

AGENDA

CITY OF RANCHO PALOS VERDES NOTICE OF MEETING OF THE FINANCE ADVISORY COMMITTEE

OCTOBER 22, 2008

COMMUNITY ROOM
30940 HAWTHORNE BOULEVARD
RANCHO PALOS VERDES

7:00 PM CALL TO ORDER

1. Roll Call
2. Approval of Agenda
3. Approval of Draft Minutes for the meeting conducted August 27, 2008
4. Discussion of the Proposed General Fund Reserve Policy Prepared By City Staff
5. Oral Update of the City Council's Process for Reappointing Committee Members
6. Public Comments (This section of the agenda is for audience comments for items **NOT** on the agenda.)
7. Adjournment

American with Disabilities Act: In compliance with the Americans with Disabilities Act of 1990, if you require a disability-related modification or accommodation to attend or participate in this meeting, including auxiliary aids or services, please call the City Clerk's Office at 310 544-5208 at least 48 hours prior to the meeting.

NOTE: Staff reports are available for inspection at City Hall, 30940 Hawthorne Boulevard during regular business hours, 7:30 A.M. to 5:30 P.M. Monday – Thursday and 7:30 A.M. to 4:30 P.M. on Friday. Materials related to an item on this Agenda submitted to the Committee after distribution of the agenda packet are available for public inspection in the Finance Department at 30940 Hawthorne Boulevard, Rancho Palos Verdes during regular business hours.

Written materials, including emails, submitted to the City are public records and may be posted on the City's website. Accordingly, you may wish to omit personal information from your oral presentation or written materials as it may become part of the public record regarding an agenda item.

Materials related to an item on this Agenda submitted to the Finance Advisory Committee after distribution of the agenda packet are available for public inspection at the front counter of the lobby of the City Hall Administration Building at 30940 Hawthorne Boulevard, Rancho Palos Verdes during normal business hours.

You can also view the agenda and staff reports at the City's website www.palosverdes.com/RPV.

MINUTES
CITY OF RANCHO PALOS VERDES
FINANCE ADVISORY COMMITTEE

AUGUST 27, 2008

Chair James called the meeting to order at approximately 7:05 p.m. at the Community Room, 30940 Hawthorne Boulevard, for the purpose of conducting business pursuant to the Agenda. Roll call was answered as follows:

PRESENT: James, Emenhiser, Self, and Misetich
ABSENT: McLeod, Moon, and Coleman

Also present were Deputy Director of Finance and Information Technology Downs and Senior Administrative Analyst Singer.

APPROVAL OF AGENDA

Chair James requested a motion to approve the agenda. Vice-Chair Emenhiser motioned for approval of the agenda and Member Self seconded. Hearing no objection, Chair James ordered approval of the agenda.

APPROVAL OF DRAFT MINUTES FOR THE MEETING CONDUCTED JUNE 5, 2008

Chair James proposed several amendments to the June 5, 2008 meeting minutes. Staff made the amendments and projected the revised minutes on the screen for the Committee to review. Member James motioned for the approval of the June 5, 2008 meeting minutes as amended and Member Misetich seconded. Hearing no objection, the June 5, 2008 minutes were unanimously approved, as amended.

APPROVAL OF DRAFT MINUTES FOR THE MEETING CONDUCTED JUNE 12, 2008

Chair James proposed several amendments to the June 12, 2008 meeting minutes. Staff made the amendments and projected the revised minutes on the screen for the Committee to review. Member James motioned for the approval of the June 12, 2008 meeting minutes as amended and Member Self seconded. Hearing no objection, the June 12, 2008 minutes were unanimously approved, as amended.

DISCUSSION OF THE FRAMEWORK OF THE CAPITAL IMPROVEMENT PLAN

Senior Administrative Analyst Singer presented the draft framework for the Capital Improvement Plan (CIP). The Committee had a comprehensive discussion of the framework of the CIP and the public participation process. The committee asked questions regarding the framework to which Staff responded. The FAC offered several constructive comments to improve the presentation and staff report in preparation for the City Council meeting. Additionally, the FAC congratulated Staff for their thorough research and survey of other cities.

ACTION: The FAC recommends forwarding the framework to the City Council for approval. The FAC also recommends that a cost benefit analysis be one of the factors included in the approval process. (Vice-Chair Emenhiser motioned, Member Missetich seconded, Approved 4-0)

PUBLIC COMMENTS

No public comments were made.

ADJOURNMENT

Hearing no objection, Chair James ordered adjournment of the meeting at approximately 8:32 P.M.

Chair, Financial Advisory Committee

ATTEST:

Sara Singer, Recording Person



MEMORANDUM

**TO: HONORABLE CHAIR AND MEMBERS OF THE
FINANCE ADVISORY COMMITTEE**

**FROM: DENNIS McLEAN, DIRECTOR OF FINANCE &
INFORMATION TECHNOLOGY**

DATE: OCTOBER 22, 2008

SUBJECT: GENERAL FUND RESERVE POLICY

Project Manager: Sara Singer, Senior Administrative Analyst

BACKGROUND AND DISCUSSION

The set-aside of reserves, rainy-day funds, or contingency funds is a prudent fiscal policy and an important factor in the analysis of financial condition, credit worthiness and fiscal management. Local governments have experienced volatility in their financial stability due to the economy, natural disasters, terrorist attacks, and actions taken by state government such as taking revenues from local governments to resolve state budget problems. California cities are at an even greater disadvantage than the rest of the country due to the unique regulations imposed by Proposition 13 and the inability to raise property taxes if the need would arise. Sound financial management includes the practice and discipline of maintaining adequate reserve funds for known and unknown contingencies. Such contingencies include, but are not limited to: cash flow requirements, economic uncertainties including downturns in the local, state or national economy, local emergencies and natural disasters, loss of major revenue sources, unanticipated operating or capital expenditures, uninsured losses, tax refunds, future capital projects, vehicle and equipment replacement, and capital asset and infrastructure repair and replacement. The establishment of prudent financial reserve policies is important to ensure the long-term financial health of the City.

The 2008-2009 Finance Advisory Committee (FAC) Work Plan established by the City Council includes the following:

Review and provide comments and recommendations regarding the development of a General Fund Reserve Policy to be formally adopted by the City Council.

Management Partners recommended in their 2008 Organizational Assessment that the City

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create and adopt a formal reserve policy and periodically review the reserve policy based on information about the City's specific risk environment. Reserves do not per se reflect an agency's financial capacity or underlying fiscal strength, but rather the agency's ability to manage risk. It measures the fiscal capacity that the organization believes is prudent to respond to unexpected circumstances. Management Partners states in their report:

Scientific calculation is not possible, so good judgment based on understanding of significant risks provides the best approach to reserve setting.

The Government Finance Officers Association (GFOA) recommends, *at a minimum*, that general-purpose governments, regardless of size, maintain unreserved fund balance in their general fund of no less than 5 to 15 percent of regular general fund operating revenues, or of no less than one to two months of regular general fund operating expenditures (one to two months translates into about 8 percent to 17 percent of operating expenditures)¹. Staff collected data on the reserve levels for approximately 80 other California cities which varied from reserve levels of 5 percent to 75 percent. No strong conclusions were drawn from this analysis due to the unique risk environments and financial situations in different cities across the state. Staff also researched best practices and analyzed the policies of approximately 14 California cities, which have been identified as our peer cities or which have a reputation of being highly professionally managed cities, to develop a draft policy which would meet the needs of the Rancho Palos Verdes community. Based on this information, staff analyzed the following fiscal risks to consider for development of the draft policy: revenue volatility, cost structure, uninsured losses, environmental and regulatory risks, and capacity maintenance and transition policies. The risk factors are consistent with those offered by Management Partners in their February 2008 report.

FISCAL RISKS

Revenue Volatility

The diversity and stability of revenue sources affect revenue volatility and can be considered a risk factor for cities when developing reserve policies. Rancho Palos Verdes does not face significant revenue volatility risk due to the City's large dependence on property tax revenues. Property Tax currently represents about half of the City's General fund revenue. Based on information from a number of sources, including the Southern California Association of Governments and HDL Companies (a major consultant specializing in governmental revenue), the City of Rancho Palos Verdes has been less affected by the recent housing market decline than other cities. Because the average property assessment in Rancho Palos Verdes is still considerably less than current market values, Staff has independently determined that a decrease in the City's property tax revenue is a highly improbable event.

Cash flow is another factor that can impact revenue volatility. In staff's analysis of the City's cash flow, it proved to be insignificant due to the steady and predictable trend. The

¹ *Appropriate Level of Unreserved Fund Balance in the General Fund (2002).*

<http://www.gfoa.org/downloads/budget-appropriate.pdf> This policy was approved by the Executive Board of the GFOA on February 15, 2002.

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only spikes in the fiscal year reflect the two large collections of property tax revenues. Another variable to consider in examining revenue volatility is the stability of revenue receipts from the state, especially in light of the recent State budget issues. The State of California has a history of taking revenues from local governments to resolve the State's budget problems. Although Proposition 1A that was established by the voters of California in 2006 restricted the State's ability to raid local government revenue, the City will need to monitor future ballot initiatives that could shift local government revenues to the State, especially to solve future budget crisis.

Planning, building and safety permit revenues are the only significant General fund revenue source that is potentially cyclical with the economy. Because it is only about 10% of total annual General fund revenue, the impact of revenue cycles does not necessarily cause a need for adjustments to the delivery of services by the City.

While all of these factors show that revenue volatility is not a significant risk factor, this should be reevaluated after the Terranea resort begins to generate additional tax revenues. These revenues will certainly be more volatile, but the trends will need to be closely monitored to determine how they should be considered regarding the City's reserve policy.

Cost Structure

As Management Partners highlights in their report, municipal cost structures are very difficult to reduce rapidly due to service contracts, demands from residents, energy costs, employee benefits, and continuity of basic services to residents. High levels of fixed costs can require higher reserve levels. While the City prefers "pay as you go" financing for capital projects, if any debt was to be issued in the future, the reserve policy should be reviewed and modified accordingly.

Uninsured Losses

These risks from potential uninsured losses are best estimated through a complete actuarial analysis, which can be very costly to perform. Insurance deductibles and co-insurance terms were evaluated by staff and showed to be immaterial. The deductibles range from \$5,000 to a \$100,000 minimum for earthquake and flood damages. As noted in the City's financial statements, during the prior three fiscal claim years, no settlements or judgments have exceeded pooled or insured coverage. Liability risks not normally covered by insurance, such as labor relations issues such as allegation of discrimination should also be given some consideration in evaluating the City's reserve level.

Over the last decade, the City has been a defendant in several significant lawsuits resulting from challenges by property owners regarding regulatory decisions, including view, antenna and other land use issues. Insurance loss protection would not have been available in the event significant monetary damages were awarded by trial courts. Several lawsuits were the result of City ordinances that have been enacted by voters and/or the City Council and facts and circumstances that may continue to be challenged by property owners. The City successfully appealed one trial court decision before the Supreme Court recently, avoiding an uninsured award that may have exceeded millions of dollars. The possibility of uninsured future trial court awards should continue to be considered during the assessment of the City's reserve policy.

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Environmental and Regulatory Risks

Rancho Palos Verdes' physical environment creates substantial risks to the environment due to the City's aged infrastructure, land movement, and changing environmental regulations and penalty provisions. With 7.5 miles of coastline, The City carries a significant risk for polluting the shoreline and the ocean in the event that a sewer line or storm-drain system fails. This type of event should be considered because environmental fines can cost up to \$10,000 per day for these types of events. Other cities have faced significant fines, and typically these are settled for an agreed upon amount, but they can still be very costly.

Disaster and Terrorism Risks

Many costs of declared disasters are covered by state and federal funds, but there is still a portion of the cost that is not and the receipt of state and federal funds may not be immediately available. The City faces risk from fire, earthquakes, flood, landslide, and terrorist threats and it is critical that reserves be available to respond to these events appropriately. Staff consulted with our Area G coordinator to gather information about risks specific to Rancho Palos Verdes. The City's coordinator stated that there are no best practices for quantifying the potential damages. The City's portion of FEMA uncovered disaster costs would be 6.25% of the total amount of the damages. FEMA provides cash advances for disaster relief differently depending on the size of the event, and the amount would likely be immaterial. There is a high level of uncertainty in trying to determine the amount needed for upfront costs for repairs due to so many unknown variables. Additionally, federal advances of funds for disaster assistance are subject to audit, disputes, potential negotiations and settlements.

Capacity Maintenance and Transition Policies

When permanent changes in resources or costs occur, reserves should be adequate to provide funds for a smooth transition while seeking new resources or reducing ongoing costs. A common example of this change would be the building and development activity, which is significantly impacted by the local and national economy. When the economy slows down, it is common for building activity to also slow, and this can cause a loss in revenues. Reserves are necessary to balance any cyclical changes in activity.

Infrastructure

Staff recommends establishing a dedicated reserve of a minimum of \$3 million in the Capital Improvement Projects (CIP) fund as a reserve for major improvement projects related to roadways, parks, buildings, rights-of-way, and the sewer system. The dedicated reserve for major improvement projects is based upon the minimum annual amount expected to be transferred from the General fund to the CIP fund to finance such projects. All interest earnings in this fund will be used for capital improvement projects.

During the City's early history, financial resources were not sufficient to fund repair and maintenance of infrastructure resulting in further deterioration. Over the last decade, the City has begun to establish systems to regularly evaluate the status and need for repair and maintenance of its street, arterial roadways, sewer and storm drain infrastructure. Although the City has made significant progress improving the condition of its infrastructure

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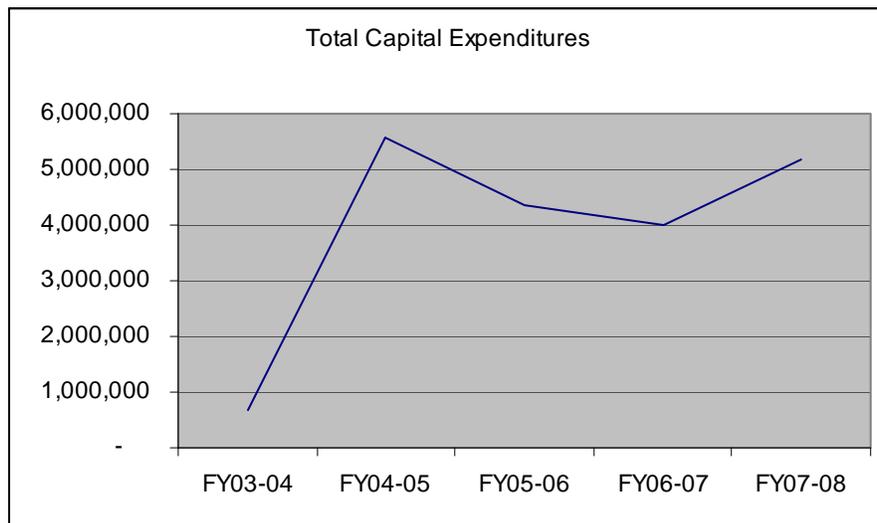
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systems, Staff believes that the cost of known repairs and maintenance of infrastructure exceeds the current level of net annual revenue and fund reserves. As an example, the Oversight Committee for the storm drain program reported:

“Realistic five-year planning reveals a WQFP program funding deficit that is substantially more than \$10 million at the end of FY 2012-13 to address storm drain repair needs that are known at this time but are not included in the 2008 Five-Year Financial Model.”

The proposed Lower San Ramon/Tarrapaca/25th Street storm drain project was not included in the 30-year storm drain program established in 2005. Although the proposed project has not been scoped, preliminary cost estimates exceed \$10 million.

Staff has provided a summary of the trend of infrastructure capital improvement expenditures over the last 5 years below:



HISTORICAL EVENTS

For the review of this policy, staff looked back from a historical perspective to consider the unplanned events from the past ten years which required a large unexpected disbursement from the General fund or money from the General fund reserves. The projects listed below represent some of the significant, unplanned projects from FY98-99 to the present.

FY00-01

- The City completed the emergency Bronco storm drain repair project at a cost of \$1,076,914.
- The City completed re-construction of a portion of Palos Verdes Drive South that was damaged due to an El Nino storm at a total cost was \$1,012,118. Although the City was able to use restricted funding sources to pay for the project (federal STIP, gas tax and prop C), those funding sources are already earmarked for future projects over the next five years. If a similar occurrence were to happen today, it would either be funded with General fund money or cause postponement of other

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road projects.

FY02-03

- The City completed the emergency Upper San Ramon drainage and landslide stabilization project at a cost of \$4,066,778. The project was funded with the General fund reserves; however the City received a partial insurance reimbursement of \$1.7 million in FY03-04.
- Lead bullets were discovered during the grading phase of the expansion project at the Point Vicente Interpretive Center (PVIC). The expansion project was halted for several years until the PVIC Soil Remediation project was completed at a total cost of \$1,250,105 using General fund reserves.

FY04-05

- The City completed repair of the Western Avenue sinkhole at a cost of \$634,523. A reimbursement from FEMA of \$586,314 was received, and the General fund covered the \$48,209 difference. A total of \$634,194 of FEMA money, which includes the \$586,314 and reimbursements for other small emergency projects on Western Avenue, is currently set aside in the CIP fund pending legal uncertainty of which agency is ultimately responsible.

FY07-08

- Approximately \$12 million of property damage claims were filed against the City resulting from the winter storms that occurred on February 19, 2005. The likelihood of an unfavorable outcome or the amount of any potential uninsured losses cannot be determined at this time. As a result of the 2005 storm, the City determined that the McCarrell Canyon storm drain system is the highest priority drainage project. The City began the \$7.2 million McCarrell Canyon project in FY07-08 and the project is still under construction with a final cost undetermined. About 90% of the estimated cost of the McCarrell Canyon project is funded with General fund reserves.

POLICY

Currently, the City has an informal General Fund Reserve policy level based upon 50 percent of annual revenue. Staff has developed a draft policy using best practices, including a comprehensive review of reserve policies of other California cities and an internal assessment of the City's risk environment. This draft document explains the proposed General Fund reserve policy in addition to reserve levels or practices set for other funds in the City. In some cases, the reserve levels established for other funds have been established by binding agreements executed by the City as well decisions made by the City Council at the time new funds were established and budgeted.

The most significant change in the proposed draft policy would be the addition of the CIP fund reserve. Staff has proposed maintaining a minimum of \$3 million in the CIP fund as a reserve for major emergency capital projects. The current general fund reserve includes this amount, but the interest earnings of about \$50,000 to \$100,000 are recorded in the General fund. With the proposed policy, any interest earnings from the CIP fund would be

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retained in the CIP fund and dedicated to capital uses. Staff is proposing a change to the General fund reserve threshold from 50 percent of annual revenue to 50 percent of operating expenditures, a lesser amount. The financial impact of these modifications on the total reserve levels for the General fund and the CIP fund would be an increase of approximately \$1.9 million of *required* reserves based on the FY08-09 budget. Because the City's General fund reserve currently exceeds the 50 percent revenue threshold, these proposed modifications would effectuate a decrease of approximately \$395,000 in total actual reserves (see attached Schedule A).

**Illustration of Current and Proposed Reserve Thresholds
Schedule A**

	Current General Fund Reserve
FY08-09 Budgeted Revenue Threshold	19,680,563 <hr/> 50%
Required Reserve	9,840,282
Estimated Actual Reserve	<hr/> 12,138,739
Excess Reserve	2,298,458

	Proposed Reserves
FY08-09 Budgeted Expenditures Threshold	17,485,994 <hr/> 50%
Required General Fund Reserve	8,742,997
Required CIP Fund Reserve	<hr/> 3,000,000
Total Required Reserve	11,742,997
Estimated Actual Reserve	<hr/> 12,138,739
Excess Reserve	395,742

CITY COUNCIL POLICY

NUMBER: XX

DATE ADOPTED/AMENDED: November XX, 2008

SUBJECT: Reserve Policies

POLICY:

The City utilizes a variety of accounting funds for accounting and budgeting for revenues and expenditures of the City. Appropriations lapse at each fiscal year-end. The City Council authorizes continued appropriations for certain incomplete capital projects, other one-time projects and services which have not been billed. Remaining dollars left in each fund that are undesignated and unencumbered constitute available reserves of the City. It is appropriate that reserve policies for the City be established for each of the various funds, that the purpose of these reserves be designated, and that dollars available in excess of the reserve amounts be appropriately and effectively utilized. This policy governs the City's reserves as follows:

A. General Fund

The City will maintain a minimum fund balance of at least 50 percent of annual operating expenditures in the General Fund. This is considered the minimum level necessary to maintain the City's credit worthiness and to adequately provide for:

1. Economic uncertainties, local disasters, and other financial hardships or downturns in the local or national economy.
2. Contingencies for unseen operating or capital needs.
3. Cash flow requirements.

B. Capital Improvement Fund

The City will maintain a minimum of \$3 million in the Capital Improvement Projects (CIP) fund as a reserve for major improvement projects related to roadways, parks, buildings, rights-of-way, and the sewer system. All interest earnings in this fund will be used for capital improvement projects.

C. Equipment Replacement Fund

The City will maintain retained earnings equal to the estimated replacement cost for equipment assets held by this fund.

D. Water Quality Flood Protection Fund

Project spending in the Water Quality Flood Protection (WQFP) fund fluctuates year to year. The Storm Drain User Fee is a source of funding

for these projects. To avoid a fluctuating Fee, the City will maintain retained earnings over the life of the WQFP fee to establish rate stabilization, thereby enabling fund availability for scheduled projects and maintenance.

E. Building Replacement Fund

The City will maintain retained earnings in this fund to accumulate monies and interest earnings to finance major improvements (e.g. roofing), and partially provide for future replacement of City owned buildings.

F. Utility Undergrounding Fund

The City will maintain retained earnings in this fund to accumulate monies for relocating utility poles and lines on City arterial roadways underground, as well as provide residents assistance with the process leading to utility undergrounding in residential areas of the City.

G. Street Maintenance Fund

The City will maintain a minimum of one year's appropriations for road maintenance on Palos Verdes Drive South in the landslide area.

H. Habitat Restoration Fund

The City will maintain a minimum of \$50,000 in this fund as required by the National Communities Conservation Plan (NCCP) for emergency use for habitat restoration purposes in addition to maintaining any interest earnings.

I. Subregion One Maintenance Fund

As part of the development agreement for Subregion One, the developer provided \$750,000 as an endowment to generate interest earnings for future maintenance of the open space area in Subregion One.

J. Improvement Authority Abalone Cove Fund

In connection with the Horan lawsuit, the Redevelopment Agency's Reimbursement and Settlement Agreement with property owners and the County stipulated that \$1,000,000 of County loan proceeds was to be deposited in the Abalone Cove Maintenance Nonexpendable Trust Fund of the Joint Powers Improvement Authority. Interest earnings from this deposit are used to maintain landslide abatement facilities in the Abalone Cove area of the active landslide.

Reserve levels will be reviewed annually during the budget process. Any recommended adjustments to reserve levels will be presented to City Council for its consideration during the annual budget process.

BACKGROUND:

Reserves, rainy-day funds, or contingency funds are a prudent fiscal policy and an important credit factor in the analysis of financial analysis and management. Local governments have experienced much volatility in their financial stability due to the economy, natural disasters, terrorist attacks, and actions taken by state government which includes taking revenues from local governments to resolve state budget problems. California cities are at an even greater disadvantage than the rest of the country due to the unique regulations imposed by Proposition 13, and the inability to raise property taxes if the need would arise. Sound financial management includes the practice and discipline of maintaining adequate reserve funds for known and unknown contingencies. Such contingencies include, but are not limited to: cash flow requirements, economic uncertainties including downturns in the local, state or national economy, local emergencies and natural disasters, loss of major revenue sources, unanticipated operating or capital expenditures, uninsured losses, tax refunds, future capital projects, vehicle and equipment replacement, and capital asset and infrastructure repair and replacement. The establishment of prudent financial reserve policies is important to ensure the long-term financial health of the City.