

February 4, 2002

Honorable Mayor and Members of  
the Hermosa Beach City Council

City Council Meeting of  
February 12, 2002

## **MIDYEAR BUDGET REVIEW 2001-02**

### **RECOMMENDATION:**

It is recommended that the City Council:

- (1) Approve the revisions to estimated revenue, appropriations, budget transfers and fund balances as shown in the attached Budget Summary and Revenue Worksheet.
- (2) Approve the amendment to the transfer policy and creation of a Contingency Fund.
- (3) Receive and file the information on the impact of electricity rates on Utility User Tax revenue

### **BACKGROUND:**

The City has conducted a Midyear Budget Review annually since fiscal year 1981-82. The review is a good tool to ensure that assumptions and estimates originally used to prepare the budget ten months earlier remain realistic.

### **ANALYSIS:**

#### **Overview**

The revenue changes recommended at midyear 2001-02 reflect a net increase in the General Fund and a net decrease in the Parking Fund. With the revisions recommended, the budget does remain in balance, however, some effects from the downturn in the economy are apparent and are discussed below.

#### **Revenue (see Revenue Worksheet)**

The net change in revenue in the General Fund is \$137,288 or less than 1%. Though the overall change is small, there are some notable fluctuations.

#### **Taxes**

The tax category overall increases by 2.6%. Secured Property Taxes increase 9% over 2000-01, based on the actual levy, and Unsecured Taxes increase 12%. A conservative estimate for Supplemental Roll Property Taxes is included, based on last year's revenue. These taxes are difficult to project since they are generated by ownership changes and are processed sporadically by the County.

Sales tax for the first two quarters is up 4% over 00-01. For the same period, Los Angeles County is down .14% and the State is down .61%. The midyear revision, which factors in the loss of the Pacific Porsche dealership as of February and Audi as of April, results in an overall increase over last year of 2%, which is significantly lower than the last few years, but is reflective of economic conditions.

The chart on the next page compares sales tax on major accounts for the first half of this year to the first half of last year by the top ten categories.

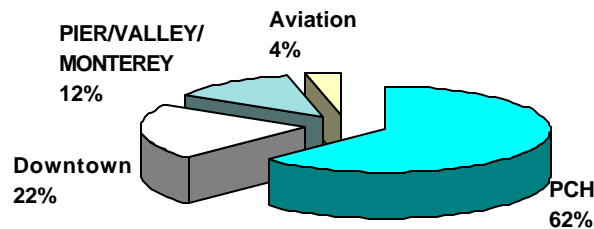
**SALES TAX**  
**Comparison of First Half of 2000/01 to 2001/02**  
**Top Ten Categories**

RANK	BUSINESS CLASS	2001-02	INC/ (DEC)	% CHANGE PREV YEAR	% OF TOTAL
1.	AUTO DEALERS	398,331	\$62,485	18.61%	36.37%
2.	EATING/DRINKING PLACES	300,687	13,731	4.79	27.46
3.	GROCERY STORES/LIQUOR STORES	102,101	(3,127)	(2.97)	9.32
4.	AUTO LEASES	72,466	5,970	8.98	6.62
5.	LUMBER/BUILDING MATERIALS	58,995	2,104	3.70	5.39
6.	SPECIALTY STORES	40,831	(4,722)	(10.37)	3.73
7.	SPORTING GOODS/BICYCLES	40,061	(1,188)	(2.88)	3.66
8.	SERVICE STATIONS	34,377	(5,753)	(14.34)	3.14
9.	WHOLESALE TEXTILES/FURNISHINGS	25,337	(2,739)	(9.76)	2.70
10.	HOUSEHOLD/HOME FURNISHINGS	21,999	(9,453)	(30.06)	2.30

**Sales Tax Comparison by Geographic Area**

LOCATION	REVENUE 00-01	% OF TOTAL	% CHG	REVENUE 01-02	% OF TOTAL
PCH	615,662	61%	11%	686,416	62%
Downtown	233,416	23%	1%	236,813	22%
Pier/Valley/Monterey	131,292	14%	3%	135,606	12%
Aviation	36,675	4%	8%	39,471	4%

**2001-02 MIDYEAR SALES TAX BY GEOGRAPHIC AREA**



Refuse Franchise revenue is reduced due to the lower rates from the new refuse company.

Transient Occupancy Tax (hotel tax) receipts are up 22% (including the October-December quarter, received in January) because the Holiday Inn Express and Phase II of the Beach House were operational in all quarters of this fiscal year, whereas only the Holiday Inn Express was included for one quarter last year. Until the latest quarter was received, receipts were on target with the budget estimate. However, since the occupancy rate for that quarter is 53%, as compared to 84% for the same quarter of the prior year and the quarterly revenue is slightly lower than the previous year even though 114 rooms were added, the budget estimate is being revised down almost 12%.

The Utility User Tax estimate is being revised up 8% over last year based on receipts for the first half. The impact of electricity rate increases on the UUT is evaluated later in this report.

### **Licenses and Permits/Current Service Charges**

The most significant changes in these two categories are Building Permits and Plan Check Fees. Revenue revisions are based on first half revenue, which is down 43% and 52%, respectively, from last year. Planning submittals are down by approximately 25%.

### **Use of Money and Property**

Interest projections for all funds have been recalculated based on receipts for the first half. Rates for LAIF (the State pool), where most of our funds are invested, has declined from 6.52% at 12/31/00 to 3.52% at 12/31/01. LAIF projects rates of 2.7% for the quarter ending March 2002 and 2.3% for the quarter ending June, 2002.

### **Parking Lot/Structure Revenue**

Revenue for the lot and parking structure are higher than the first half of the previous year due to the rate increase but less than expected, compared to the budget estimate provided by the parking operator. Due to the difficulty in projecting the impact of the increased rates and the change in the flat rate, the estimate is not being revised at this time. If actual revenue is lower than anticipated, there is no real impact in this fund (Downtown Enhancement Fund) since there are additional funds available. Future revenue will be somewhat easier to predict after this full year of operation at the new rates.

### **Parking Fines**

Parking Fund revenue revisions affect the General Fund since any funds remaining at year end automatically transfer to the General Fund. The revenue for the first half is higher than last year due to the fact that the fines were increased, however 6% fewer citations were issued last year and 6% fewer citations were issued the first half of this year, which translates to lower revenue than estimated overall.

### **Additional Appropriations**

The following additional appropriations are requested:

#### **GENERAL FUND (001)**

City Treasurer		
Contract Services/Private	\$6,125	Increase in bank service

charges, earnings allowance on bank balances has dropped to 1.2%.

Personnel			
Contract Services/Private	\$30,000		Increase in legal services for personnel matters such as grievances, appeals and litigation.
Prospective Expenditures			
Unclassified	(\$61,983)		Reduced to offset midyear appropriation requests and revenue revisions.
Public Works			
Street Maintenance/Traffic Safety			
Utilities	\$5,674		Increase in electricity charges.
Non-capitalized assets	\$10,000		Traffic signal controller and cabinet at 16th/Valley at school crossing. Currently renting controller at a cost of \$600 per month.
Building Maintenance			
Contract Services/Private	\$1,500		Hazardous waste removal for fluorescent tubes and ballasts.
Parks			
Contract Services/Private	\$1,600		Rental of Hi-lift truck to replace light fixtures at Clark Field which have failed.
Maintenance Materials	\$1,500		Replace 6 Clark Field light fixtures. Old fixtures have failed and cannot be repaired.
CIP 622			
ADA Compliance, City Hall			
Contract Services/Private	(\$33,172)		Reduce General Fund appropriation for ADA related construction management services. CDBG funds will be used for these costs

**TOTAL GENERAL FUND  
APPROPRIATIONS**

**(\$38,756)**

CIP 630		
Pier Renovation/Phase III		
Contract Services/Private	(\$303,401)	Reduction in current budget to reflect design only. Funds will be reserved for future construction project.
<b>RESERVE FUNDS FOR PIER RENOVATION/PHASE III</b>	<b>\$303,401</b>	
<b>DOWNTOWN ENHANCEMENT FUND (109)</b>		
Public Works		
North Pier Parking Structure		
Contract Services/Parking Lot Operator	\$8,514	Salaries for Parking Structure/Lot A revised to reflect actual employees assigned.
Utilities	\$10,570	Increase in electricity charges.
Parking Lot A		
Contract Services/Parking Lot Operator	(\$10,356)	Salaries for Parking Structure/Lot A revised to reflect actual employees assigned.
County Share Parking Structure Revenue		
Contract Services/Government	(\$9,542)	Decrease net income estimate due to midyear salary and electricity cost revisions.
Lifeguard Serv/Beach Maint		
Contract Services/Government	\$55,000	1996-97 Lifeguard services and beach maintenance per County Lifeguard agreement. (\$275,000 in 5 equal installments beginning January 1, 2002 and ending January 1, 2006).
<b>TOTAL DOWNTOWN ENHANCEMENT FUND</b>	<b>\$54,186</b>	

**PROP A OPEN SPACE FUND (121)**

Public Works

CIP 305

Installation of CDS Clarifier Units

Contract Services/Private

(\$322,761)

Project was cancelled.

CIP 306

Installation of Catch Basin Inserts

Contract Services/Private

(\$25,000)

Project completed FY 00-01  
Funds not needed.

CIP 630

Pier Renovation Phase III

Regular Salaries

(\$5,992)

No construction this fiscal year.

Retirement

(\$448)

No construction this fiscal year.

Employee Benefits

(\$564)

No construction this fiscal year.

Medicare Benefits

(\$87)

No construction this fiscal year.

Contract Services/Private

(\$229,291)

No construction this fiscal year.

**TOTAL PROP A OPEN SPACE FUND**

**(\$584,143)**

**PARKS/REC FACILITY TAX FUND (125)**

Public Works

Parks

Contract Services/Private

\$5,000

Installation of restroom dividers  
at Clark Stadium as requested  
by Little League and approved  
by City Council 1/8/02.

**TOTAL PARKS/REC FACILITY TAX FUND**

**\$5,000**

**COMMUNITY DEVELOPMENT BLOCK  
GRANT FUND (140)**

Public Works

CIP 147

Curb Cut-Handicap Ramps/Various Locations

Contract Services/Private

\$100,000

ADA related construction in public right of way at various locations.

CIP 622

ADA Compliance, City Hall

Contract Services/Private

\$33,172

ADA related construction management services.

**TOTAL COMMUNITY DEVELOPMENT  
BLOCK GRANT FUND**

**\$133,172**

**GRANTS FUND (150)**

Police

Domestic Violence Advocacy Grant

Contract Services/Private

(\$185)

Adjust appropriation to actual amount approved in grant contract.

Maintenance Materials

(\$185)

Adjust appropriation to actual amount approved in grant contract.

Public Works

CIP 139

Hermosa Avenue/16th to 26th

Contract Services/Private

(\$30,000)

Costs for 19th Street are not eligible for reimbursement by STPL grant. Capital Improvement Fund will be used for these costs.

CIP 630

Pier Renovation/Phase III

Contract Services/Private

(\$100,000)

No construction this fiscal year.

**TOTAL GRANTS FUND**

**(\$130,370)**



**SEWER FUND (160)**

Public Works

Sewer and Storm Drains

Utilities	\$660	Increase in electricity charges.
CIP 305		
Installation of CDS Clarifier Units		
Contract Services/Private	(\$57,899)	Project cancelled.
CIP 306		
Installation of Catch Basin Inserts		
Contract Services/Private	(\$3,750)	Project completed FY 00-01. Funds not needed.
CIP 410		
Sewer Rehab/Loma District		
Contract Services/Private	(\$548,834)	No construction this fiscal year.
CIP 411		
Sewer Rehab/Reconstruction-Target Area 1		
Contract Services/Private	(\$822,283)	No construction this fiscal year.
CIP 412		
Sewer Rehab/Reconstruction-Target Area 2		
Contract Services/Private	(\$720,503)	No construction this fiscal year.
CIP 413		
Sewer Rehab/Reconstruction-Target Area 3		
Contract Services/Private	(\$42,684)	No construction this fiscal year.
CIP 630		
Pier Renovation/Phase III	(\$90,000)	No construction this fiscal year.
<b>TOTAL SEWER FUND</b>	<b>(\$2,285,293)</b>	

**CAPITAL IMPROVEMENT FUND (301)**

Public Works

CIP 139

Hermosa Avenue/16th to 26th

Contract Services/Private	\$30,000	Costs for 19th Street are not eligible for reimbursement by STPL grant.
CIP 107		
Traffic Signal/Ardmore Avenue & 16th Street		
Contract Services/Private	\$75,000	Proposed traffic signal at

Ardmore and 16th Street.  
 Approved by Council 12/11/01.

CIP 171		
Street Improvements/Ardmore & Gould		
Contract Services/Private	(\$38,958)	Project completed under budget.
CIP 192		
Various Street Improvements		
Contract Services/Private	(\$933,227)	No construction this fiscal year.
CIP 410		
Sewer Rehab/Loma District		
Contract Services/Private	\$20,606	Additional funding needed for design services.
<b>TOTAL CAPITAL IMPROVEMENT FUND</b>	<b>(\$846,579)</b>	
<b>LOMA UTILITY UNDERGROUND IMPROVEMENT FUND (308)</b>		
Public Works		
CIP 183		
Utility Undergrounding/Loma Drive		
Contract Services/Private	\$15,545	Construction management funds should have been reappropriated from 2000-01.
<b>TOTAL LOMA UTILITY UNDERGROUND IMPROVEMENT FUND</b>	<b>\$15,545</b>	
<b>INSURANCE FUND (705)</b>		
Personnel		
Liability Insurance		
Contract Services/Private	\$78,100	Supplemental Risk Premium due to ICRMA and increase to general liability premium.
<b>TOTAL INSURANCE FUND</b>	<b>\$78,100</b>	

**EQUIPMENT REPLACEMENT FUND (715)**

## Community Resources

Auto Maintenance	\$750	Repair of transmission on department vehicle was not anticipated.
Fire		
Vehicles	\$4,289	Additional funding requested to replace Chevy Caprice with a Dodge Durango.
Information Systems		
Regular Salaries	\$16,443	Increase salary range of current position and add a second Technician position per City Council approved Technology Master Plan. Assumes new position filled in April 2002.
Retirement	\$1,232	See explanation for salaries.
Employee Benefits	\$2,060	See explanation for salaries.
Medicare Benefits	\$238	See explanation for salaries.
<b>TOTAL EQUIPMENT REPLACEMENT FUND</b>	<b>\$25,012</b>	

**Transfer Policy/Contingency Level**

In fiscal year 1995-96, the City Council approved a policy whereby any funds left at year end in the General Fund would transfer equally to the Compensated Absences Fund, Insurance Fund and Equipment Replacement Fund (ERF). The Compensated Absences Fund was created to set aside funds for amounts owed to employees for accumulated sick leave, vacation leave, etc. The purpose of the transfer to the Insurance Fund and ERF was to build equity in the funds. The Insurance Fund had negative equity at the time and the ERF was underfunded since it was newly created.

In 1998-99, the policy was changed to discontinue allocating funds to the Compensated Absences Fund and create a Capital Improvement Fund, which would receive 1/3 of the transfer from the General Fund.

Anticipated fund balances at 6/30/02 in each fund are as follows:

Compensated Absences Fund	\$664,005
Capital Improvement Fund	1,034,960
Insurance Fund	1,381,999
Equipment Replacement Fund	1,084,215

(net of fixed assets)

Staff recommends that the current policy of transferring to the Capital Improvement Fund, Insurance Fund and Equipment Replacement Fund be amended to include the Contingency, with goal amounts added for the Insurance Fund, ERF and the Contingency. Funds for the Capital Improvement Fund are needed on an ongoing basis, so would have no goal amount. We also recommend transferring the amount designated as the Contingency to a separate fund. Upon reaching any of the goal amounts, staff would come back to the City Council to direct the funds elsewhere.

### **Amendment to Transfer Policy**

#### **Insurance Fund**

We recommend that a goal of \$3,000,000 in retained earnings be set for the Insurance Fund based on the following criteria:

- 1) Estimated claims reserves, including estimates for IBNR (incurred but not reported) are recorded as liabilities in the Insurance Fund. The actuary retained by Independent Cities Risk Management Authority (ICRMA), our insurance pool, provides these estimates. ICRMA has an actuarial study performed for ICRMA claims and in the process a “review” of each city is performed to provide claims estimates for the cities. Since the “review” does not rise to the level of an actuarial analysis of our city’s claims, the expected accuracy level is only 50%, which means the estimates could be off by 50%. For that reason, staff will recommend in the 2002-03 Budget that we have an actuarial analysis of our claims performed. In the meantime, we believe it is prudent to set a goal reserve amount equal to 50% of the current claims liability, which would be approximately \$1m.
- 2) In addition, staff recommends setting a goal amount for a reserve for catastrophic losses, such as an earthquake. One method of calculating amounts to set aside for catastrophic losses is to use our self-insured retention (SIR) multiplied by a number of claims. Staff recommends that we use the SIR multiplied by three, which is a commonly used rule of thumb. Our combined SIR for Worker’s Comp and Liability is \$575,000, therefore the amount in round numbers would be \$2m.

Adding the \$1m for differences in claims reserves and the \$2m for catastrophic losses gives us a retained earnings goal of \$3m for the Insurance Fund. Estimated retained earnings as of 6/30/02 in the Insurance Fund are \$1,381,999. At the past average rate of transfer, adjusted for 1/4 to each fund instead of 1/3, the goal would be reached in approximately six years. Of course, depending on economic conditions and amounts left unspent in the General Fund, the length of time could vary.

#### **Equipment Replacement Fund**

We recommend that the goal for the ERF be the “accumulated amount” calculated on the Equipment Replacement Schedule. The Vehicle and Computer Replacement Schedules, found in the Adopted Budget, calculate what the accumulated amount should be based on the replacement cost and life of the equipment. The 2001-02 Accumulated Amount is \$1,435,531. Estimated retained earnings as of 6/30/02 in the ERF are \$1,084,215.

### **Contingency Level/Accrued Comp Fund**

### **Accrued Comp Fund**

As mentioned earlier, transfers to the Accrued Comp fund were discontinued in 1998/99. The balance in the fund is \$664,005. Accrued liabilities for vacation, etc. equals \$573,155. Staff recommends that we adopt a 50% funding level for these liabilities, which would be \$286,577, and transfer the remaining \$286,577 to the Contingency.

### **Contingency Level**

The current contingency level, set in 1995-96 as a static amount, is \$1,564,296, or 9.57% of appropriations. There is no “best practice” in this area as to the contingency amount. Cities generally set levels of reserves based on their individual circumstances and the economic climate. Standard & Poor’s, one of the credit rating agencies for debt issues, looks for reserve levels of at least 5% in cities’ financial statements to demonstrate financial flexibility during times of cash flow deficiencies, economic downturns, etc. The partner in charge of our audit indicated at a recent City Council meeting that the average for his client base of 46 cities was in the area of 33%. A recent survey on the California Society of Municipal Finance Officers website indicated that of the 33 cities responding that used a percentage for setting the contingencies, the range was from 5% to 100%, with an average of 18%. Manhattan Beach uses 20%; Redondo Beach uses 7.5%.

Staff recommends that we establish a goal of 15% to be accomplished as part of the transfer of unspent funds from the General Fund. With the deposit of the \$286,578 from the Accrued Comp Fund, the Contingency balance would be \$1,850,874, or 11% of appropriations. With a 15% goal, it would take approximately two years to reach that level.

### **Impact of Electricity Rate Increases on UUT Revenue**

In September, Staff agreed to report back on UUT revenue from electric providers. Receipts for service periods July – October 2001 (the rate increase was effective July 1) are \$92,111 (63%) higher than the prior year. Receipts for July – November 2001 appear to be higher by only 58%, although it is not certain how much is owed by Enron and whether it will be received.

Electric costs for the City are higher, just as they are for residents. In fact, the percent of increase for business is actually higher. With the recommended midyear revisions, City utility estimates are higher than last year by \$137,045 or 36%.

Since it is difficult to estimate (with only five months of history since the rate increase) what the City’s costs will actually be and what the overall additional revenue from the UUT on electricity will be for the year, Staff recommends that we re-evaluate at year end when all of the actual numbers are known.

Upon completion of Midyear Budget Review, staff will begin work on the 2002-03 Budget. Instructions go out next week!

Concur:

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Viki Copeland  
Finance Director

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Stephen R. Burrell  
City Manager