

February 3, 2006

Honorable Mayor and Members of
The Hermosa Beach City Council

City Council Meeting of
February 14, 2006

MIDYEAR BUDGET REVIEW 2005-06

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 personnel changes as discussed herein under "Personnel Changes".
3. Approve the recommendations discussed herein under "Recommendations on Policies/Goals."

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 discussed herein reflect increases in the General Fund. (Parking Fund revenue items are now shown in the General Fund since the two funds were combined on 7/1/05). Significant line item changes are discussed below.

REVENUE (see Revenue Worksheet)

The overall change in revenue in the General Fund is \$774,212 or 3.48%. One-time funds from the State's early repayment of the vehicle license fees withheld in 2003-04 are included in that revenue. Those funds were scheduled for repayment in August 2006 but were paid one year early (These funds are shown under the Intergovernmental/State category in account 3506.) Without those one-time funds, the change in revenue would only be 2%. The most significant changes by category are addressed below.

Taxes

The majority of the revenue increase is in the Tax category. The secured property tax levy is 12% higher than the previous year and 6% over our original estimate. This increase is consistent with the past few years' history, reflecting the increases in residential property values and the turnover rate. This is the second and final year of the State's reduction of \$326,429, which was taken from local government to help balance the State budget.

The sales tax estimate has been revised up 6% based on activity for the first half, however it is estimated that \$126,742 of the last quarter will not be received until January 2007 due to the State's swap of sales tax funds for property tax ("triple flip"). Since this amount will be unavailable for appropriation until next year, the amount is designated in the General Fund.

As in the original budget, sales tax is split into two accounts now, 3108 Sales Tax and 3104 In Lieu Sales Tax. The In Lieu amount is the State's "Triple Flip" 25% reduction of local government sales tax, which will be repaid in January and May with property tax funds.

The following chart 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 to show what the trends are by category and geographic area.

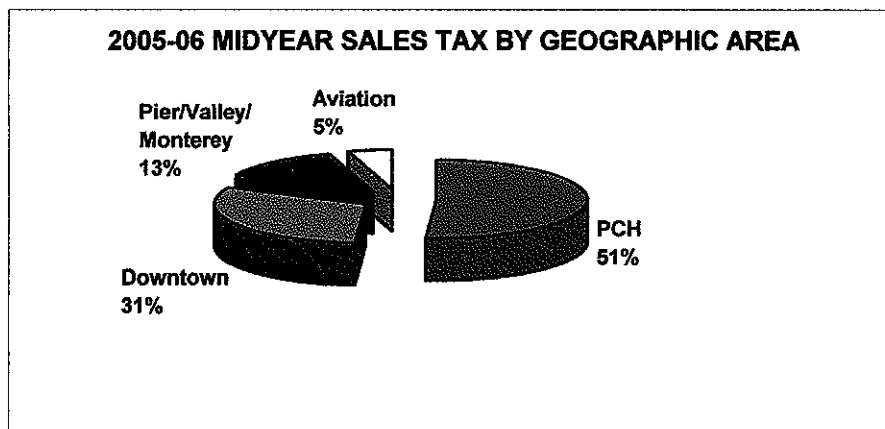
**SALES TAX
Comparison of First Half of 2004/05 to 2005/06
Top Ten Categories**

RANK/BUSINESS CLASS*	Sales Tax 2005-06	Inc./ (Dec.)	% of Change Prev. Yr.	Percent of Total
1. EATING/DRINKING PLACES	372,349	\$44,712	13.65%	34.51%
2. AUTO DEALERS AND SUPPLIES	150,978	(\$229,269)	-60.29%	13.99%
3. OTHER RETAIL STORES	148,202	\$12,735	9.40%	13.73%
4. BUILDING MATERIALS	107,370	\$8,034	8.09%	9.95%
5. FOOD STORES	100,446	\$9,118	9.98%	9.31%
6. SERVICE STATIONS	*	*	35.90%	*
7. BUSINESS, SERVICE, REPAIR	60,781	\$6,344	11.65%	5.63%
8. DRUG STORES	*	*	66.31%	*
9. FURNITURE/APPLIANCE	26,773	(\$1,864)	-6.51%	2.48%
10. APPAREL STORES	19,706	\$3,877	24.49%	1.83%

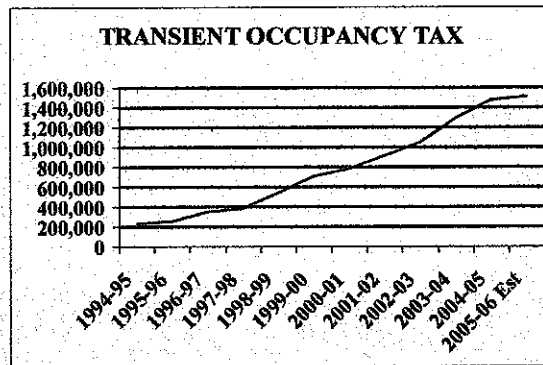
* Drug store and service station amounts are not listed because there are too few in the category

Sales Tax Comparison by Geographic Area

LOCATION	Revenue	% of	% Chg	Revenue	% of
	2004-05	Total		2005-06	Total
PCH	683,089	62%	-26%	506,302	51%
Downtown	260,548	24%	17%	304,637	31%
Pier/Valley/Monterey	111,990	10%	15%	129,340	13%
Aviation	42,779	4%	12%	48,025	5%

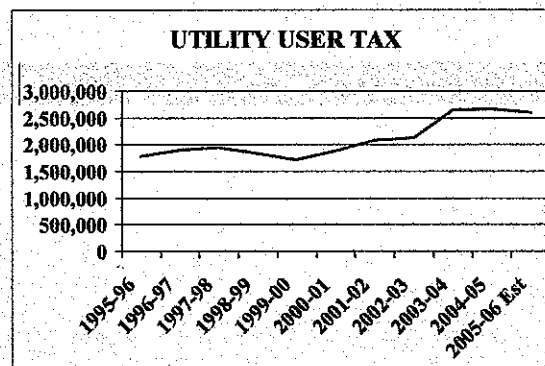


Transient Occupancy Tax (TOT) is being adjusted up by approximately 4%, slightly above the 04/05 level. As you can see from the trend line, revenue is leveling off after increasing 23% from 02/03 to 03/04 and 14% from 03/04 to 04/05.



Utility User Tax (UUT) revenue is being adjusted down 3% from the 04/05 fiscal year and 9% from the original budget. We were unaware when the budget was prepared that one of the telecom providers was over-reporting their revenue. In addition, as reported at year end, there are a number of issues and concerns with utility user taxation as it relates to new technologies and the taxation of these services. Staff will be working with our consulting attorney for this issue, Don Maynor, and the City Attorney to recommend updates to our current ordinance to address some of these issues.

The volatility we are seeing in this revenue source (given that the UUT is our second highest source of revenue and provides funding primarily for public safety and sewer operation/maintenance) underscores why it is necessary to have adequate funds in our Contingency Fund.



Fines and Forfeitures

The estimate for Municipal Court Fines is decreasing by 29%, based on revenue for the first half. Revenue is lower due to a Police Department policy change on arrests for public intoxication, which results in less revenue from fines.

User Fee Study

A combined estimate of \$300,000 was included in the original budget under "Other Revenue" to account for the impact of the fees implemented through the user fee study. Since the new fee amounts have now been approved, the impact of the changes is included in each line item where the fee is recorded.

One user fee, which was approved in the study, was for the Community Development costs of Appeals of Planning Commission Actions to the City Council. It was not recognized at the time that the amount of \$594 shown as "Current Fee" was not being collected. The new fee calculated by the study is \$1,492. Since the fee was approved, it is our intent to collect the fee unless the appeal is made by the City Council, in which case the fee is waived.

ADDITIONAL APPROPRIATIONS

The following additional appropriations are requested:

GENERAL FUND (001)

City Clerk

Part Time/Temporary	\$5,526	Special election premium for City Clerk approved by Council 1-10-06
Medicare Benefits	\$81	Medicare benefits on additional election premium
Contract Services/Private	\$813	Election supplies for special election June 6, 2006.
Contract Services/Government	\$35,000	County estimate for consolidated election June 6, 2006.
Office Supplies	\$1,000	Additional supplies and publications costs for special election June 6, 2006.
Community Development Building Division Contract Services/Private	\$1,900	Revision of estimate to convert building/property data index cards to laserfiche data base.
Contract Services/Private	\$20,000	Grease trap and NPDES inspection services were not budgeted in 2005-06.
Finance Administration Contract Services/Private	\$1,245	Increase to Utility Users tax audit services contract based on formula for actual collections in 2004-05.
Finance Cashier Contract Services/Private	\$10,652	MC/VISA charges have more than doubled compared to 04-05 due to usage.

Fire			
Equipment more than \$1,000	\$1,219	Women's Club donation in 2004 for power fan was inadvertently overlooked during reappropriations.	
Personnel			
Contract Services/Private	\$95,000	Additional unanticipated legal costs were not budgeted in 2005-06.	
Police			
Safety Gear	\$(5,153)	Reduce cost of ballistic vests for grant award from Ballistic Vest Partnership Program.	
Public Works			
Building Maintenance Division			
Contract Services/Private	\$10,413	Unanticipated expenditures for repairs at Base III.	
Maintenance Materials	\$3,636	Unanticipated expenditures for materials and supplies for the Base III remodel.	
TOTAL GENERAL FUND	\$181,332		
DOWNTOWN ENHANCEMENT FUND (109)			
Public Works			
Downtown Enhancement			
Contract Services/Private	\$30,000	Install clock donated by the Kiwanis Club and reinforced concrete planter as runaway vehicle barrier.	
Public Works			
County Share of Parking Structure Revenue			
Contract Services/Government	\$6,352	Adjust Net Income for Midyear Changes	
TOTAL DOWNTOWN ENHANCEMENT FUND	\$36,352		
PROP A OPEN SPACE FUND (121)			
Public Works			
CIP 630			
Municipal Pier Upgrades/Phase III			
Contract Services/Private	\$(27,939)	Year end expenditures in 2004-05 were more than anticipated therefore the 2005-06 budget must be reduced to match grant amount available.	
TOTAL PROP A OPEN SPACE FUND	\$(27,939)		
MYRTLE DISTRICT ADMINISTRATIVE EXPENSE FUND (137)			
Finance			
Administrative Charges			
Contract Services/Private	\$150	Delinquency management costs increased for 2005-06.	
TOTAL MYRTLE DISTRICT ADMINISTRATIVE EXPENSE FUND	\$150		

PROPOSITION A FUND (145)

City Manager

Afterschool Program Shuttle

Contract Services/Government

\$6,500 After- school program shuttle was previously budgeted as part of WAVE program. The program is now shown separately.

Special Event Shuttle

Contract Services/Government

\$14,661 Special Events shuttle (Fiestas, Navy port call and AVP) was previously budgeted as part of WAVE program. The program is now shown separately.

Community Development

Dial-A-Ride

Salaries

\$(15,997) WAVE program was discontinued in 2005-06.

Contract Services/Government

\$(107,738) WAVE program was discontinued in 2005-06.

Finance Cashier

Bus Pass Subsidy

Contract Services/Government

\$568 Bus Pass sales have increased more than anticipated in 2005-06.

TOTAL PROPOSITION A FUND

\$(102,006)

GRANTS FUND (150)

Police

Bulletproof Vest Partnership Program

Safety Gear

\$5,153 Grant award for ballistic vests to be purchased in 2005-06.

TOTAL GRANTS FUND

\$5,153

SEWER FUND (160)

Public Works

Sewers and Storm Drains Division

Contract Services/Private

\$20,000 Increase funding for exceptionally high number of emergency sewer repairs to date and additional repairs that may be needed.

Contract Services/Private

\$15,000 Additional root removal via herbicide in sewer system to decrease wear and tear caused by other means of cleaning sewer lines.

TOTAL SEWER FUND

\$35,000

EQUIPMENT REPLACEMENT FUND (715)

Police Department
Vehicles

\$25,000 Early replacement of detective vehicle and additional radio for Interim Police Chief

Community Resources
Auto Maintenance

\$1,800 Unanticipated repair to vehicle due to collision.

Auto Maintenance

\$2,000 New batteries for GEM electric vehicle were not budgeted in 2005-06.

TOTAL EQUIPMENT REPLACEMENT FUND \$28,800

PERSONNEL CHANGES

Three personnel changes are recommended:

Community Development

\$4,695 Provide benefits for the Building/ Planning Technician that was budgeted 100% in the 2005-06 Budget. Annual amount \$14,085.

Public Works

\$19,009 Add one Public Works Inspector to provide in-house inspection for street projects. Annual amount \$76,037.

\$6,672 Add 10% premium for attainment of Public Engineer Certification. Annual amount depends on eligibility.

No change in the Information Systems budget is being recommended at this time, but it is anticipated that a change will be recommended in the 2006-07 Budget. Since the retirement of one Information Systems Technician in November and with the second position vacant since the previous December, the City has been using our network support contractor, Prosum, to provide day to day services on a trial basis. This change is anticipated to save approximately \$50,000 a year, yet provide a wider range of technical expertise and staffing flexibility, with no coverage issues for vacations, sick time, etc. All departments have been very satisfied with the service level during the initial trial period and if this continues through the end of the fiscal year, the intent would be to recommend this as a permanent change.

FINANCIAL POLICIES

The City Council's adopted policies are:

General Fund - 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.

Compensated Absences Fund - Goal of fund balance equal to 50% funding for accrued liabilities for employee vacation, sick and compensatory time.

Contingency Fund - Goal of fund balance equal to 15% of the General Fund appropriations for economic uncertainties, unforeseen emergencies.

Insurance Fund - Goal of \$3,000,000 in retained earnings for claims reserves and catastrophic losses.

Equipment Replacement Fund – Goal of retained earnings equal to the accumulated amount calculated for all equipment, based on replacement cost and useful life of equipment.

Retirement Stabilization Fund – Created with the 2004-05 Budget for use during times of rising retirement costs, which recently have resulted primarily from reduced investment earnings.

Recommendations on Policies/Goals

- Since we budget for estimated payouts of accrued time and any known retirements, it is recommended that the goal in the Compensated Absences Fund be reduced to 25% of liabilities.
- As is shown in the Over/(Under) Goal Amount column below, the Contingency Fund, Insurance Fund and Equipment Replacement Fund (ERF) are somewhat under funded according to our policy. This occurred as a result of combining the General and Parking Fund and because of the loans to the Downtown Enhancement Fund (DEC) from these funds to purchase the property adjacent to City Hall. It is recommended that a loan repayment of \$424,734 be made from the DEC to the Contingency, Insurance and ERF, which boosts the balance in each fund. The estimated balance left in the DEC after this payment would be \$71,234.
- Combining the Parking Fund with the General Fund resulted in a higher appropriation amount for calculation of the 15% of appropriations goal in the Contingency Fund. Rather than trying to reach the 15% in one year, it is recommended that \$490,523 be transferred from the Retirement Stabilization Fund now, bringing the percentage to almost 13%, with the balance of the 15% to be achieved next fiscal year. Since the increase in our retirement costs for 2006-07 is estimated to be far less than in recent years, it seems appropriate to lower the balance in the Retirement Stabilization Fund and put the funds in our Contingency Fund.
- For 2005-06, the standard policy of transferring funds remaining at year-end 2006 will be followed, which allocates 1/4 each to the Capital Improvement Fund, the Insurance Fund, the ERF and the Contingency Fund.

Progress on Funding Goals				
Fund Name	Goal	Estimated Fund Balance 6/30/06	Over/(Under) Goal Amount	Balance After Midyear Recommendation
Compensated Absences Fund	\$268,481	\$486,381	\$217,900	\$268,481
	25.00%			25.00%
Contingency Fund*	\$3,459,858	\$2,119,335	(\$1,340,523)	\$2,969,336
	15.0%	9.19%	(5.81%)	12.87%
Insurance Fund*	\$3,000,000	\$1,117,309	(\$1,882,691)	\$1,258,887
Equipment Replacement Fund*	\$1,684,102	\$307,361	(\$1,376,741)	\$448,939
Retirement Stabilization Fund		\$1,536,398		\$1,045,875

*Balances shown are cash balances and do not include funds to be received over time from the payback of loans made to purchase the storage property adjacent to City Hall.

Funding for Retiree Health Benefits

For the past two years, the City set aside monies in a separate fund to make the Annual Required Contribution for Police Association retiree benefits as determined by an actuarial study. During 2005 labor negotiations, an actuarial study was conducted to value retiree benefits for all employee groups and determine the Annual Required Contribution. The total amount is \$543,080. \$152,910 was already budgeted for Police benefits based on the 2004 actuarial study. It is recommended that the balance of \$390,170 be funded by using the one-time vehicle license fee revenue repaid by the state, with the remaining \$61,792 transferred from the General Fund.

While there is no accounting requirement currently that requires recording of the liability for these other post employment benefits (OPEB), the City will be required in 2007-08 to comply with new reporting standards. The reporting requirement will be similar to standards for reporting our retirement costs. By choosing to fund this Annual Required Contribution, and setting aside funds, which will be held in trust, the City is meeting its contribution requirement, as we do with CalPERS.

THE CHALLENGE FOR NEXT YEAR

The results of the Midyear Review are positive, with a net increase of revenue over additional appropriations of \$172,334. Unallocated funds of \$136,255 were added to Prospective Expenditures and the balance represents appropriated donations and designations occurring during the first half of 05-06.

For next year, as with the current year, there will be several factors, negative and positive, affecting preparation of the 2006-07 budget:

- ERAF III, the property tax shift to the state ends, meaning there will be no reduction to property tax revenue of \$326,429.
- There will be no replacement revenue for the closure of South Bay BMW site other than sales from the new Lotus dealership. If strong property tax growth continues, this will help offset the loss of sales tax. As expressed earlier, UUT revenue volatility is a concern.
- Retirement costs are projected to increase by only 8%, as compared to last year's increase of 46%.
- Three-year labor contracts exist for all employee groups except Fire.
- The projected balance in the Lighting and Landscaping District is roughly \$20,000. An increase in the assessment will be placed on the ballot per City Council direction.

2006-07 budget preparations begin immediately after the midyear revisions are approved.

Respectfully submitted,

Concur:



Viki Copeland
Finance Director



Stephen R. Burrell
City Manager