CITY OF LAGUNA BEACH

5 YEAR LONG-TERM FINANCIAL ASSESSMENT

MARCH 6, 2017

LONG-TERM FINANCIAL ASSESSMENT

PURPOSE

- ✓ Prepare five year forecast of revenue and expenditures as a tool for financial sustainability.
- ✓ Should compliment other planning processes that the City uses such as strategic planning, capital improvement planning, and budgeting.
- ✓ Helps to identify significant future expenses, liability, problems and resources that are not included or recognized in the two-year budget (like the long-term impact of pension costs).
- ✓ Forecast is not a budget and a projected budget gap (shortfall) is not the same thing as a budget deficit.
- ✓ A budget gap can be eliminated through strategies that will achieve long-term sustainability to City's services, meet capital improvement objectives and address other financial challenges.
- ✓ First Financial Assessment and presentation, incorporate additional items in the future based on City Council feedback.

LONG-TERM FINANCIAL ASSESSMENT

LONG TERM PLANNING STEPS ALREADY BEING DONE

- ✓ Fiscal Policies
  - 20% General Fund Reserve
  - Disaster Fund
  - Strategy to reduce unfunded liability
- ✓ Six month budget reviews
- ✓ Two-year budget
- ✓ Ten year capital improvement program
- ✓ Ten year sewer financial plan

KEY TOPICS

FORECAST

PENSIONS

RECOMMENDATIONS

FORECAST

FORECAST | PENSION | RECOMMENDATION

GENERAL FUND FORECAST 5 YEARS, FY 2017-18 THROUGH 2021-22

REVENUE ASSUMPTIONS

- Property taxes = 3.0%-4.5%
- Sales taxes = 2%
- TOT taxes = 4%
- Community Development Fees = Flat
- No tax or fee increases
- Does not assume recession
- Overall, GF revenues growth = 3.1% year

EXPENDITURES ASSUMPTIONS

- No new positions
- Salaries and benefits = 3% forward
- Includes CalPERS change in discount rate
- Healthcare = 12% a year
- Maintenance and Operations = 1.5%
- Special Programs (BID matches TOT) 1.5%
- Increase Insurance by $200,000 annually
- Overall, GF expenditure growth = 4.0% year

GF ASSUMPTIONS | GF REVENUE | GF EXPENDITURES

FORECAST | PENSION | RECOMMENDATION

GENERAL FUND REVENUE AND EXPENDITURES FORECAST

Fiscal Year	Revenue	Expenditures	Surplus (Deficit)
2017-18	$61.8M	$60.3M	$1.5M
2018-19	$63.7M	$62.4M	$1.3M
2019-20	$65.2M	$64.9M	$0.3M
2020-21	$66.9M	$67.9M	($1.0M)
2021-22	$68.6M	$71.1M	($2.5M)

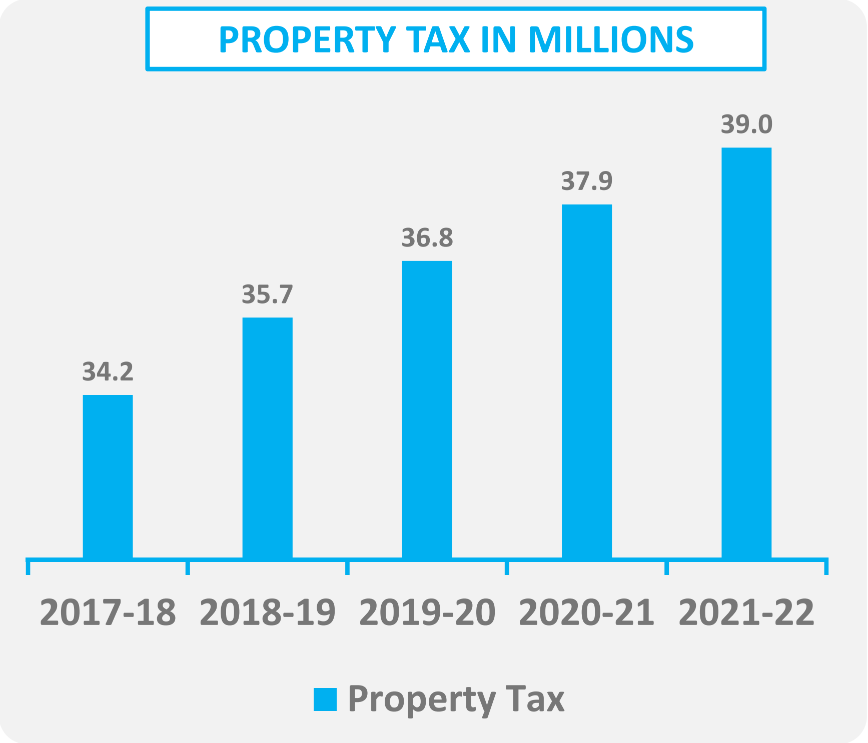
- General Fund forecast predicts expenditures will outpace revenues beginning in FY 2020-21
- Operating deficit of $1.0M in FY 2020-21 and $2.5 million in FY 2021-22

GF ASSUMPTIONS | GF REVENUE | GF EXPENDITURES

FORECAST | PENSION | RECOMMENDATION

Assessed Value Last Ten Years

YEAR	GROWTH
2007-08	10.1%
2008-09	7.1%
2009-10	4.0%
2010-11	1.9%
2011-12	1.3%
2012-13	2.0%
2013-14	4.7%
2014-15	6.7%
2015-16	6.8%
2016-17	6.9%



Property Tax

YEAR	FORECAST	% GROWTH
2017-18	$34.2M	4.5%
2018-19	$35.7M	4.5%
2019-20	$36.8M	3.0%
2020-21	$37.9M	3.0%
2021-22	$39.0M	3.0%

1% GROWTH = $300,000

GF ASSUMPTIONS | GF REVENUES | GF EXPENDITURES

FORECAST

PENSION

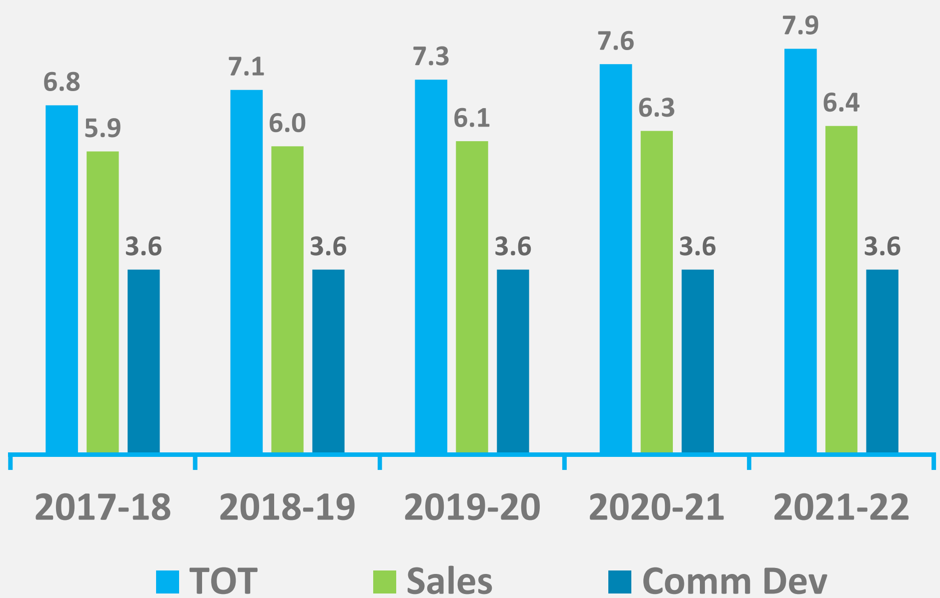
RECOMMENDATION

TOT and Sales Tax Last Ten Years

YEAR	TOT	Sales
2007-08	4.4%	4.3%
2008-09	-5.6%	-15.4%
2009-10	-16.1%	-8.7%
2010-11	5.8%	8.3%
2011-12	10.2%	8.9%
2012-13	3.4%	6.8%
2013-14	11.8%	6.1%
2014-15	3.4%	6.7%
2015-16	8.9%	9.8%
2016-17	4%	3.0%

1% GROWTH TOT = $70,000
1% GROWTH SALES = $60,000

TOT / SALES / COMMUNITY DEVELOPMENT ($17M)



TOT Tax

YEAR	FORECAST	GROWTH
2018	$6.8M	4%
2019	$7.1M	4%
2020	$7.3M	4%
2021	$7.6M	4%
2022	$7.9M	4%

Sales Tax

YEAR	FORECAST	GROWTH
2018	$5.9M	2%
2019	$6.0M	2%
2020	$6.1M	2%
2021	$6.3M	2%
2022	$6.4M	2%

GF ASSUMPTIONS

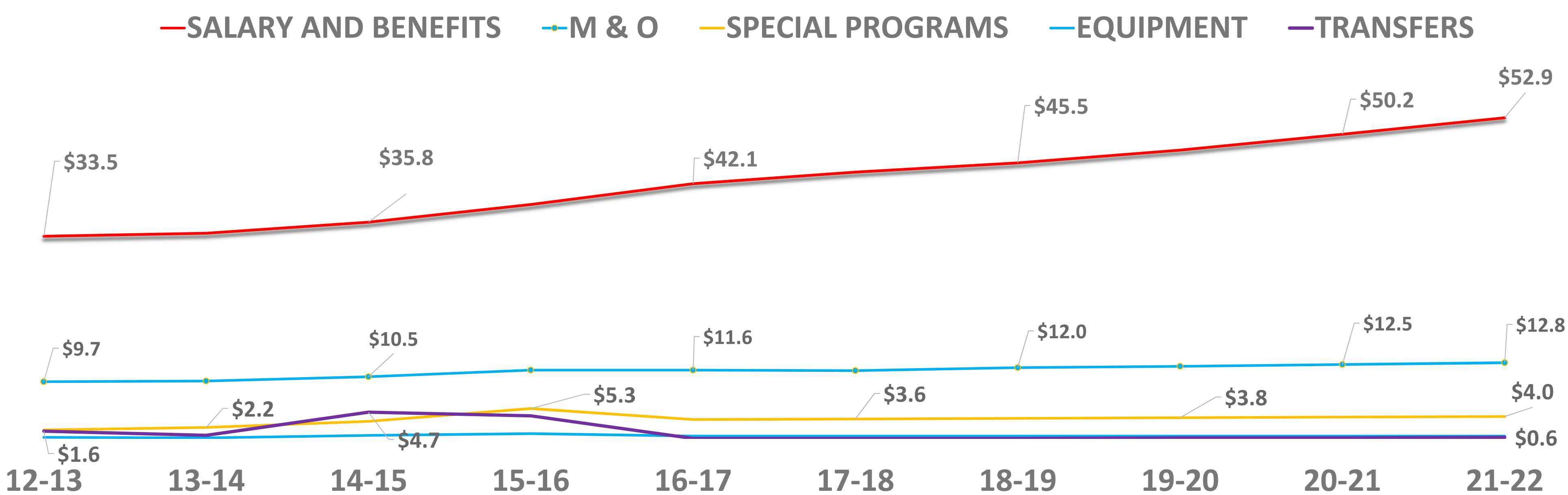
GF REVENUES

GF EXPENDITURES

FORECAST

PENSION

RECOMMENDATION



GF ASSUMPTIONS

GF REVENUE

GF EXPENDITURES

FORECAST

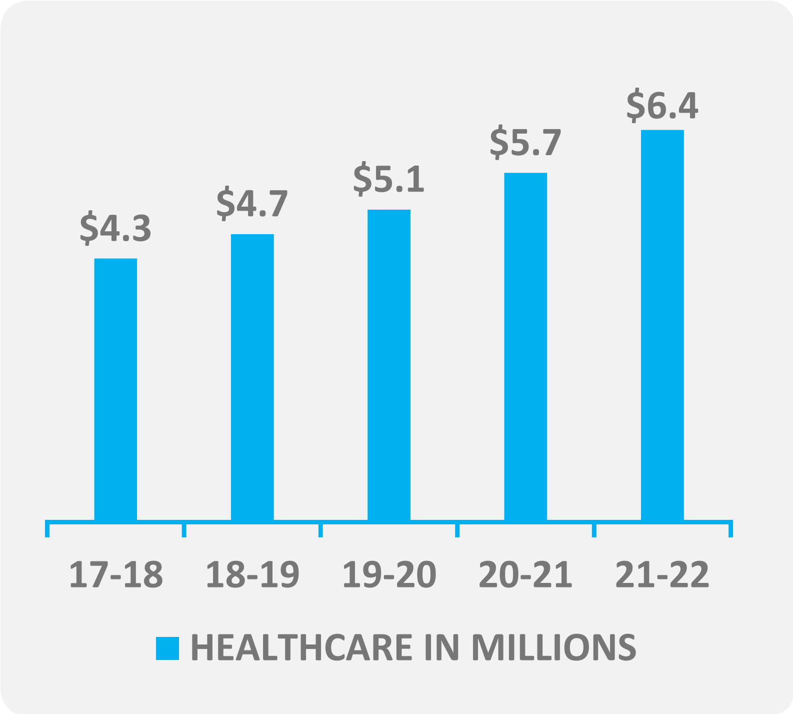
PENSION

RECOMMENDATION

HEALTHCARE PREMIUMS
% INCREASE BY YEAR

YEAR	INCREASE
2012-13	0.0%
2013-14	5.0%
2014-15	5.0%
2015-16	2.0%
2016-17	18.6%

- The average increase in medical costs over previous three years = 3%
- 2017, increase was over 18%.
- Difficult to predict future rates do to uncertainty of Affordably Care Act
- Forecast assumes 12% annual increase



GF ASSUMPTIONS

GF REVENUE

GF EXPENDITURES

FORECAST | PENSION | RECOMMENDATION

CAPITAL IMPROVEMENT FUND

POTENTIAL LARGE PROJECTS	ESTIMATED COST
FIRE STATION #4	$6.0M
COMMUNITY POOL	$15.0M
SIDEWALKS ON PCH	$9.7M
SENIOR HOUSING UNITS AT LANG PARK	$??
OTHER	$??
TOTAL	$30.7

1. $6M in Revenue each year for projects
2. Adding large projects will create deficits unless debt financed.
3. 10-Year CIP is being updated as part of two-year budget

QUESTIONS

1. Is the City Council willing to issue debt with, no new fees or taxes, for large projects (like community pool) or postpone projects until cash is available to proceed?

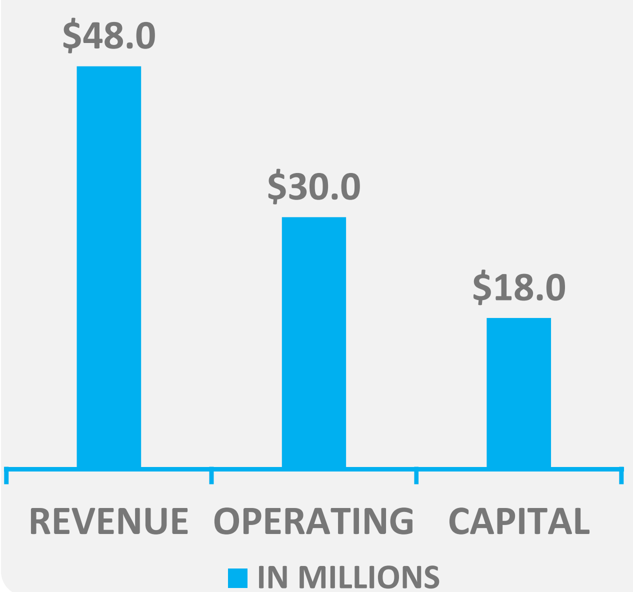
CAPITAL IMPROVEMENT | PARKING | SEWER | MEASURE LL | OTHER

PARKING FUND

- Current balance about $7M
- Presently, revenue exceeds expenditures by roughly $2 million annually.
- Funding for Trolley replacements may increase transfer to the Transit Fund.
- The Project V Grant expires in FY 2021-22, if not renewed this will required an additional contribution to the Transit Fund of roughly $800,000 annually.
- Future funding for parking projects (needs to be determined).
- To maintain 85% occupancy, parking fees will need to be increased.

SEWER FUND

REVENUE AND EXPENDITURES OVER NEXT FIVE YEAR



- 10-Year Plan approved in 2014
- Forecast assumed 4% rate beginning FY 2019-20
- Set aside $200,000 toward reserve
- Future Concerns:
  - State-Mandates Regulations
  - Changes at SOCWA could impact projects schedule
  - Necessary repairs to sewer lining will need to be incorporated into the plan
  - Setting funding for reserve difficult

FISCAL YEAR	RATE INCREASE
2016-17	4.75%
2017-18	4.75%
2018-19	4.75%
2019-20	4.0%
2020-21	*4.0%*
2021-22	*4.0%*
2022-23	*4.0%*
2023-24	*4.0%*
2024-25	*4.0%*

FORECAST | PENSION | RECOMMENDATION

MEASURE LL ($2.2M ANNUALLY)

PUBLIC SAFETY $750,000

- 2 Beach Patrol Officers
- 1 Community Outreach Officer
- Civilian Fire Marshal
- Upgrade 3 Paramedic Positions
- 2 Year-Round Marine Safety Officers
- 2 Additional Lifeguard Days

PUBLIC WORKS $450,000

- Lead Worker for Enhanced Cleaning
- Beach Cleaning and Kelp Removal
- Summer Main Beach Restroom Cleaning
- Sidewalk Steam Cleaning and Detailed Cleaning and Daily Maintenance

UTILITY UNDERGROUNDING $1M

- Utility Undergrounding

CAPITAL IMPROVEMENT | PARKING | SEWER | MEASURE LL | OTHER

FORECAST | PENSION | RECOMMENDATION

OTHER FUNDS OVER NEXT TEN YEARS

STREET LIGHTING FUND

- $6.5M available (Revenues over expenditures)
- Used for Laguna Canyon Road Master Plan and Undergrounding Utilities

GAS TAX FUND

- $10M available
- Used to Slurry Seal all Streets over 10 years

INFRASTRUCTURE REPLACEMENT FUND

- $4.5M available
- Probably needed for LCR

CAPITAL IMPROVEMENT | PARKING | SEWER | MEASURE LL | OTHER

RESERVES

GENERAL FUND

20% ($11.5M)

- Inline with similar agencies
- Provides for major decline in revenue coverage, natural disasters and catastrophic events
- Provides a minimum of 3 months' operating expenses (16.7%)

DISASTER CONTINGENCY

10% GF ($6M)

- Exclusively for emergencies
- Equal to 10% of General Fund Operating Expenditures
- Must be repaid in 3 years if borrowed

VEHICLE REPLACEMENT

$5.9M

- Maintained for replacement of vehicles
- Funded by charge back to General Fund of roughly $1.5 annually
- Fully funded based on current assumptions (vehicle useful life)

INSURANCE

$6.0M

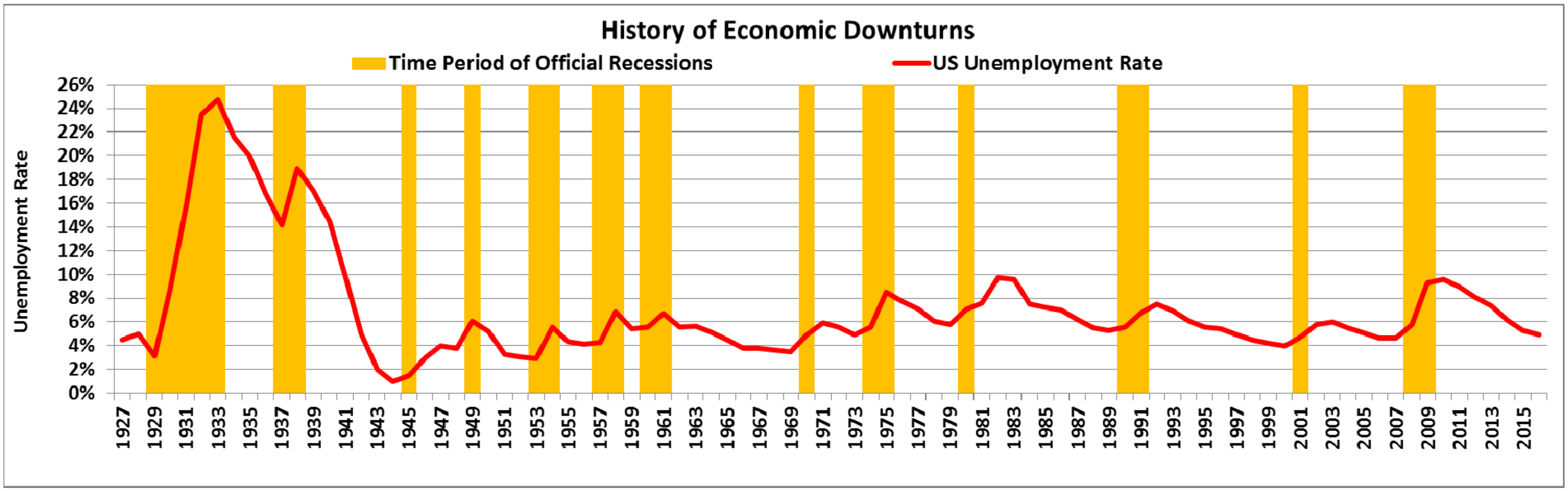
- General Liability and Workers' Compensations for City Self Insurance retention levels
- Claims
- Reserve for employee vacation and sick leave balances (payouts at separation)
- Funding for City Medical Plan

FORECAST

PENSION

RECOMMENDATION

ANOTHER RECESSION IS INEVITABLE



Source: Bureau of Labor Statistics, National Bureau of Economic Research

- Since 1927, 13 recessions have occurred on average every 6.8 years; Now 7 years since “official” end of Great Recession
- Last recession, General Fund revenues decrease $1.2 million over 12 months, roughly 2 years to recover

Source:

PENSION

BACKGROUND CALPERS

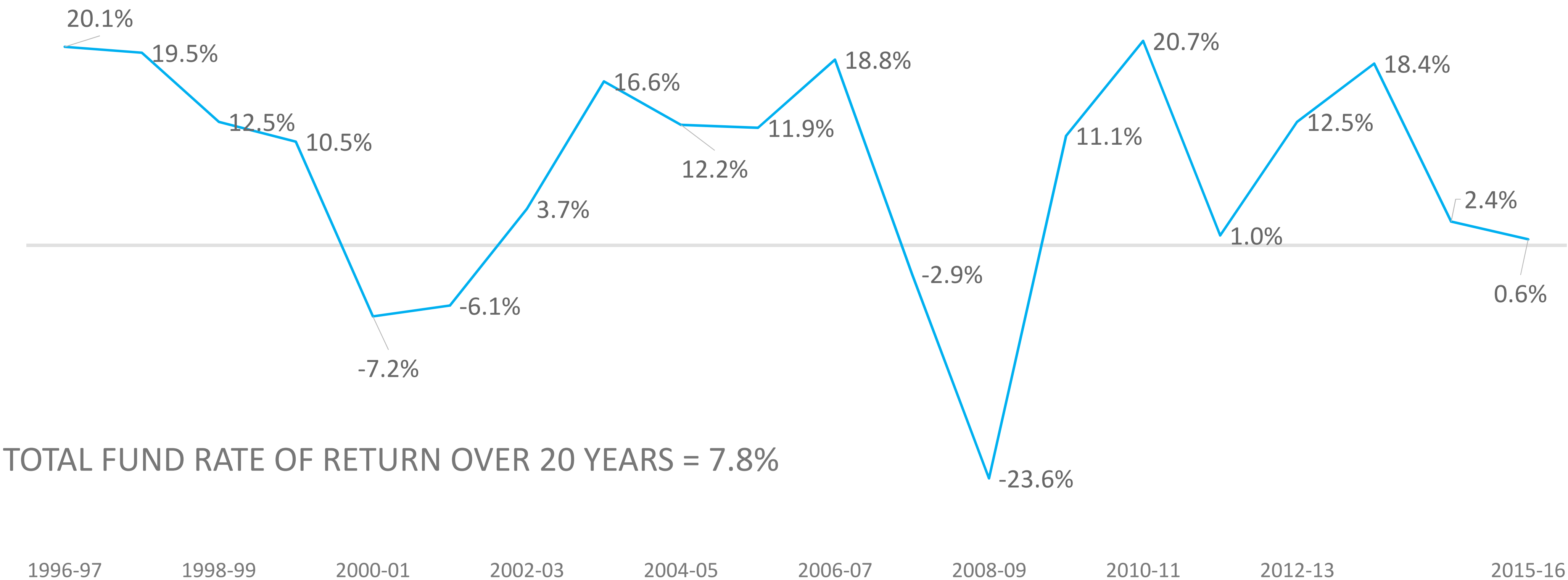
- City has contracted with CalPERS since 1945
- Approximately 245 active and 362 retired employees in CalPERS system
- The City has five retirement plans with CalPERS
  - 2% at 62 (PEPRA), 2.5% at 55, 2.7% at 57 (PEPRA), 3% at 55 and 3% at 50
- Employees earn a retirement allowance (defined benefit) based on
  - Years of Service
  - Final Compensation
  - Age at Retirement
- City and employees share in the normal cost (annual cost of service)
- Unfunded liability occurs when projected benefits payable to members exceed the projected funds available to pay those benefits ($52M)
- Cost to leave is over $460M and is financially prohibitive.
- Not being a member of CalPERS is at a competitive disadvantage to recruit and retain employees.

FORECAST

PENSION

RECOMMENDATION

CALPERS INVESTMENT RETURNS LAST 20 YEARS



HISTORY

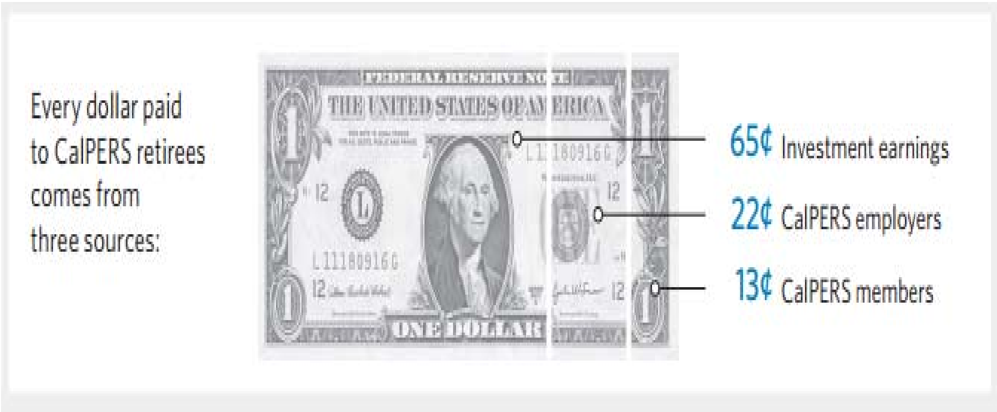
IMPACT DISCOUNT RATE

STRATEGIES

FORECAST | **PENSION** | RECOMMENDATION

CALPERS PLAN

- CalPERS is working to reach 100% funded in 30 years
- Higher contributions short-term
- Lower contributions long-term
- Recently lowered expected investment rate of return from 7.5% to 7.0%
- Will continue to lower discount rates if investment returns are good. For example, a 20% investment return would lower the assumed rate by 20 basis points.
- Better Funded Status



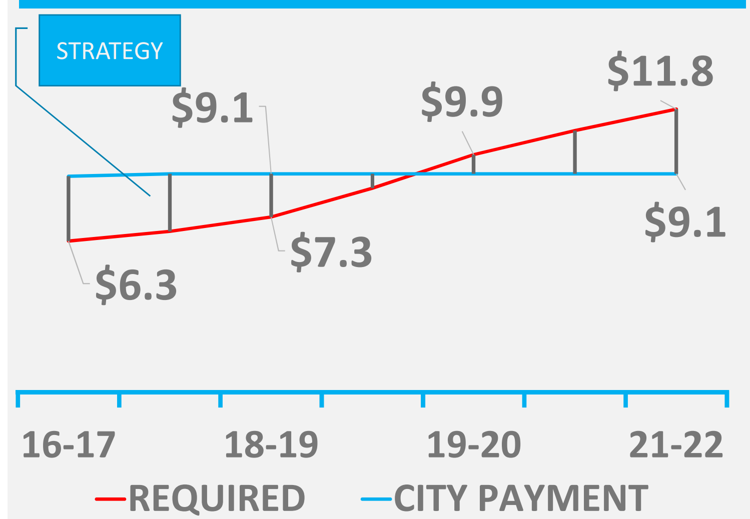
HISTORY | IMPACT DISCOUNT RATE | STRATEGIES

FORECAST | **PENSION** | RECOMMENDATION

CITY STRATEGY ACCELERATED FUNDING

- Additional discretionary payments above required amount
- Have paid $6.4 million to date over required amount
- Additional payments were expected to continue through FY 2021-22
- Payments made ***only*** benefit City Plans
- Projected to save City $21 million over 30 years
- Strategy assumed:
    - CalPERS earnings would average 7.5% over 30 years.
    - No changes in CalPERS assumptions
- Each $1 million payment is estimated to save $1.7 million over 30 years

PAYMENT TO CALPERS ALL FUNDS



HISTORY | IMPACT DISCOUNT RATE | STRATEGIES

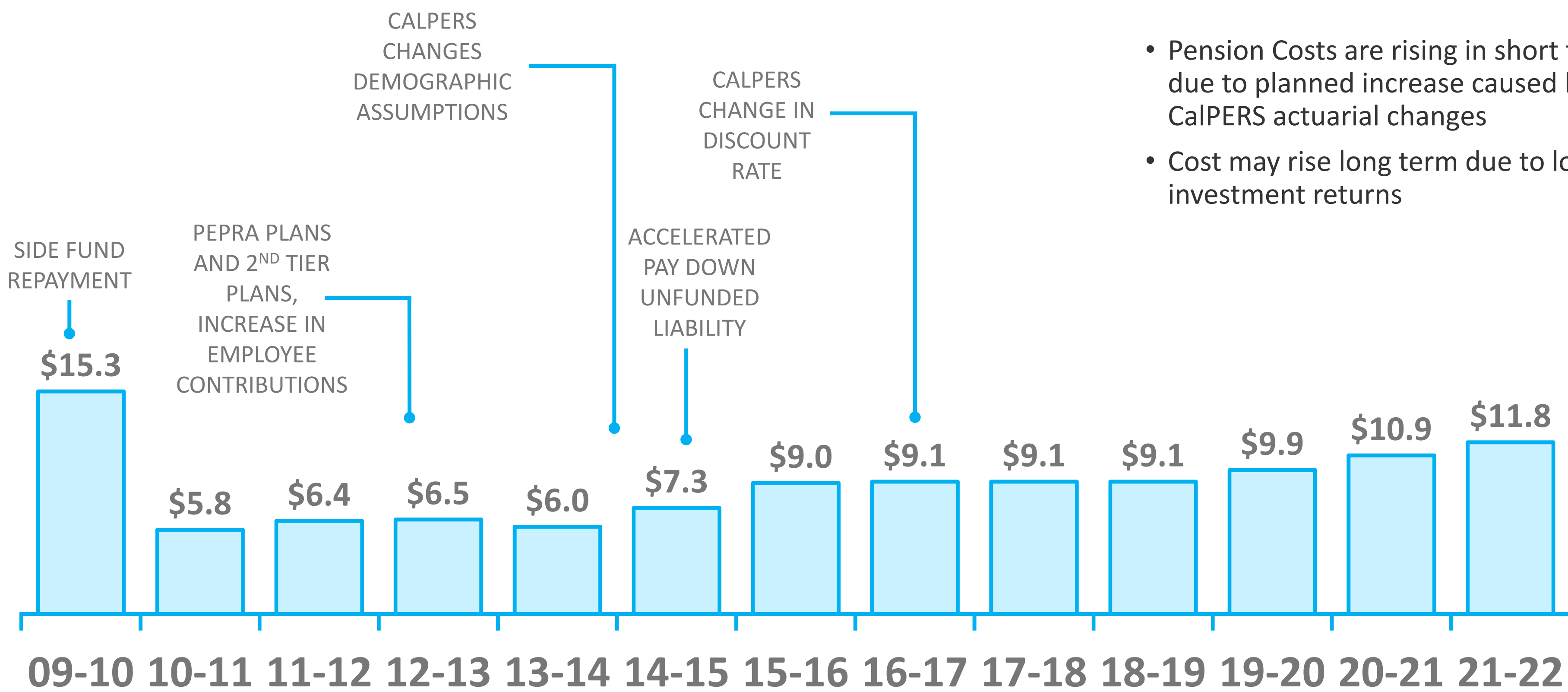
FORECAST | PENSION | RECOMMENDATION

CITY STRATEGY SIDE FUND

- Approved in 2010
- General Fund Borrowed $10 million, repaid over 15 years
- Paid off existing unfunded liability when safety plans joined risk pool
- Save $4 million over the 15 years
- Reduced the contribution to safety plans by 30%

		General		Parking Auth	Insurance	Comp Abs	Vehicle Rplc	Street Light	Total
	Year	Principal	Interest	Principal	Principal	Principal	Principal	Principal	Principal
1	2009-10	195,154.89	90,537.66						195,154.89
2	2010-11	596,301.33	260,776.31						596,301.33
3	2011-12	612,907.89	244,169.75						612,907.89
4	2012-13	545,514.90	227,100.71	84,462.03					629,976.93
5	2013-14		209,556.30	647,521.33					647,521.33
6	2014-15		191,523.30	568,016.64	97,537.68				665,554.33
7	2015-16		172,988.10		684,089.54				684,089.54
8	2016-17		153,936.70		703,140.93				703,140.93
9	2017-18		134,354.73		515,231.85	207,491.05			722,722.90
10	2018-19		114,227.42			742,850.21			742,850.21
11	2019-20		93,539.58			763,538.05			763,538.05
12	2020-21		72,275.60			784,802.03			784,802.03
13	2021-22		50,419.43			1,318.66	700,000.00	105,339.54	806,658.20
14	2022-23		27,954.59					829,123.05	829,123.05
15	2023-24		5,847.68					565,537.41	565,537.41
		1,949,879	**2,049,208**	**1,300,000**	**2,000,000**	**2,500,000**	**700,000**	**1,500,000**	**9,949,879**

HISTORY | IMPACT DISCOUNT RATE | STRATEGIES



- Pension Costs are rising in short term due to planned increase caused by CalPERS actuarial changes
- Cost may rise long term due to lower investment returns

Source: Finance Staff

ADDITIONAL INFORMATION

- Payments made by the City benefit only the City (Confirmed by CalPERS).
- Involuntary Terminations are agencies that can't or refuse to make payments (e.g. bankruptcy)
  - Takes between 8-17 months
  - Termination liability prepared by CalPERS staff
  - If not making payments, CalPERS Board reviews to reduce benefits (liabilities) to available assets
  - Assets are moved from current plan (e.g. pooled plans) to a Terminated Agency Pool (TAP)
  - Benefits are paid from TAP

- Why San Bernardino didn't cut pensions during Bankruptcy (Source: CalPensions article)
  - Lead to exodus of City employees.
  - Impair future recruitment of new employees due to the noncompetitive compensation packages. This is particularly true for safety positions.

CHANGE IN DISCOUNT RATE BY FISCAL YEAR

Valuation Date	FY Required Contribution	Discount Rate
June 30, 2015	2017-18	7.50%
June 30, 2016	2018-19	7.375%
June 30, 2017	2019-20	7.25%
June 30, 2018	2020-21	7.00%

IMPACT OF DISCOUNT RATE CHANGES ON CONTRIBUTIONS

Three Components to Discount Rate Impact

1. Permanent Increase in Normal Cost
   - Shared by PEPRA members (possibly Classic members in the future)
2. Additional UAL payments toward increases in accrued liability
   - 20-year payment periods
3. Decreases to UAL payments toward existing layers of UAL
   - CalPERS will be charging less interest on prior bases

- Total discount rate impact = 1. + 2. - 3.

FORECAST | PENSION | RECOMMENDATION

CHANGE IN DISCOUNT IMPACTING TWO COMPONENTS

		Normal Cost				UAL Payments			
Valuation Date	Fiscal Year Impact	Misc. Plans	Middle of Range	Safety Plans	Middle of Range	Misc. Plans	Middle of Range	Safety Plans	Middle of Range
6/30/2016	2018-19	0.25% - 0.75%	0.50%	0.5% - 1.25%	0.88%	2% - 3%	2.50%	2% - 3%	2.50%
6/30/2017	2019-20	0.5% - 1.5%	1.00%	1.0% - 2.5%	1.75%	4% - 6%	5.00%	4% - 6%	5.00%
6/30/2018	2020-21	1.0% - 3.0%	2.00%	2.0% - 5.0%	3.50%	10% - 15%	12.50%	10% - 15%	12.50%
6/30/2019	2021-22	1.0% - 3.0%	2.00%	2.0% - 5.0%	3.50%	15% - 20%	17.50%	15% - 20%	17.50%
6/30/2020	2022-23	1.0% - 3.0%	2.00%	2.0% - 5.0%	3.50%	20% - 25%	22.50%	20% - 25%	22.50%
6/30/2021	2023-24	1.0% - 3.0%	2.00%	2.0% - 5.0%	3.50%	25% - 30%	27.50%	25% - 30%	27.50%
6/30/2022	2024-25	1.0% - 3.0%	2.00%	2.0% - 5.0%	3.50%	30% - 40%	35.00%	30% - 40%	35.00%

HISTORY | IMPACT DISCOUNT RATE | STRATEGIES

FORECAST | PENSION | RECOMMENDATION

BENEFITS OF REDUCING DISCOUNT RATE

- Strengthens long-term sustainability of the fund to pay promised benefits
- Reduces negative cash flow; additional contributions will help to offset growing pension payments
- Reduces the long-term chances of falling below an undesirable funding level
- Lower expected future investment losses leading to more stable required contributions

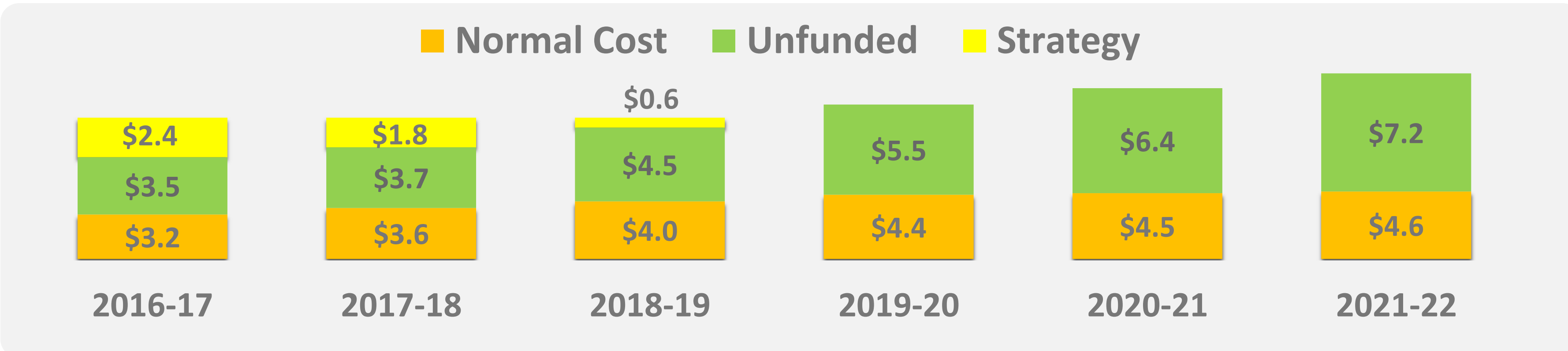
OTHER CONSEQUENCES

- Required contributions from employers and members will increase
- Plan funded ratios will drop near-term
- Pension Expense under GASB 68 will increase
- Net Pension Liability under GASB 68 will increase near-term

HISTORY | IMPACT DISCOUNT RATE | STRATEGIES

FORECAST | PENSION | RECOMMENDATION

IMPACT OF LOWER DISCOUNT RATE FROM 7.5% TO 7.0%



	2017-18	2018-19	2019-20	2020-21	2021-22
ORIGINAL STRATEGY PAYMENT	$ 1.9M	$1.2M	$0.7M	$0.3M	$0.2M
UPDATED STRATEGY PAYMENT	$ 1.8M	$.6M	$0	$0	$0

Source: Finance Staff

HISTORY | IMPACT DISCOUNT RATE | STRATEGIES

POSSIBLE PENSION STRATEGIES

1. Phase in future pension increase as soon as possible, use difference between required payment and budgeted payment to pay down unfunded liability (current strategy).
2. For the next five year use 1/3 to 1/2 of mid-year savings toward unfunded pension liability, re-evaluate at end of five years.
3. Reprogram Side Fund Loan repayment ($857,000 a year), need to analyze.
4. If feasible, use existing cash:
   - Lower General Fund Reserve requirement, use cash toward payment
   - Use Insurance or Vehicle Replacement reserves repaid with future pension cost savings (side fund approach)
   - Disaster Contingency Fund, temporarily replace with Bank Line of Credit, repaid with cost savings
   - Parking Fund contribution of $1 million a year for 5 years, repaid with future savings

POSSIBLE PENSION STRATEGIES

4. Alternative to paying CalPERS is payments to a Section 115 Trust
   - Can only be used to pay pension obligations
   - Investment strategy tailored to City's risk tolerance
   - Pay pension cost in a given year free up funds for other obligations
5. Bring back a recommendation as part of the two year budget

PENSION STRATEGIES NOT RECOMMENDED

1. Pension Obligations Bonds (POB): In 2015, Government Finance Officers Association issued an advisory recommending state and local governments ***do not*** issue pension obligation bonds and listing 5 reasons including:
   1. The investing POB proceeds might fail to earn more than the interest rate owed on the term of the bonds, leading to increasing overall liabilities
   2. POBs are complex instruments carrying considerable risk
   3. Issuing taxable debt increases bonded debt burden and potentially uses up debt capacity
   4. POBs are frequently structure in a manner that defers principal payments or extends repayment period
   5. Rating agencies may not view issuance of POBs as credit positive

2. Alternative pension plans; currently require terminating contact with CalPERS at a cost of $460 million.

RECOMMENDATIONS

RECOMMENDATIONS

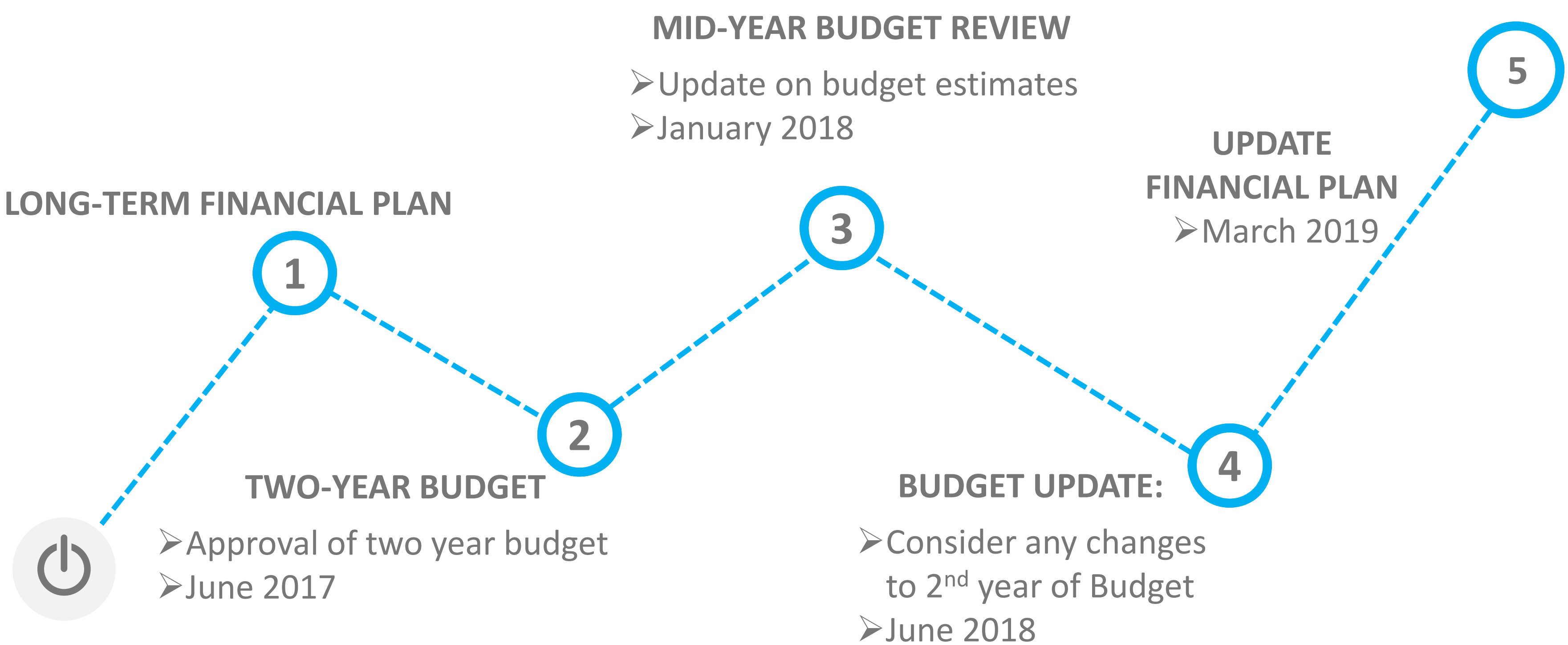
It is recommended that the City Council approve the following policies to help guide the City Manager and staff in preparing and managing future budgets.

1. Phase in future pension increases as soon as possible, use the difference between required payments and future budgeted payments to pay down unfunded liability (similar to the current strategy);
2. For the next five years use one-third (1/3) to one-half (1/2) of mid-year savings to pay down the unfunded pension liability, re-evaluate at the end of five years;
3. As part of the budget in May, return with additional strategies to address pension unfunded liabilities;
4. Rely on Community Assistance Grants to provide assistance to non-profits with the assumption that grants outside of that process should not be anticipated;

RECOMMENDATIONS

5. Identify capital projects for which the City Council may be willing to use debt financing or determine to postpone them for five years and direct the City Manager to report back on those items;
6. Incorporate operating and maintenance forecasts for new facilities in capital improvement project planning;
7. Review city fees every four years to keep pace with inflation and account for changes in services;
8. Consider establishing an Information Technology reserve for the replacement and repair of critical IT infrastructure;
9. Update Five-Year Financial Assessment prior to the start of the two-year budget process;
10. Incorporate items in future Five-Year Financial Assessment presentations based on feedback from the City Council.

FORECAST PENSION **RECOMMENDATION**



QUESTIONS?