



Scenic Pacifica
Incorporated Nov. 22, 1957

CITY OF PACIFICA

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June 13, 2016

To the City Council and the Community of Pacifica,

On behalf of the City staff, I am pleased to present a balanced operating budget for Fiscal Year 2016-17. Like many in the past, this budget development process has not been an easy one and required many changes to continue to provide services and meet community needs.

The 2016-17 Operating Budget is designed to deliver an even greater degree of clarity and understanding of the City's financial status. Staff and I continue to move the City forward and appreciate the support and patience of the Council and the community.

2016-17 Operating Budget Development

In reviewing the 2016-17 Operating Budget, readers will find that we continue to rely on the following themes included in the last two years' operating budgets:

- ❖ **Pursue cost recovery.** The City continues to move toward achieving full cost recovery as appropriate in setting our fees and charges.
- ❖ **Budget annual expenses at or below annual revenues.** We continue to maintain our projected expenses at or below projected revenues for 2016-17, and not rely on reserves or one-time revenues to meet ongoing financial needs.
- ❖ **Align one-time money to cover one-time expenses** rather than ongoing operations. This is a direction that the City has been moving toward for some time and a "best practice." The 2016-17 Operating Budget continues the practice of appropriately aligning these funds.
- ❖ **Increase financial transparency.** Staff continues to be focused on sharing financial information in such a way as to engender trust in how the City manages the public's money.

This balanced operating budget has taken several months to complete and includes preparing revenue and expense projections, understanding the result, and developing strategies for

bringing them into balance. In addition, this 2016-17 Operating Budget document continues to be presented as a comprehensive summary view of the City's fiscal health in an easy-to-read format.

We continue to conservatively project tax revenues and to recommend appropriate increases to our fees and charges that help offset increased costs.

Together, the staff and I developed a number of strategies to meet the City's needs and bring the budget into balance. The following summarizes the key recommendations accepted by the City Council and included in the 2016-17 Operating Budget.

2016-17 Work Plan and Goals

Cities typically identify goals and plan activities on an annual basis in the spring so that city resources can be aligned with achieving or completing them during the budget development process.

We began this same process this past spring but were not able to complete it by the time of budget adoption. (A special City Council meeting has been scheduled for July 9, 2016, to complete the process.) In the meantime, we continue to rely on the six (6) goals the City Council-adopted at its meeting on June 8, 2015, and the Updated 2015-16 Work Plan approved by the City Council at its March 28, 2016, meeting to guide City activities. A copy of both documents is included in this budget document as a separate section.

The purpose of the Work Plan is to ensure clear expectations and that the City's meager resources are directed toward Council-approved activities.

The Work Plan doesn't include all the services the City delivers nor all the projects underway. Using an iceberg analogy, the Work Plan represents projects and initiatives that appear "above the water line" and are highly visible to the Council and the community. Below the "water line" and not as visible but at least equally important are the myriad foundational activities City staff engage in every day to serve the community such as issuing permits, patrolling streets, responding to emergencies, mowing lawns, hiring employees, operating the sewage treatment facility, etc.

Once the 2016-17 Work Plan is developed, it will be presented to the City Council for adoption, most likely in late summer or early fall of 2016.

Tax Revenues

Pacifica's revenues are modestly increasing as the economy improves. For 2016-17, trends contributing to the increase include more homes sold and at higher prices as the housing market improves, more meals eaten in our restaurants, and more visitors staying in our hotels. This positive growth is reflected in the projected property tax revenues expected to increase by 2.75% and transient occupancy tax (hotel tax) projected to increase by 3.2%; overall our tax revenues are expected to increase by 2%.

Excess Educational Relief Augmentation Fund (Excess ERAF)

Another significant financial change continued this year is to treat "Excess ERAF" funds¹, a significant source of discretionary revenue, differently than in the past and to segregate it from City operating funds. As staff reported in 2014, San Mateo County began advising cities and other agencies in 2011 to begin treating these revenues as "one-time funds" and not to include them in the operating budget as ongoing revenues because the funds are not expected to continue indefinitely.

Starting in 2015, we established a new fund, Fund 30, to hold the revenue prior to appropriation toward Council-determined projects or initiatives.

These funds have become the primary source of monies available to respond City emergencies. Most recently, the emergency needs have been focused on responding to the impact of the El Nino storm season of 2015-16. Staff expects these funds to be needed as the matching funds required by State grants to complete repairs to the Pacifica Pier, Beach Blvd. Sea Wall & Promenade, the Milagra outfall storm water drainage pipe, and other damaged infrastructure. Our grant applications are still being processed so the exact amounts that will be required are not yet known.

For 2016-17, the Council approved a grant of \$83,000 for the Pacifica Resource Center. Staff will return in February or March of 2017 with the Pacifica Beach Coalition's request for City co-sponsorship of EcoFest 2017 with a grant of \$3,000 following our notification of the 2017 allocation of Excess ERAF funds.

Council confirmed that this practice of receiving the funds and then determining their use should continue for 2016-17.

Loan from Fund 34 to General Fund to Smooth Pension Obligation Bond Payments

As part of the 2014-15 Budget, the City Council approved an inter-fund loan between *Fund 34 – Sewer Facility Construction Fund* and *Fund 01 – General Fund* to help smooth repayment of the 2010 Pension Obligation Bonds through 2020-21. Please see the "Pension Obligation Bond Loan Repayment" section of the budget for more information. The budget document continues to include this information in detail as part of our efforts to improve transparency.

Adjustments to Fees & Charges Master Schedule

A number of fees and charges have been modified for various reasons. Some fees charged for City services are set at a flat dollar amount (i.e., recreation class fees) while others depend on the amount of time spent on the service (i.e., development review). In this latter case, we use an

¹ San Mateo County collects property taxes and deposits a portion into the Educational Relief Augmentation Fund (ERAF) to fund K-12 schools and community colleges. Excess ERAF is the revenue that remains after all schools receive funding that meets the State mandated funding levels. Excess ERAF revenues, prior to the dissolution of Redevelopment, were to be returned to the taxing entity (City) from which it was collected. The recent legislation dissolving Redevelopment Agencies (RDA) changes how property taxes are distributed for school funding and eventually eliminates Excess ERAF and its subsequent distribution to cities. The exact timing of this change remains uncertain.

hourly rate that reflects the staff costs to provide the service. The Cost Allocation Plan and Fee Study completed by Willdan Financial Services in 2013 helped determine the appropriate starting hourly rate.

For 2016-17, the current year's hourly rate was increased by the Consumer Price Index of 3.2% or the Construction Cost Index of 2.1% (depending on the staff providing the service) to reflect part of the cost increases associated with the personnel providing the service. Other changes have been made to fees that are based on meeting State or County requirements or to reflect market changes (mostly for Parks, Beaches, and Recreations class or rental costs).

In addition to the individual increases, the total projected revenue expected to be collected from fees and charges for City services and programs reflects staff's projections for increases in various activities, e.g., more people sign up for classes, more permits issued for home remodels and more development projects get underway.

This revenue category comprises more than 37% of the General Fund for 2016-17 and has become the City's largest single source of funding.

Significant Changes affecting City Departments

In this year's budget there have been a number of significant changes that involve staffing (defined as "full time equivalents" or FTEs) and/or department budgets and they are highlighted here.

The proposed 2016-17 Budget includes changes in personnel costs that exist in bargaining agreements currently in place and that affect **all Departments**.

To strengthen the City's administrative support services, two half-time positions have been added to the **General Government** - Finance Division and -Human Resources Division:

- ❖ Add 0.5 FTE Administrative Assistant to the Finance Division. This action converts an existing half-time position into a full-time position.
- ❖ Add 0.5 FTE Human Resources Manager to plan, organize, direct, and coordinate the Human Resources Division. This action increases the personnel assigned to provide Human Resource services to a total of 1.5 FTEs.

The budget adds \$930,000 in reimbursable expenditure authority and projected revenues to the **Planning Department's** budget for the anticipated activity related to various large projects.

In addition, the **Public Works and Waste Water Departments** will have a number of changes associated with returning to the former organizational structure of having Waste Water operate as a division within Public Works. Specific changes are described below:

- ❖ Convert 2.0 FTE Maintenance Worker I Positions into Maintenance Worker II positions to provide a path for career growth;
- ❖ Establish 1.0 Public Works Deputy Director – Engineering & Field Services position;
- ❖ Convert 1.0 Waste Water Director position into a 1.0 Public Works Deputy Director – Waste Water Operations position;
- ❖ Split the Public Works Director's time to allocate 0.5 FTE to Public Works' Engineering and Field Services Division and 0.5 FTE to Waste Water Division; and
- ❖ Add 1.0 Senior Engineer to the Waste Water Division.

This restructuring is recommended as the best way to accomplish the capital projects required to meet the Cease & Desist Order (CDO) deadlines under which the City operates. Failure to meet the CDO requirements would result in significant financial penalties and prolong the negative environmental impacts.

The Waste Water enterprise funds, Fund 18 and Fund 34, will continue to be separate from the General Fund. More information about these funds can be found later in this budget message.

All Funds Budget Summary

The City's full operating budget includes more than just the General Fund even though that is the topic that often gets the most attention and for good reason. The General Fund is comprised of discretionary revenues and is focused on the City's operations. In addition, the majority of staff is funded from the General Fund.

However, there are a number of other funds that make up the City's full financial picture and that are important to understanding the City's overall financial status. Staff and I spent significant time delving into these funds in order to understand their status and expected activity over the next year. An "All Funds Budget Summary" is included as part of the operating budget document as well as a list of fund descriptions.

These funds may show deficits as projects are underway prior to the City receiving grant funds or other reimbursement for activities. In addition, any inter-fund loans would also be represented in the balances shown here. More specifics follow:

- **Fund 01 General Fund.** The General Fund is shown with a Fund Balance of just over \$2.38 million that reflects the audited results for 2014-15 as well as projected budget savings for 2015-16. There are also a number of special "reserves" connected to the General Fund and of note are the following three:

- **Reserve—General Fund.** This reserve designation was established by Council Policy in June 2013. The reserve has not yet been funded but Council identified beginning to fund the reserve as a high priority and doing so is on the Updated 2015-16 Work Plan.
- **Reserve—Legal.** This fund was established as a way to differentiate typical “regular” activities associated with the City Attorney’s Office and activities beyond those expected. Staff is hopeful that access to these funds won’t be necessary but if they are needed, Council action will be requested to transfer funds to meet specific needs.
- **Reserve for Advance-RDA.** Some years ago, the General Fund loaned funds to the Redevelopment Agency for investment in activities designed to increase property value and strengthen the local business base. The loan(s) would be paid back via tax increment realized as property values increased. Such actions were common among cities. The amount shown here, approximately \$2.5 million, is the portion of the loan that could still be eligible for repayment under the new Successor Agency structure. When the State of California dissolved Redevelopment Agencies, many cities were left holding loans that are no longer collectible and such is the case here. The City continues to carry the loan in hopes that a fraction of the funds will be repaid by the State at the conclusion of transition activities currently underway, however staff considers full repayment unlikely.
- **Fund 38 Disaster Accounting Fund.** This fund is used to track reimbursements (revenues from grants and fund transfers), and expenses related to unexpected catastrophic events.

Unfortunately, the City has a history of sustained damage as a result of significant storm events. Grant funds from State and Federal agencies have helped offset the repair costs over the years but require a local match of typically 25%. The negative balance is a result of having to borrow those matching funds from other sources.

This fund is also where the expenses and revenues associated with repairs that are currently being made as a result of our emergency declaration earlier this year and various other El Niño related issues are shown. The City has applied for grants from multiple sources to offset the repair costs and has received positive responses from potential grantors. The revenue amount shown for 2016-17 of \$3.8 million reflects a combination of grant funds and City matching funds coming from Fund 30 - Excess ERAF Fund.

The fund balance reflects the expenses and reimbursement for those expenses to date. Unfortunately full recovery of all costs from sources other than the City is not expected.

For **Capital Project Funds**, the following specifics are offered:

- **Fund 09 Street Construction Fund and Fund 22 General Capital Improvement Fund.** These fund balances reflect the expected revenue and projected expenses shown in the Capital Budget.

In addition, the balances also contain the impact of interest accruing on the Interfund loan from Fund 09 to Fund 22 of \$2,218,700, approved by Council in November 2003 and discussed in more depth during last year's budget development process. The related staff report indicated repayment of 2.0% annual interest on the principal, payable from Fund 22 to Fund 9. However, the annual interest payable has not been paid or accrued since the inception of the loan.

The outstanding interest payable since November 2003 through June 2016 is approximately \$631,000. Although the annual amount of interest (\$44,374) is typically displayed in the Fund's balance sheet, we have reflected it in the expenditure column (for Fund 22) and revenue column (for Fund 9) of this schedule only to show its ultimate impact on the fund balance. As a result, the impact of this interest accrual since the inception of the loan is reflected in the 06/30/16 and 06/30/17 projected fund balances for both funds.

For the **Enterprise Funds**, all will remain separate from the General Fund; more information follows:

- **Fund 18 - Sewer Charge Fund:** Accounts for all revenue (except connection charges) generated by operations, and all expenditures (including Debt Service) associated with operating and maintaining the Calera Creek Water Recycling Plant and the sanitary sewer collection system.

This fund also reflects the budget impacts associated with the restructuring of Waste Water Operations as a division within the Public Works Department organization with the staffing changes described above.

- **Revenues from Sewer Service have Decreased**
Beginning in 2015-16, we have seen a decline in revenues related to sewer service sales. Revenues from sewer services are down \$1.1 million or 8% in 2015-16; however, we were fortunate to receive an additional payment from San Mateo County this year which brought the decline to only \$412,000 or 3%.

The reduction in revenues is due to lower water usage by sewer service customers. In drought years, a water customer may conserve water. Since the methodology of

sewer rates is based on water usage, the more water conservation that takes place, the less the City collects for sewer charges.

As a result, we are budgeting revenues lower by \$521,000 or 4% from 2015-16 base levels in 2016-17. This will necessitate a \$1.6 million transfer from Fund 34 to Fund 18 to backfill the lost revenues needed to support Waste Water Treatment Plant's operations for the 2016-2017 fiscal year.

During 2016-17, the City will commission a sewer service rate study that will ideally generate a more stable revenue model for Fund 18. The City will also commission a facilities assessment to ensure that all capital needs are identified, planned for, and supported by the new revenue model.

- **Fund 34 - Sewer Facility Construction Fund:** Receives all revenues associated with connection fees and accounts for Capital Improvement Projects expenditures associated with plant and collection system projects.

The Capital Budget contains \$7 million in Wastewater Plant improvements. The Council reviewed and discussed the Capital Budget at the study session on May 11, 2016, and the final version that includes Council's feedback is included in the budget.

Repaying or Replenishing the Interfund Loans

In 2014, I reported that a number of interfund transfers or loans between funds had been made over past years and had produced deficits in some funds. Some of those deficits continue, primarily in Funds 38 and 22.

Temporary deficits (even over years) that are due to lags between receiving grants or reimbursement of expenses are common and easy to understand. In addition, loans between funds can be good practice as evidenced by the one made to help with the pension obligation bond payments two years ago. A crucial part of these actions, though, is to document them and include a plan for repayment or replenishment.

As part of the budget development process last year, the City Council asked for a formal policy on Interfund Loans that includes documentation of repayment of such transfers. The City Council adopted the attached policy (Attachment 1) at its meeting on February 22, 2016.

Getting back to addressing the loans that produced the deficit numbers, the strategies available to us to address them include the following:

- Applying future annual revenues (for funds other than the General Fund) we receive that are eligible to be transferred into the deficient fund or applied to offset the expenses that the deficits represent (staff continues to collect this historical information);

- Assigning a portion of General Fund balance revenues toward the amounts;
- Using one-time revenues such as the proceeds from the sale of the Beach Blvd. property;
- And lastly, directing available Excess ERAF funds toward these deficits.

The City Council has given high priority to beginning to address the loans as well as beginning to fund the emergency reserve and both actions are included in the 2015-16 Work Plan. In the meantime, the City will continue to meet its obligations and City services will continue to be provided.

Conclusion

Taken in total, the City's funds are clearly "in the black" and able to cover obligations for 2016-17. The complicating factor is that most of the funds are not interchangeable because the revenue source has restricted the types of expense eligible for the funds. This makes tracking the revenues and expenses for each fund necessary, and repaying or replenishing the deficits a requirement.

Longer Term Challenges

The difficulty we faced in delivering a balanced operating budget this year is not new—in fact, such circumstances have unfortunately become the norm for Pacifica. Looking ahead, the City will continue to face an uphill battle in terms of expenses outpacing revenues.

Drawing new business to Pacifica and encouraging appropriate economic development where possible are our only avenues at this time for growing revenues. The City Council established a new Economic Development program in 2014-15 and hired an Economic Development Manager in May 2015. The past year has seen progress toward realizing the City Council's vision toward economic vitality and fiscal sustainability for Pacifica.

While meeting daily operating needs in order to continue services tends to be our primary focus, the continual deterioration of Pacifica's infrastructure (e.g., streets, storm water system, and civic buildings) is an even larger problem and also one that the City Council has raised to a higher level of visibility and priority in the 2015-16 Work Plan.

Gratitude for Staff's Work on the 2016-17 Budget

The City staff has shown a great deal of flexibility in responding to the many changes introduced around City financial activities. Indeed, developing the operating budget and preparing this operating budget document have required many hours of preparation and quality control that I recognize and truly appreciate. They have worked in concert and their teamwork has contributed to this operating budget's successful completion.

In particular, I want to recognize the efforts of the Executive Team—Police Chief **Dan Steidle**; Deputy Fire Chief **Rich Johnson**; Planning Director **Tina Wehrmeister**; Public Works Director **Van Dominic Ocampo**; Parks, Beaches and Recreation Director **Mike Perez**; City Clerk **Kathy O'Connell**; Interim Waste Water Treatment Plant Director **Lorrie Gervin**; City Attorney

Michelle Marchetta Kenyon; Assistant City Attorney **Matthew Visick**; and especially Assistant City Manager **Lorenzo Hines, Jr.** and Financial Services Manager **Cindy Mosser**—as well as the staff of the Finance Department-- Accounting Technicians **Vivian Penaredondo**, **Mario Xuereb**, **Ying Chen** and **Carol Luebben**—and my executive assistant **Sarah Coffey**, each of whom played a crucial role in putting this operating budget together.

Finally, I want to thank the **City Council** for its stewardship through the budget development process, and its unwavering support of staff in moving the City of Pacifica forward.

Sincerely,



LORIE TINFOW
City Manager

Attachment 1 - Interfund Loan Policy

 <p style="text-align: center;">CITY OF PACIFICA ADMINISTRATIVE POLICY</p>	<p>No. 77</p>
<p style="text-align: center;">INTERFUND LOAN POLICY</p>	<p>DATE ISSUED: 02/22/2016</p>

PURPOSE

The purpose of this policy is to establish an administrative policy for the use and implementation of Interfund Loans.

DEFINITIONS

Interfund loans are loans from one City fund to another City fund for a designated purpose.

POLICY

To ensure that all interfund loans are appropriate, properly documented, and not established to the detriment of the fund issuing the loan, this Policy establishes the following interfund loan eligibility and documentation requirements:

- a) **Interfund Loan Eligibility Requirements** – Interfund loans must have an identified purpose, repayment source and date; include an interest component that equals the investment earnings the fund would have received had the loan not occurred; and be immediately due and payable if needed by the fund that provided the loan.
- b) **Interfund Loan Documentation Requirements** – Purpose of the loan, loan amount, term, and repayment source and schedule will be identified any time a loan is recommended. Loans will be coordinated with the Finance Department to ensure compliance with the Municipal Code and must be approved by the City Council. Payments made on outstanding loans shall be reflected in the Proposed and Adopted Budget and Annual Report, as applicable.

A summary of all outstanding interfund loans will also be included in the annual Proposed and Adopted Operating Budget and the Comprehensive Annual Financial Report (CAFR). The CAFR will also consistently include the loan term, rate of interest, and the interest amount due in its calculation of the total liability associated with the loan.

The development of interfund loans requires coordination among several parties, including the departments overseeing the funds that would provide or receive the loans, the Finance Department, and the City Manager’s Office (CMO). Interfund loans must be approved by the City Council. Procedures for developing and presenting interfund loan proposals will be determined by the CMO and the Financial Services Manager.