the mid-year review for FY 14-15 predicts a further strengthening of fund balance positions

I hope the Council finds the information in the report useful and complimentary to the mid-year budget update.

Russell J. Morreale
Finance Director

FISCAL HEALTH REPORT

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Appendix - Factor Calculations

FACTOR SUMMARY SHEET

	2011	2012	2013	2014
1 Growth in Assessed Values				
2 Property Tax as % of General Fund Revenue				
3 General Fund Revenue per Capita				
4 General Fund Expenditures per Capita				
4a Public Safety Expenditures per Capita	N/A	N/A	N/A	
4a Revenues/Expenditures per Capita	N/A	N/A	N/A	
5 Personnel Costs as % of General Fund Expenditures				
6 Benefit Costs as % of Personnel Costs				
7 General Fund Balance as % of Total Operating Expenditures				
8 Operating Position				
9 Revenue Shortfall/ Budget Expenditure Overruns				



Favorable Stable Watch Unfavorable

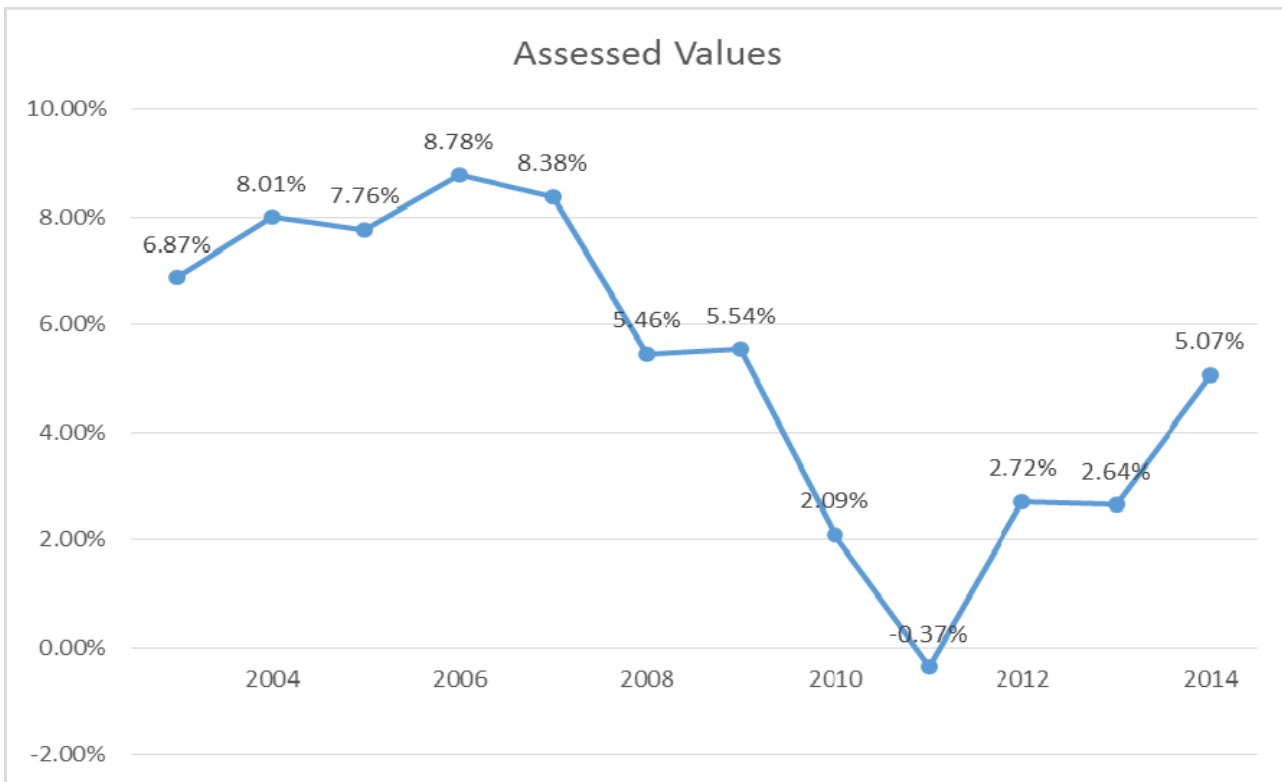


FACTOR 1 - GROWTH IN ASSESSED VALUES

DESCRIPTION – Assessed values (AV) are a key component of fiscal health since property taxes represent 54% of 2013 total general fund revenue. 2013 assessed values increased by 5%, aided by the maximum 2% CPI adjustment permitted under Proposition 13. Prior recent years were flat. As predicted in past reports, FY 2014-15 has displayed notable improvement as the economy in general sheds the impact of the recent recessionary period. The AV projection for FY 14-15 also is in the 5% range. Although a favorable condition, it cannot be understated that the City dependence on Property Tax is both a blessing and a curse. This is because its stability is offset by the absence of a diversified revenue within the City. Hence the importance of keen fiscal stewardship.

FORMULA -
$$\frac{\text{Current Year Assessed Value minus Last Year's Value}}{\text{Last Year's Property Value}}$$

WARNING SIGN - DECREASING GROWTH OF ASSESSED VALUES



TREND



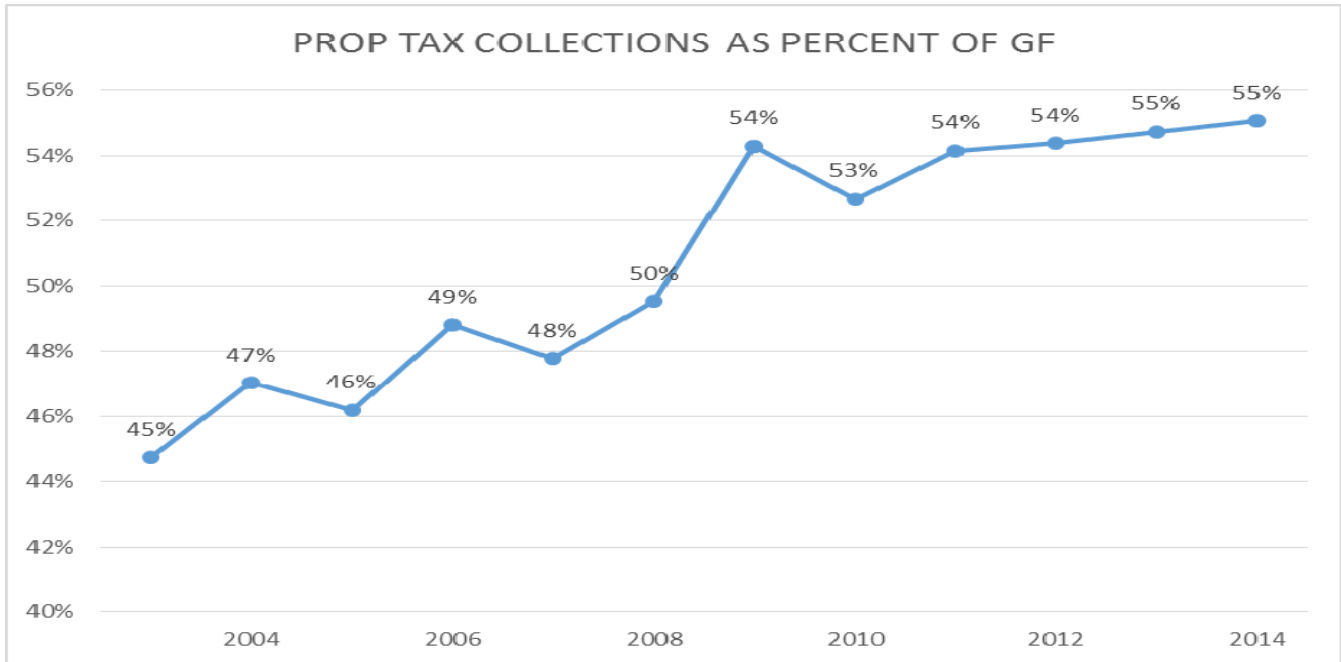
Favorable

FACTOR 2 - PROPERTY TAX COLLECTIONS AS PERCENTAGE OF GENERAL FUND REVENUE

DESCRIPTION – This factor focuses attention on property taxes, which are a key revenue source for this City. An increasing or decreasing percentage of property tax compared to total revenue could indicate a problem. An increasing percentage may indicate a lack of revenue diversification and an over-reliance on property tax, while a decreasing percentage may indicate lack of assessed value growth and/or an increasing delinquency rate. For FY 2014, property tax revenue (all sources) equaled 55% of General Fund revenue which was the same rate as 54% in 2013. In the absence of an economic recovery, which would result in higher development revenue, sales taxes and other sources influenced by discretionary income (e.g. concession fees), the City, by its residential nature, will continue to show a heavy reliance on property taxes.

FORMULA -
$$\frac{\text{Property Tax Revenue}}{\text{General Fund Operating Revenue}}$$

WARNING SIGN - SIGNIFICANTLY INCREASING OR DECREASING PERCENTAGE OF PROPERTY TAX REVENUE AS A PERCENTAGE OF GENERAL FUND OPERATING REVENUE



TREND
 Stable

FACTOR 3 - GENERAL FUND REVENUE PER CAPITA

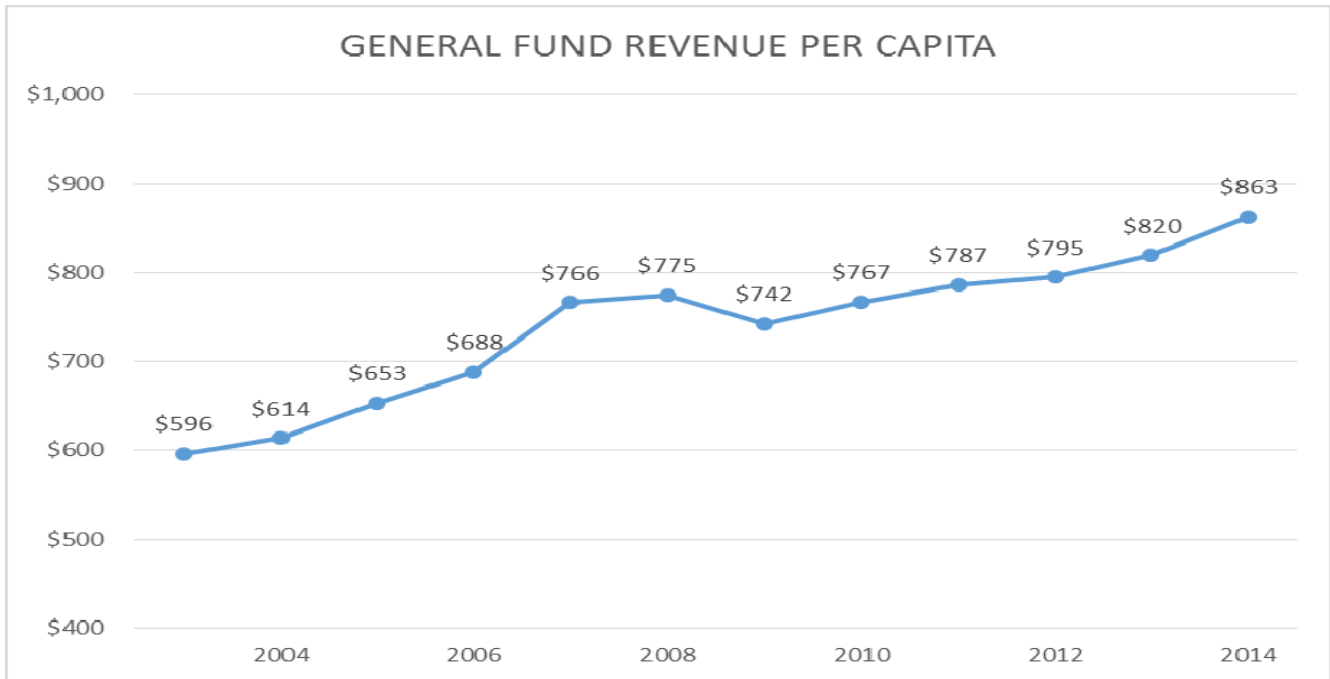
DESCRIPTION – This factor is designed to show if revenues are keeping pace with growth in the community in order to gauge if there are resources to meet demands for services. While population growth is not expected to be a factor in Palos Verdes Estates, the per capita analysis does provide a useful approach to analyzing revenues and expenditures, once we account for the effects of population adjustments based on census results.

Per capita revenue for 2014 totaled \$863 compared to \$820 in 2013. This is an improvement in rate of growth. General Fund revenues increased 5.86% in 2014 as opposed to 3.7% in 2013. We do not expect prolonged growth rates of 5% and conservatively budget our revenue expectations accordingly.

Factor 4B (page 9) provides the graphic representation of both revenue and expenditures per capita, and it is important to view these factors in relation to each other.

FORMULA -
$$\frac{\text{General Fund Operating Revenue}}{\text{Population}}$$

WARNING SIGN - DECREASING OPERATING REVENUE PER CAPITA



TREND



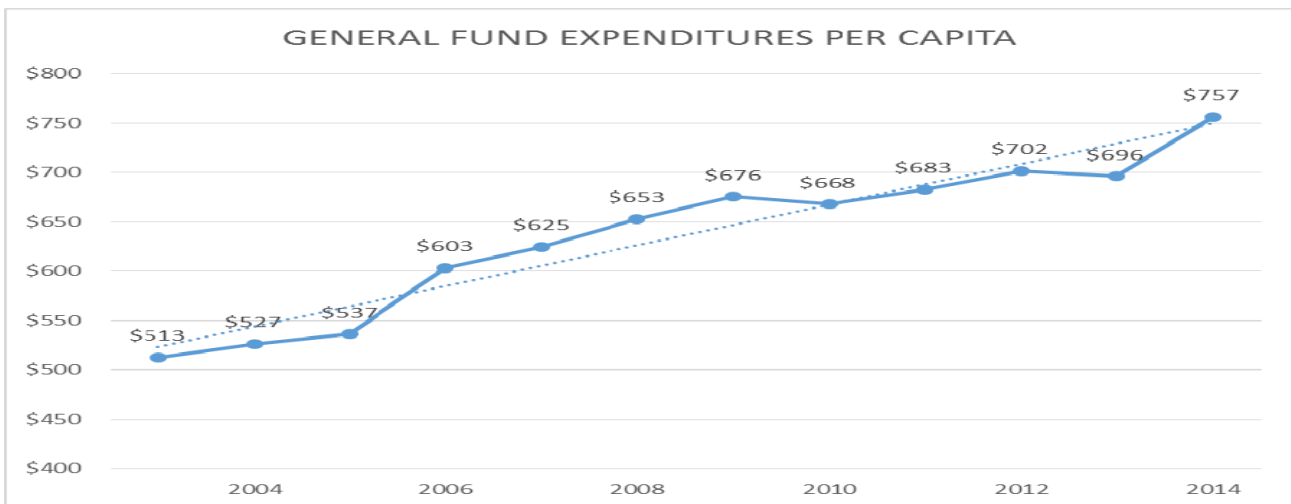
FACTOR 4 - GENERAL FUND EXPENDITURES PER CAPITA

DESCRIPTION - This factor is designed to show the cost-per-person of providing General Fund City services. Increasing expenditures per capita can be a concern if revenues do not keep pace or are declining. In this particular year, that is not the case, the increased level of expenditures in 2014 are both timed properly and responsive to long standing needs. In particular, the expenditure patterns of 2014 reflect attention to long deferred maintenance and technology items, replacement of a dated safety fleet, increases in pension and healthcare rates, and the hiring and filling of key strategic management positions. Per capita expenditures totaled \$757 in 2014 compared to \$696 in 2013. Total General Fund expenditures increased by 9% in FY 2014 relative to several flat years, yet remained well within budget plans. Savings in recent past years had to do with deferred maintenance and equipment replacements, and position vacancies, post the 2008/2009 period of recession. 2014 represents a year of reinvestment and is timed to coincide with supporting revenues and strengthened fund balance positions. That said, keeping a watch on cost load is a constant.

As mentioned in previous reports, and displayed in Factor 4B (page 9), General Fund revenues continue to perform in a manner which allows a comfortable margin above expenditures.

FORMULA -
$$\frac{\text{Total Operating Expenditures}}{\text{Population}}$$

WARNING SIGN - SIGNIFICANTLY INCREASING OPERATING EXPENDITURES PER CAPITA, ESPECIALLY WHEN COMBINED WITH A STABLE OR UNFAVORABLE TREND IN FACTOR 2 - REVENUES PER CAPITA.



TREND

 Watch

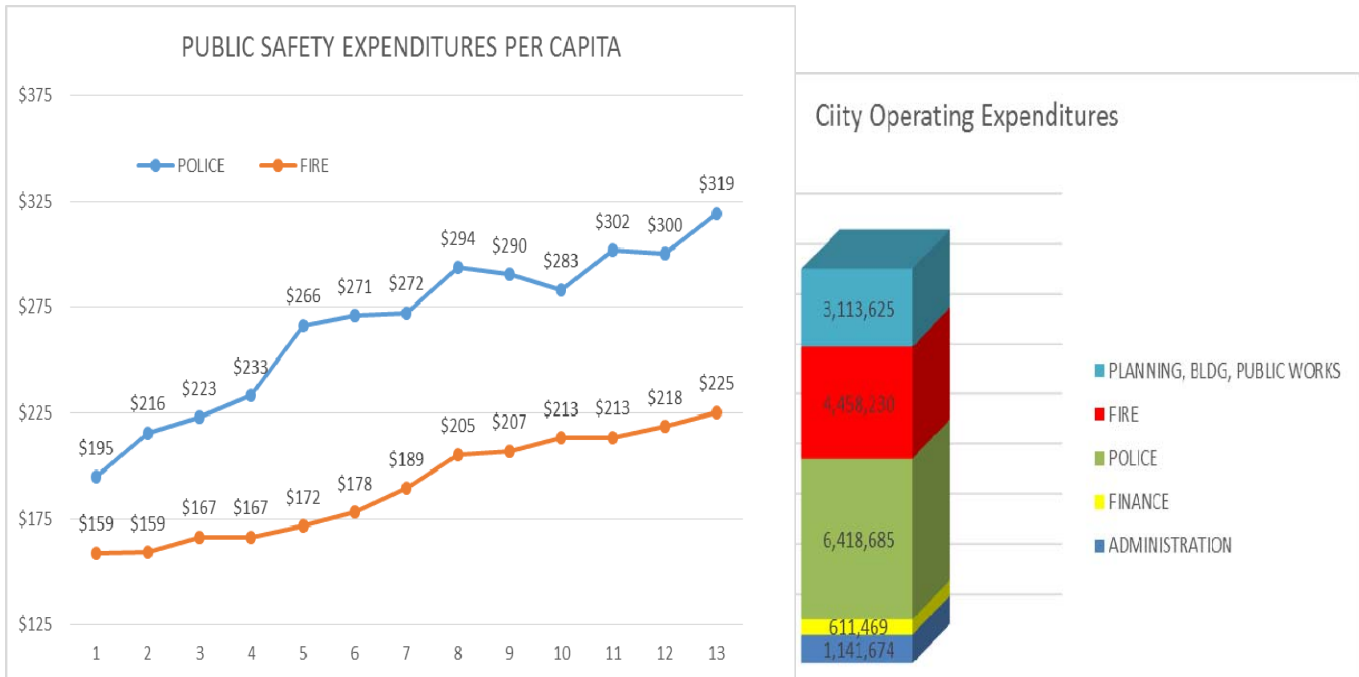
FACTOR 4.A. - PUBLIC SAFETY EXPENDITURES PER CAPITA

DESCRIPTION – Public Safety, police and fire costs, represented over 50% of total operating expenditures. Personnel costs represent the vast majority of the costs for these departments – 83% in the Police Department and over 70% within fire. The annual increase in the fire contract cost is capped at a maximum 4.2%. The Police Department costs are determined in large part by terms of the labor agreements, as well as employer PERS costs. In addition, since the analysis for the Police Department includes General Fund costs only, the extent expenses are shifted to the General Fund from restricted funds, as occurred beginning in 2006, affects the trending / per capita costs as well.

In 2014, the per capita cost differential between police and fire was \$94, compared to \$82 in 2013. General Fund costs for Police operations in 2014 increased a total of \$281,000 (or 5%) compared to 2013, mostly due to salary and benefit costs. The department is also close to full staffing. Due to the very small department, any vacancy, even temporary, can have a notable impact on the per capita cost. Fire Expenditures are more than 1/3 of total operating costs and are wholly funded by a parcel based property tax assessment due for renewal in 2017.

FORMULA -
$$\frac{\text{Public Safety Expenditures}}{\text{Population}}$$

WARNING SIGN - SIGNIFICANTLY INCREASING PER CAPITA EXPENDITURES



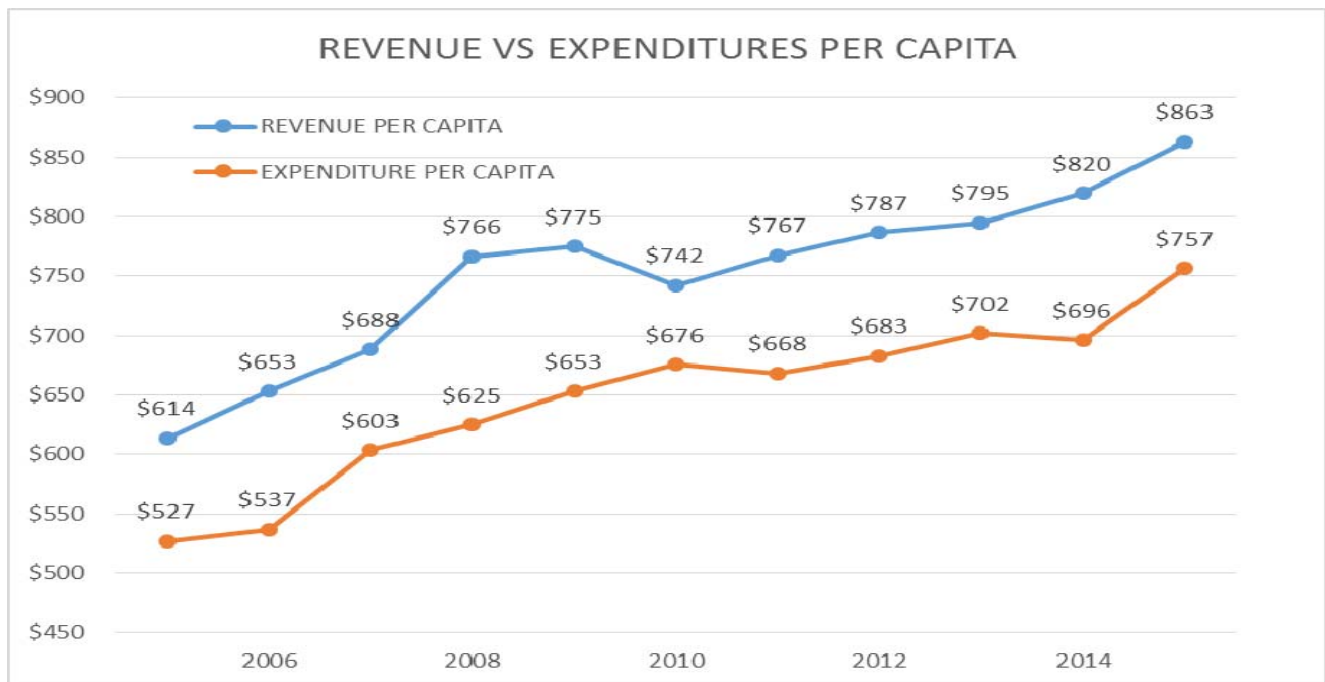
TREND
Stable

FACTOR 4.B. - REVENUES AND EXPENDITURES PER CAPITA

DESCRIPTION - This item shows Factors 3 and 4, Revenues and Expenditures per Capita, in tandem. Data from 1997 forward is shown to provide a longer historical perspective. Results in 2005, 2006 and 2009 reflect state property tax diversions that occurred in those years. FY 2007 represented the peak of fiscal performance with the widest margin of revenue in excess of expenditures (\$141), which coincides with the peak in median home values. The results for 2014 show General Fund revenues per capita in excess of expenditures of \$106. The City continues to experience a healthy surplus. This is a favorable condition especially considering its consistency. The challenge in the future will be to preserve the sensitive revenue streams, ensure the continuance of the paramedic/fire service parcel tax, while finding a solution for long term facility replacements and maintenance.

Per capita revenues have exceeded expenditures by the following margins:

1997	\$ 7.86	2003	\$ 82.99	2009	\$ 66.69
1998	\$ 53.62	2004	\$ 87.01	2010	\$ 99.39
1999	\$ 65.85	2005	\$ 116.79	2011	\$ 105.80
2000	\$ 86.36	2006	\$ 84.61	2012	\$ 93.15
2001	\$ 121.65	2007	\$ 141.35	2013	\$ 123.81
2002	\$ 95.60	2008	\$ 121.79	2014	\$ 106.00



TREND
 Favorable

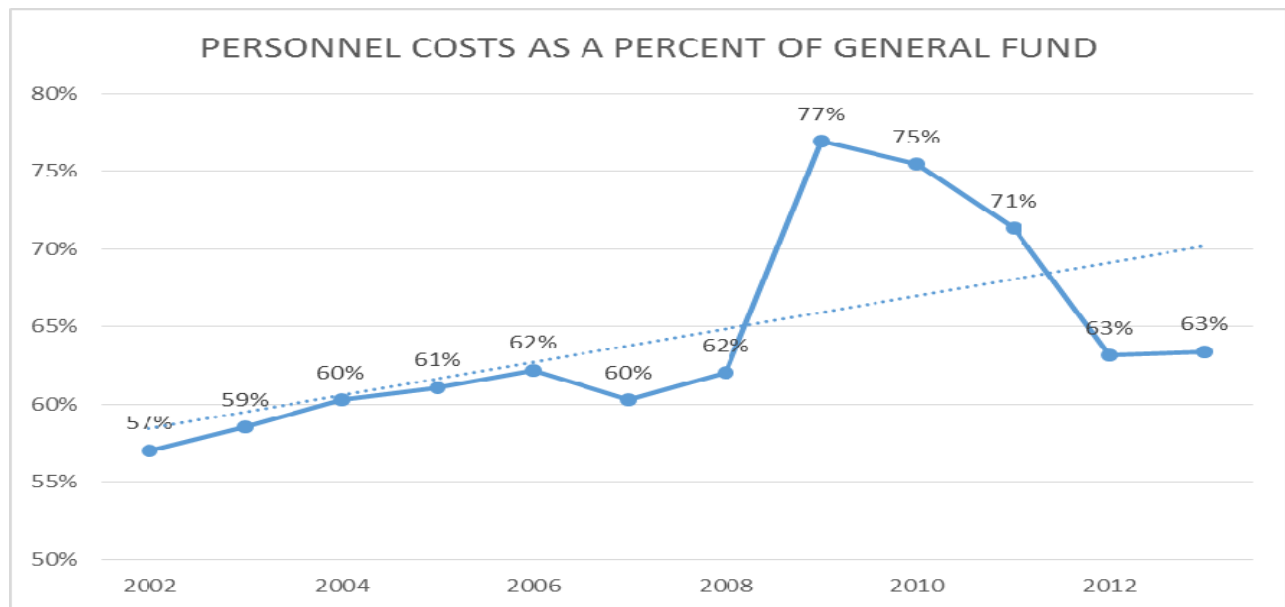
FACTOR 5 - PERSONNEL COSTS AS PERCENTAGE OF TOTAL GENERAL FUND EXPENDITURES

DESCRIPTION - This factor is designed to show the percentage of General Fund expenditures devoted to personnel costs. There is no ideal percentage or municipal standard for this factor and services provided by City personnel as opposed to contract affects the percentage. Building and planning contract service costs related to development activity are deleted from total costs in order to give a more consistent picture.

The City has a history of maintaining a stable level of staffing costs – being staffed at a total count of 58 employees. The chart below reflects a trend anomaly in 2009 to 2011 representing the judicious use of funds to pay down existing pension liabilities. This payment reduced pension rates for the City and will mitigate the rate of future cost increases. The City’s labor cost to total expenditures has ranged consistently at the 60% watermark. 2014 labor negotiations developed in a manner that will preserve this fiscal prudence.

FORMULA -
$$\frac{\text{Total Personnel Costs}}{\text{Total General Fund Expenditures-Cost for Development Services}}$$

WARNING SIGN - SIGNIFICANTLY INCREASING PERSONNEL COSTS COMPARED TO TOTAL EXPENDITURES ABSENT NEW EMPLOYEES OR BENEFITS



TREND

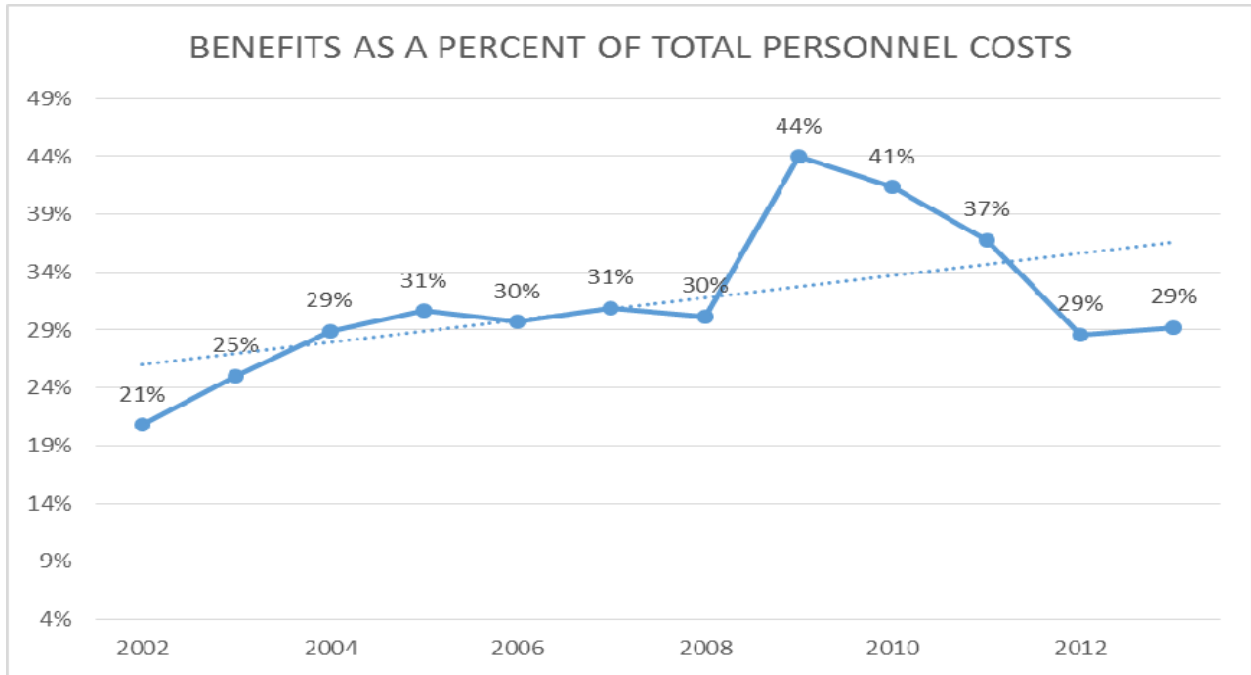
 Stable

FACTOR 6 - BENEFIT COSTS AS PERCENTAGE OF TOTAL PERSONNEL COSTS

DESCRIPTION - This factor is designed to demonstrate the impact of fringe benefit costs on a City finances. Fringe benefits are sometimes viewed as low cost items compared to salaries, which may not always be the case. This factor was rated unfavorable from 2004-2006, when experiencing rapidly escalating retirement rates prior to PERS implementing rate smoothing and “pooled” plans for small cities. In 2007-2011, a “watch” rating was applied to given potential increased PERS costs related to the fund’s investment performance. Medical insurance costs also have been a concern even though the City’s contribution is capped through agreements with the employee associations. The “watch” rating remains again for 2014, not because of the rate of increase, as a leveling is noted, but due to the external pension climate. Pension reforms have and will result in further cost strains in the near term with the promise of stability in the long term; this may take several years to be realized with recent changes to the discount rate, methods and mortality rates.

FORMULA -
$$\frac{\text{Benefit Cost}}{\text{Total Personnel Costs}}$$

WARNING SIGN - INCREASING FRINGE BENEFIT COSTS COMPARED TO TOTAL SALARY AND WAGE COSTS



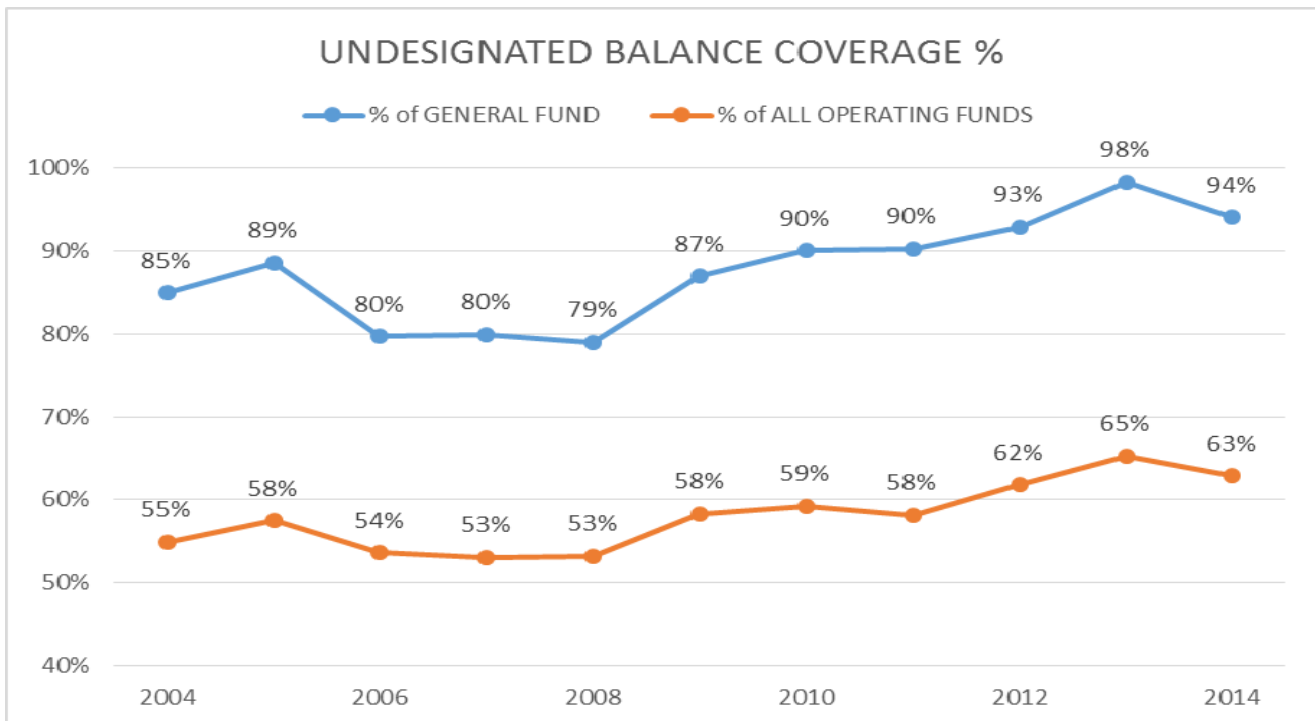
TREND 
Watch

FACTOR 7 – GENERAL FUND BALANCE AS A PERCENTAGE TO TOTAL OPERATING EXPENDITURES

DESCRIPTION - This factor is designed to show the undesignated portion of the General Fund balance as a percentage of the next year's (FY13-14) total budgeted operating expenditures, including the cost of fire service, which is financed outside the General Fund. This provides a means to gauge a City’s ability to respond to unforeseen emergencies, representing available funds expressed as a percentage of total expenditures. In 2011, the City implemented provisions of GASB 54 and adopted a formal fund balance policy. The Council approved a “committed” General Fund balance of \$7.2 million to address economic uncertainties. In prior years, funds in excess of the targeted balance (50% of operating budget) were transferred to the capital funds, except during 2009 and 2010 when excess funds were used to reduce the PERS safety plan side fund liability. In 2014 the City has maintained these contingency reserves –a level that is quite impressive given its steadfast application and General Fund coverage of over 90%.

FORMULA -
$$\frac{\text{General Fund Undesignated Balance}}{\text{Total Budgeted Operating Expenditures}}$$

WARNING SIGN - DECREASING UNDESIGNATED GENERAL FUND BALANCE AS A PERCENT OF TOTAL OPERATING EXPENDITURES



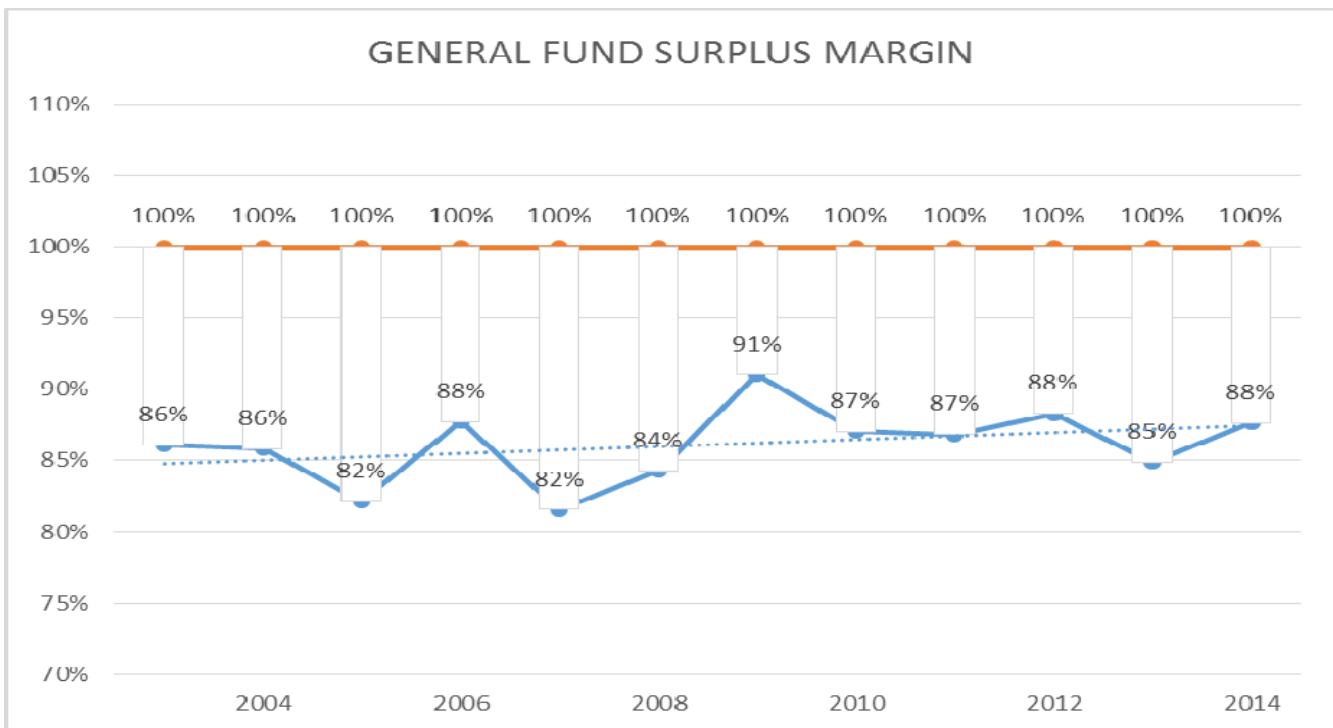
TREND  Favorable

FACTOR 8 - OPERATING POSITION

DESCRIPTION - This factor is designed to demonstrate whether a municipality is operating at “break even” or is relying on its fund balance to finance current operations. In this calculation, a number more than 100% means the City was operating at a deficit; 100% means the City broke even; less than 100% means the City had an operating surplus and earned more than was spent. *The City has realized a general fund surplus each year since 1994 and continues to realize a comfortable general fund surplus.* Dedicated special financing for fire contract costs are a critical component of the City’s fiscal picture and as stated in past reports, property tax revenues alone do not cover the cost of operations for the Police Department.

FORMULA -
$$\frac{\text{General Fund Operating Expenditures}}{\text{General Fund Operating Revenues}}$$

WARNING SIGN - INCREASING AMOUNTS OF GENERAL FUND OPERATING DEFICITS AS A PERCENTAGE OF TOTAL OPERATING REVENUE



TREND 
Favorable

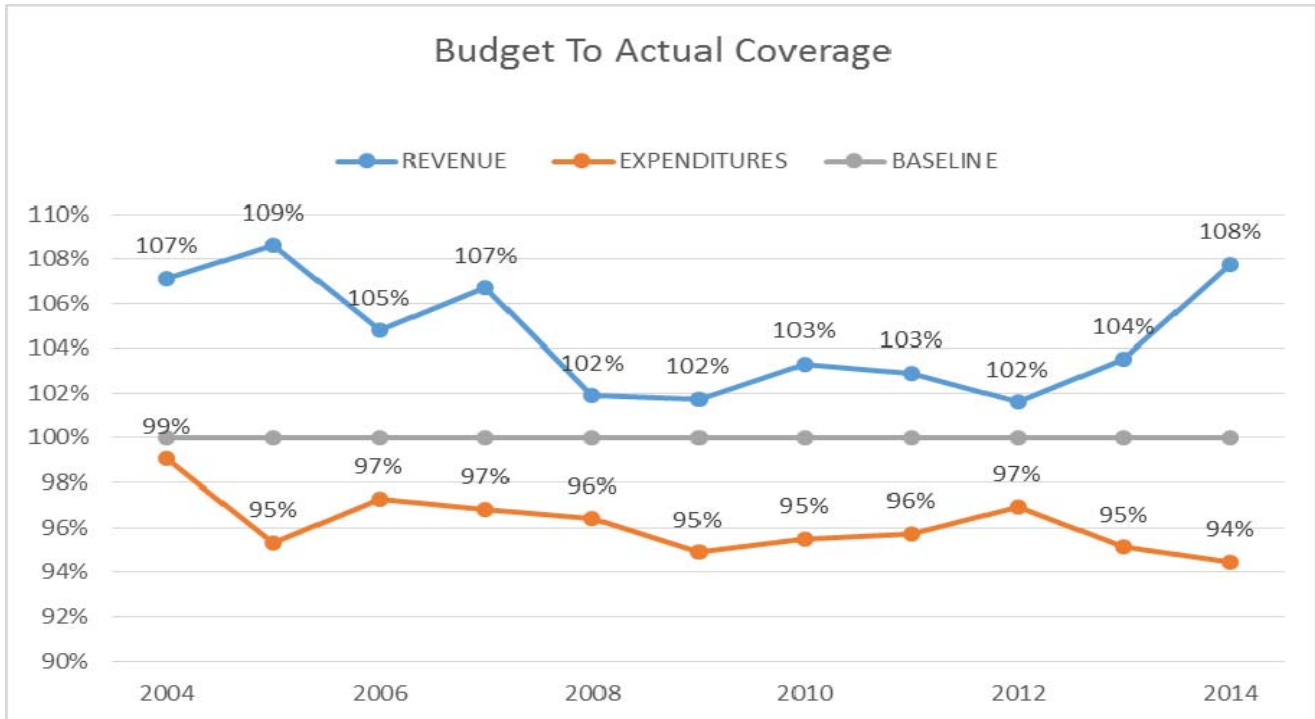
FACTOR 9 - REVENUE SHORTFALL AND EXPENDITURE OVERRUN

DESCRIPTION - This factor is helpful in determining fiscal condition and the performance of municipal officials in controlling budgets. While estimating revenues and expenditures is not an exact science, some municipalities routinely over-estimate revenues to make budgets balance. Likewise, there could also be a continuing pattern of expenditures exceeding budget. Combined with revenue shortfalls, this can lead to a serious problem in a very short time.

Our historic conservative budgeting has achieved consistent performance of revenues slightly in excess of budget and expenditures slightly below, resulting in general fund operating surplus (see Factor 8). While our goal would be to have our revenue and expenditure budgets track as closely to 100% as possible, the scenario reflected below is an acceptable alternative.

FORMULA -
$$\frac{\text{Year-end Actual Revenues and Expenditures}}{\text{Budgeted Revenues and Expenditures}}$$

WARNING SIGN - INCREASING AND/OR CONSECUTIVE REVENUE SHORTFALLS OR BUDGET OVERRUNS



TREND 
Favorable