
City of San Clemente

2004

Long Term Financial Plan



City of San Clemente

City Council

- Susan Ritschel Mayor
- Joe Anderson Mayor Pro Tem
- Jim Dahl Councilmember
- Stephanie Dorey Councilmember
- G. Wayne Eggleston Councilmember

City Manager

- George Scarborough City Manager

Executive Team

- William E. Cameron City Engineer
- Myma Erway City Clerk
- Pall Gudgeirsson Assistant City Manager/City Treasurer
- James S. Holloway Director, Community Development
- Lt. William Hunt Police Services Chief
- David N. Lund Director, Public Works/Economic Development
- Chief Dave Pierce Fire Services Division Chief
- Bruce E. Wegner Director, Beaches, Parks & Recreation

Project Director

- Pall Gudgeirsson Assistant City Manager/City Treasurer

Project Leaders

- Christine Brower Accounting Supervisor
 - William E. Cameron City Engineer
 - Kumi Elston Principal Financial Analyst
 - Bill Humphreys Marine Safety Chief
 - David N. Lund Director, Public Works/Economic Development
 - Laura Ferguson Assistant to the City Manager
 - Tom Rendina Finance Manager
 - Bruce Wegner Director, Beaches, Parks & Recreation
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Long Term Financial Plan

Mission Statement



Photograph by Will Buddenhagen

The City of San Clemente, in partnership with the community we serve, will foster a tradition dedicated to:

- ◆ Maintaining a safe, healthy atmosphere in which to live, work and play;
- ◆ Guiding development to ensure responsible growth while preserving and enhancing our village character, unique environment and natural amenities;
- ◆ Providing for the City's long term stability through promotion of economic vitality and diversity....
- ◆ Resulting in a balanced community committed to protection of what is valued today while meeting tomorrow's needs.

Long Term Financial Plan

Project Teams

Project Director

Pall Gudgeirsson, Assistant City Manager/City Treasurer
Julie Schmidt, Administrative Assistant (Administrative Support)

Steering Committee

George Scarborough, City Manager
Pall Gudgeirsson, Assistant City Manager/City Treasurer

Financial Trend Analysis

Christine Brower, Accounting Supervisor

Financial Forecast

Kumi Elston, Principal Financial Analyst

Reserve Analysis

Tom Rendina, Finance Manager

Street Improvement Program Update

David N. Lund, Director, Public Works/Economic Development
William E. Cameron, City Engineer
M. Akram Hindiye, Principal Civil Engineer

Economic Development Update

David N. Lund, Director, Public Works/Economic Development

Golf Enterprise Fund Analysis

Bruce Wegner, Director, Beaches, Parks & Recreation
Gus Nelson, Golf Course Manager

Environmental Program Update

Bill Humphreys, Marine Safety Captain
Bruce Wegner, Director, Beaches, Parks & Recreation

State Impact Financial Analysis

Laura Ferguson, Assistant to the City Manager
Wai Gordon, Financial Analyst

Long Term Financial Plan

Financial Trend Analysis

Objective

Utilizing the International City Management Association's (ICMA) Financial Trend Monitoring System, update the comprehensive Financial Trend Report, including specific recommendations to address those trends considered unfavorable or where a warning trend has been observed. Rating assigned to each trend includes: Favorable (F), Unfavorable (U) or Warning (W).

Financial Forecast

Objective

To update the comprehensive five-year financial forecast for the General and operating funds incorporating adopted City fiscal policies, expenditure patterns, revenue trends and other known financial impacts.

Reserve Analysis

Objective

To analyze and recommend appropriate levels of reserves to (a) ensure that they are adequate to provide for the needs of each fund program and (b) meet program needs without unnecessarily obligating scarce dollar resources.

Street Improvement Program Update

Objective

To provide an update of the City's Street Improvement Program and project short and long term funding requirements.

Economic Development Update

Objective

To update the progress made in the implementation of the City's Economic Development Plan and to provide projections concerning sales tax growth and business development trends.

Golf Enterprise Fund Analysis

Objective

To update the City Council regarding the general economic climate of the golf industry, create and report on a conservative five year financial forecast for the Golf Enterprise Fund, and to analyze the fund's ability to meet City Council policy objectives.

Environmental Program Update

Objective

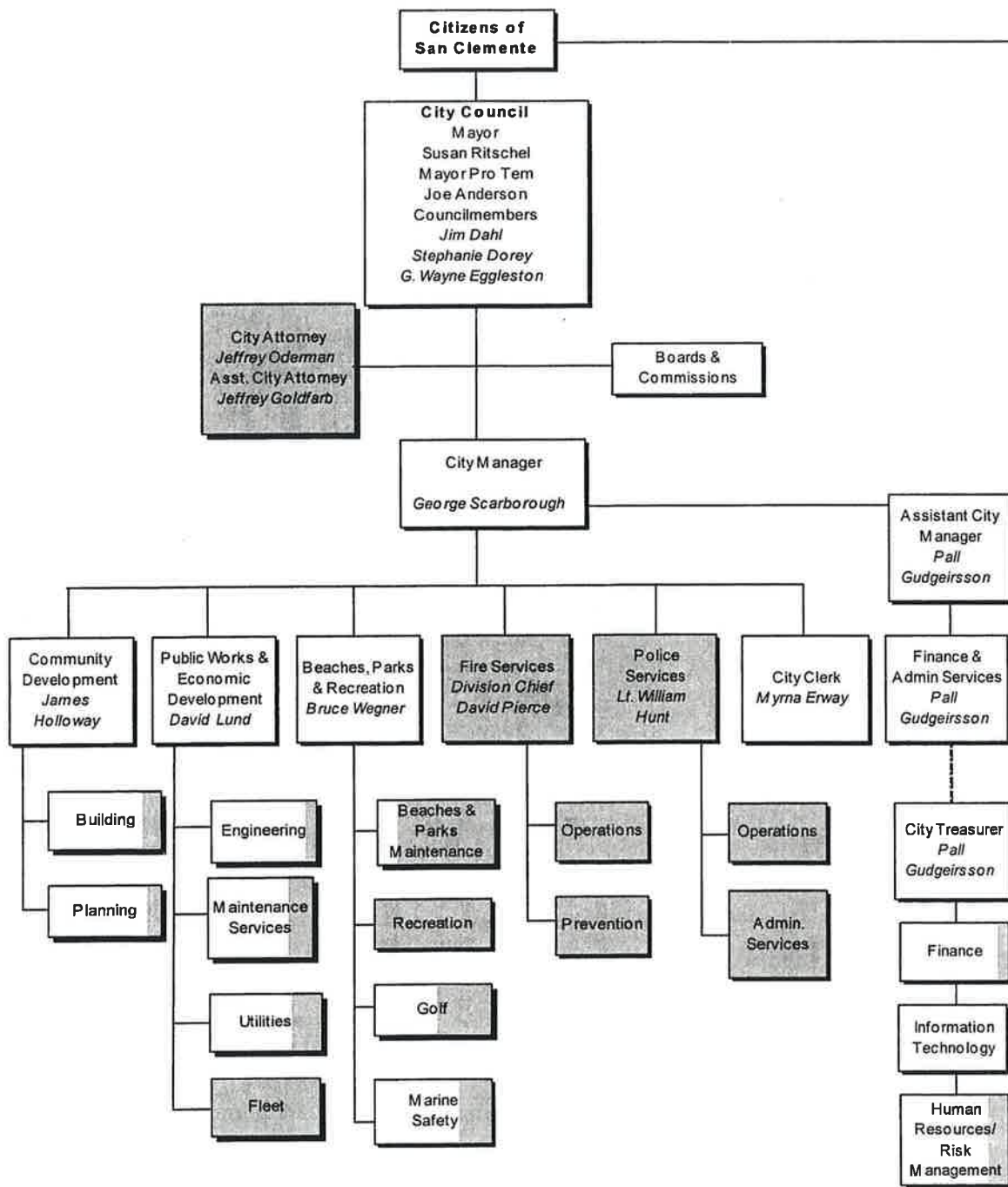
To update the City Council and the public concerning the progress that has been made managing issues relating to the coastal environment including coastal erosion and sand replenishment. These projects include continuation of the U.S. Army Corps of Engineers Feasibility Study, Coastal Canyons and Bluffs Management Guidelines, Opportunistic Sand Replenishment Policy, Sand Monitoring, and the Opportunistic Sand Replenishment Program.

State Impact Financial Analysis

Objective

This is the third consecutive year the City has addressed the impacts of the loss of control over local revenue and the associated shifts in revenue to the State due to a history of State budget crises.

City Organization Chart

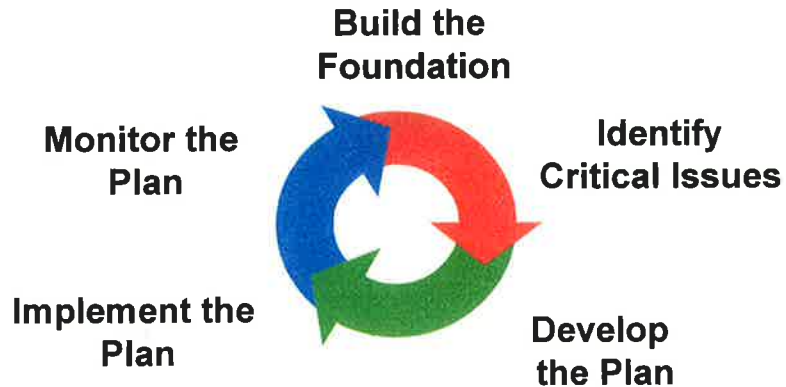


 Shading indicates contracted services

Long Term Financial Plan

Long Term Financial Plan

Long Term Financial Plan Overview



The LTFP is a financial strategic plan

The Issue Papers provide support documents used to develop the plan

The City of San Clemente, at Council direction, annually prepares a comprehensive Long Term Financial Plan (LTFP). The LTFP is intended to serve as a tool, providing Council and the public with the insight required to address issues impacting the City's financial condition. The LTFP consists of a complete financial plan, and an Issue Papers section which provides support documents used in developing a strategic plan after a thorough analysis of all issues that impact the City's financial condition.

The 2004 Long Term Financial Plan consists of the following sections:

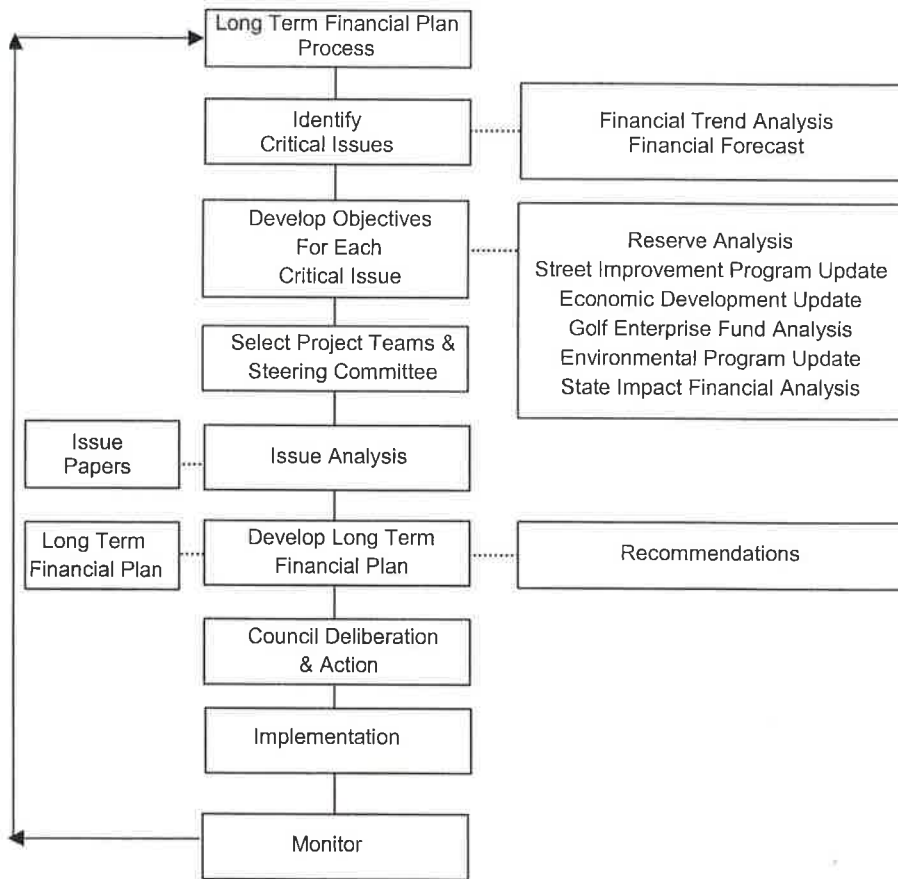
- Introduction
- City Manager Transmittal Letter
- Executive Summary
- Fiscal & Debt Policy
- Financial Trend Analysis
- Financial Forecast
- Reserve Analysis
- Street Improvement Program Update
- Economic Development Update
- Golf Enterprise Fund Analysis
- Environmental Program Update
- State Impact Financial Analysis

Long Term Financial Plan

Long Term Financial Plan Process

The Long Term Financial Plan process

The flow chart below graphically describes the **process** that went into developing the City's Long Term Financial Plan. This project was conducted by City staff. In fact, 11 City staff members contributed directly to the Plan, while countless other employees also assisted in the gathering of information, research, word processing, scheduling meetings, etc. Including the Project Director, there were 8 project leaders each assigned to teams addressing a specific critical issue.



Process & Schedule

Goals & Objectives

As indicated, the process of developing the Long Term Financial Plan began by identifying several critical areas which have, or are expected to have, an impact on the financial condition of the City over the next five years. Once the critical issues were identified, specific goals and objectives were developed for each project designed to meet the overall goal of the project:

To provide a clear and concise Long Term Financial Plan, identifying the City's current and projected financial condition, and proposing specific alternatives to address identified problems.

Project teams and team leaders were then selected based on individual talents and expertise in given critical issue areas. A steering committee was formed in order to keep the project on track and on schedule. Each team was then asked to prepare option papers that met the goals and objectives already defined. The key message expressed to each team was that the report had to be clear and concise while providing very specific and practical recommendations that addressed the issue at hand. After several months of intensive effort and time by all staff involved, the option papers were completed and incorporated into the Long Term Financial Plan.

Trends & Forecast are the Foundation of the LTFP

Once the issue papers were completed, the actual Long Term Financial Plan, was developed by using the Financial Trend Analysis and Financial Forecast as the *foundation* of the plan. Appropriate recommendations made in the issue papers were incorporated into this Long Term Financial Plan, which can essentially be described as a long-term financial strategic plan.

This Financial Plan was presented to the City Council on January 20, 2004 and adopted on February 3, 2004. Following is the project schedule.

Schedule

| | |
|-------------------|--|
| January 20, 2004 | Long Term Financial Plan provided to Council and public for review. |
| February 3, 2004 | Staff presentations to Council/Public and Council discussion of issues. Council deliberations and direction. Public input & City Council adoption. |
| February 10, 2004 | Vital Few Priority Meeting. City Council and City Manager. |

Long Term Financial Plan

City Manager's Transmittal Letter

Honorable Mayor and Councilmembers:

The 2004 LTFP represents the City's twelfth financial strategic plan

Introduction

I am pleased to present the *2004 Long Term Financial Plan* to the City Council and San Clemente residents. This financial plan represents the twelfth in a series of financial strategic plans that have been presented on an annual basis since 1993. The plan is intended to be a well thought-out analysis of issues that may affect the finances of the City of San Clemente. To provide some historical perspective, a brief review of each past financial plan is included at the end of this section.

One revision to existing fiscal policies is recommended

The Long Term Financial Plan (LTFP) includes an executive summary which describes the City's current and projected financial condition along with providing specific recommendations to maintain a positive fiscal balance over the next five years. Also included are all recommendations from each of the issue papers.

A total of 8 issues are included in the 2004 edition of the Long Term Financial Plan

The next section includes the City's Fiscal and Debt Policy. These policies are dynamic in the sense that they are reviewed and modified, as appropriate, on an annual basis. This year one change is recommended to the Fiscal Policy. No changes are recommended to the City's Debt Policy.

The City's overall financial position is very good

A total of eight issues were examined in the last section of the LTFP. This includes the City's Financial Trend Analysis, Financial Forecast and Reserve Analysis. The 2004 Long Term Financial Plan also consists of several updates to previous issue papers, including the Street Improvement Program, Economic Development, Environmental Program and State Impact Financial Analysis. One new issue paper looks at the current operating position of the Golf Fund and possible options for maintaining a positive operating position in the future.

Currently, the City's overall financial position is very good as we are well prepared for contingencies and emergencies. With the adoption of this financial plan, all City reserves will continue to be fully funded. The City's General Fund is in very good shape, but highly dependent upon the property tax and sales tax increases included in the forecast from continuing development of inland and coastal areas. Expenditure rates are also increasing, primarily from on-going operational increases from police, fire and park maintenance.

Continuing the fiscal trend of the past several years, the City's operating position is positive. With the exception of the City's Golf Course Enterprise Fund, all funds are in very good condition.

Further attesting to the *current* financial condition, twenty of twenty-one City financial trend indicators are positive as described in detail in the Trend Analysis report. However, a "warning" rating has been assigned to the revenues per capita indicator due to population increasing at a higher rate than operating revenues. This is another indication that further erosion of

Long Term Financial Plan

on-going City revenues by the State or delays in planned development could substantially change the financial outlook of the City.

The General Fund fund balance is positive throughout the five-year forecast period, with balances averaging \$8.8 million over the forecast period.

The 2004 LTFP consists largely of issue or project updates rather than new issues

With that in mind, the 2004 financial plan consists largely of issue or project updates rather than new issues, essentially maintaining the current direction from City Council. This is due to the fact that there are a number of unresolved issues, outside of our control, that will have an effect on the City's finances and could change the financial outlook dramatically. Any of these issues, separately or combined, will force the City to make some tough choices in the coming years.

The impact on San Clemente is \$522,000

For example, the City's Financial Plan does not include the impact of future State budget decisions such as the recently announced \$1.3 billion shift in local property taxes to the schools. The impact on San Clemente is approximately \$522,000. Similar State shifts of \$3.0 billion from 1992 and 1993 resulted in a permanent annual reduction of \$1.5 million in San Clemente property tax revenue.

The Financial Plan does not include the potential impact of property tax refunds (the Poole case), currently projected at \$2.0 million, if the 2% property-tax suit is upheld. Additionally, \$608,000 will be cut from future property tax revenues annually if the suit is upheld.

Delays in development could have an impact on the financial future of the City

Delays in the development of the Marblehead Coastal property could also have an impact on the financial future of the City. The City's forecast includes sales tax revenue from the commercial center beginning in FY 2006-07. This increase in revenue helps to neutralize the impact of on-going operating cost increases from two new parks and a new Community Center/gym/pool complex scheduled to come on-line in FY 2006-07. If development of Marblehead Coastal is delayed, the Community Center and La Pata/Vista Hermosa park site could also be delayed. These two facilities are not subject to current development agreements and could be delayed if funding is not sufficient to provide on-going maintenance.

I encourage the City Council during the Long Term Financial Plan, Vital Few Priorities and budget deliberations to evaluate all programs and proposals with an eye on maintaining the City's well-established fiscal balance.

I would like to take this opportunity to thank all staff members who assisted in completing the City's Long Term Financial Plan. I believe that the City's focus on long term strategic financial planning will continue to assist City administrators and the City Council in dealing with critical issues in a deliberate and carefully planned manner. The City Council's support for this time consuming project is very much appreciated.

City Manager's Transmittal Letter

Lastly, while dealing with this financial plan, I encourage the City Council to continue our established philosophy of maintaining a sound fiscal program, while addressing the long-term needs of a growing community.

I look forward to working with you, staff, and our community as we review and implement the 2004 Long Term Financial Plan and the proposed budget for Fiscal Year 2004-05.



George Scarborough
City Manager

Long Term Financial Plan

Long Term Financial Plan Review

Financial plans have been prepared since 1993

The City has prepared an annual Long Term Financial Plan since 1993. Thus, the 2004 LTFP represents the twelfth plan prepared by the City Administration for City Council consideration. The plan focuses on financial and organizational issues and is designed to provide staff initiated solutions to problems identified through the financial planning process.

In order to provide some historical perspective, this section briefly reviews each financial plan and includes a definition of problems encountered along with the adopted solutions:

| Year | Challenge | Solution |
|------|---|---|
| 1993 | <ul style="list-style-type: none"> • Annual shortfall of \$6 million • Operating deficit of \$1.8 million • Critical capital needs of \$2.4 million | <ul style="list-style-type: none"> • Contracted Police services • Established storm drain fee • Reorganized & downsized • Salary & benefit reductions • Established economic development program • Established reserves |
| 1994 | <ul style="list-style-type: none"> • Shortfall of \$2.7 million • Operating deficit of \$785,000 • Street capital & maintenance needs of \$1.8 million • Capital equipment needs of \$100,000 • ERAF shift of \$1.2 million annually | <ul style="list-style-type: none"> • Contracted Fire, fleet maintenance, meter reading, street striping and beach/park maintenance • Continued salary & benefit reductions • No cost of living increases • Established cost allocation plan to recover costs • Established capital equipment replacement reserve |
| 1995 | <ul style="list-style-type: none"> • Forecast deficit in years two through five | <ul style="list-style-type: none"> • Cutback on funding of emergency reserves • Reduced number of projected positions added • Reduced maintenance costs • Established 18 year/\$55 million Street Improvement Program |
| 1996 | <ul style="list-style-type: none"> • Positive fund balances for each year of the financial forecast • Emergency reserve level reached 5% | <ul style="list-style-type: none"> • Expedited Street Improvement Program • Issued \$7 million in street bonds • Saved on bond issuance costs |

City Manager's Transmittal Letter

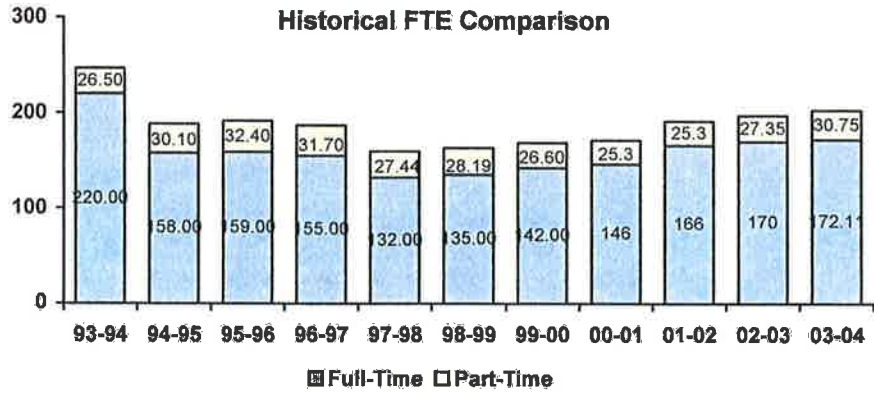
| Year | Challenge | Solution |
|------|---|--|
| 1997 | <ul style="list-style-type: none"> • \$2.8 million shortage created by Proposition 218 | <ul style="list-style-type: none"> • Increased revenues • Transferred \$425,000 from Golf Fund • Employee lay-offs • Program reductions • Transferred police dispatch operation to County • Closure of Stead Park |
| 1998 | <ul style="list-style-type: none"> • All reserves except Capital Equipment Replacement Reserve fully funded | <ul style="list-style-type: none"> • Funded Capital Equipment Replacement Reserve • Funded a market study and downtown improvement plan |
| 1999 | <ul style="list-style-type: none"> • Water Fund operating position negative • No formal plan in place for City facilities | <ul style="list-style-type: none"> • Long-term water rate structure approved • Funded a City Facilities Master Plan |
| 2000 | <ul style="list-style-type: none"> • New projects identified as priorities | <ul style="list-style-type: none"> • Funded studies for the restoration of the Casa Romantica Cultural Center, Rail Corridor Safety and Education, Coastal Resources and Downtown Revitalization |
| 2001 | <ul style="list-style-type: none"> • Public safety needs identified • Document imaging system needed • Facilities maintenance needs identified | <ul style="list-style-type: none"> • Conducted a Fire Authority staffing analysis and increased to a four-person engine company for Engine 60 • Established a document management plan • Established a new Facilities Maintenance Reserve for future maintenance needs of all City facilities |
| 2002 | <ul style="list-style-type: none"> • Identified financial impact of City's capital facility plan • Sidewalk restoration needs identified • Urban Runoff Plan implementation costs identified | <ul style="list-style-type: none"> • Restricted the use of special development fees • Funded sidewalk restoration plan • Established urban runoff fee |
| 2003 | <ul style="list-style-type: none"> • New fire station with operating costs of \$1.5 million planned • Projected deficit balance in Golf Course Fund • Identified interest costs associated with long-term loans to the RDA | <ul style="list-style-type: none"> • Eliminated new fire station. Relocated another fire station to central location and increased staffing • Established two-year loan to Golf Course • Repaid RDA loan from the General Fund and lowered interest costs |

Long Term Financial Plan

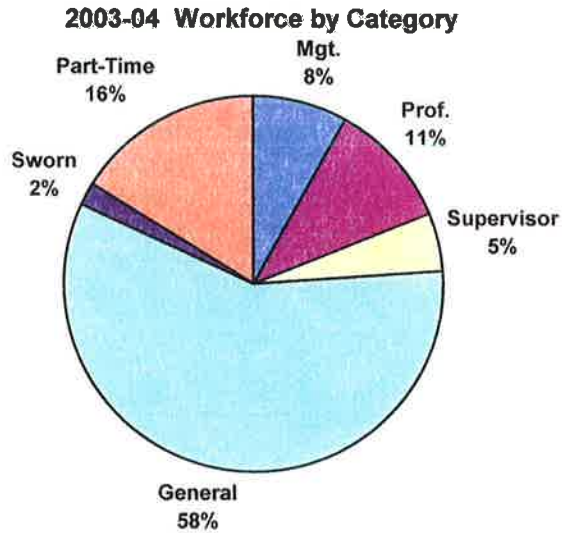
Historical Staffing Levels

Historical Staffing levels

The impact on staffing changes as a result of the implementation of the City's series of financial plans and budgets since 1993 are outlined below:



The following chart summarizes the City's current workforce by category:



Executive Summary

Financial Summary

The 2004 Long Term Financial Plan Executive Summary includes a Financial Summary

The *Executive Summary* portion of the 2004 Long Term Financial Plan includes a Financial Summary section which provides a profile of the City's present financial condition, including a summary of this year's LTFP recommendations.

Included within the *Financial Summary* section:

- *Introduction*
- *Current Financial Condition*
- *Reserve Funding*
- *General Fund Transfers*
- *Financial Trend Analysis*
- *Five Year Financial Forecast*
- *Conclusion & Projected Financial Condition*
- *Summary of Recommendations*

The 2004 LTFP is the 12th edition of the City's financial strategic plan

Introduction

The twelfth edition of the City's Long Term Financial Plan documents the progress that the City has made in attaining its financial goals, and continues to provide the City Council and citizens with an objective analysis of the fiscal issues facing the City of San Clemente. A number of issues affecting the financial condition of the City were studied and are documented in the 2004 Long Term Financial Plan.

The LTFP serves as an "early detection system"

The 2004 Long Term Financial Plan continues the tradition of reviewing the City's current financial condition and identifying potential fiscal pitfalls. This "early detection system" has served the City as a tool for quickly reacting to financial challenges and opportunities. Furthermore, the strategic fiscal planning process allows the City to thoughtfully plan for the future. To provide a framework for the study of fiscal issues, a comprehensive trend analysis report and a five-year financial forecast have been prepared.

This financial plan is based on the City's current financial condition

It is important to remember that this financial plan is based upon the City's current financial condition. As pointed out in the City Manager's Transmittal Letter, there are a number of outside influences that could have a substantial effect on City's finances. The largest threat to the City right now is the impact of the proposed state budget on local revenues. This is totally outside of our control, unless proposed legislation sponsored by the League of California Cities for the November 2004 ballot is passed. This legislation titled "The Local Taxpayers and Public Safety Protection Act", will nullify the proposed ERAF shift and keep local government revenue from the State.

The City's Financial Plan focuses on the General Fund and other Operating Funds

Current Financial Condition - Overview

The City's Long Term Financial Plan typically focuses on the financial condition of the General Fund, the City's key operating fund. The LTFP also includes an examination of the City's major operating funds, including, Water, Sewer, Storm Drain, Golf and Clean Ocean Fund.

Long Term Financial Plan

The General Fund is projected to end the year with a \$9.0 million fund balance

The City's General Fund is projected to end the fiscal year with a \$9.0 million fund balance. Revenues are expected to amount to \$36.9 million and expenditures including one-time capital and transfers will amount to \$37.1 million.

The City's current financial condition is very good

Notwithstanding potential State budget impacts and other potential issues looming, the City's current financial condition can be termed very good. All reserves are fully funded, although contributions will have to be made in order to maintain prudent reserve levels. Property taxes are increasing as anticipated and other budgetary revenue goals will be achieved.

The Golf Course Fund is facing financial difficulty

The Golf Course Fund is facing financial difficulty and is expected to end the fiscal year in a negative operating position. The Golf Fund's five-year forecast predicts that the fund will remain negative throughout the forecast period. A separate issue paper has been developed to analyze the Golf Fund's current financial condition. Revenue enhancements and expenditure reductions will be developed by staff for Golf Committee and City Council review and approval.

The 2004 LTFP examines the City's fiscal future

The Long Term Financial Plan for the year 2004 continues to provide a clear path to the City's fiscal future. Although there are certainly many challenges which lie ahead, the process of adopting and implementing a comprehensive financial strategic plan will assist the City Council in thoughtfully choosing a viable route to a secure future.

We believe that the 2004 Long Term Financial plan once again provides viable solutions to a series of financial and quality of life issues.

All reserve funds are fully funded

Reserve Funding – General Fund

Several fiscal policy statements adopted by the City Council over the past several years relate to the funding of various reserve funds and accounts. This is largely due to the fact that most reserve accounts were non-existent, depleted or in a deficit position when the first financial plan was developed. In fact, since 1993, a total of *\$11.1 million* has been dedicated to the funding of reserves and deficit fund balances by all City funds. This includes funding of workers' compensation, general liability, capital equipment, accrued leave, facilities maintenance, contingency, and emergency reserves. All reserve funds are now entirely funded and meet all fiscal policy requirements. In order to maintain reserves at prescribed levels the following transfers are proposed:

A transfer of \$100,000 to the Facilities Maintenance Reserve

Projected five-year replacement costs for the Facilities Maintenance Reserve are estimated at \$623,900. A transfer of \$100,000 from the General Fund to the Facilities Maintenance Reserve is recommended for FY 2004-05

A transfer of \$145,000 to the Accrued Leave Reserve

The 2004 LTFP recommends that the City allocate \$145,000 to the Accrued Leave Reserve to accumulate funds for the payment of accrued employee benefits (leave) to terminated employees.

Executive Summary

Emergency reserves are funded at the required 8% level

A \$330,000 contribution to the General Fund Emergency reserve is recommended for FY 2004-05 to continue full funding of the reserve at 8% of General operating expenditures.

These changes in reserve funding levels will serve to further strengthen the financial condition of the General Fund.

Transfers of \$1.1 million were included in the FY 2003-04 budget.

General Fund Transfers

Several annual transfers from the General Fund to other funds are normally included in the annual budget (not including reserve allocations). In FY 2003-04, these include total transfers of \$1.1 million for items such as the loan from the General Fund to Golf Operating Fund (\$192,000), Street Improvement Program (\$579,630), Workers' Compensation (\$276,710) and miscellaneous transfers (\$121,600).

For FY 2004-05, only the transfer from the General Fund to the Street Improvement Program of \$597,020 has been proposed .

Funding will continue in FY 2004-05 with a \$597,020 contribution to the Street Improvement Program

Street Improvement Program: General Fund contributions to the Street Improvement Program have totaled \$3.95 million during the past eight fiscal years. Funding for this program will continue in FY 2004-05 with a contribution of \$597,020. Annual contributions, which include an inflationary factor, will be made through the remainder of the program.

20 out of 21 financial indicators are positive...

Financial Trend Analysis

The City's financial condition is also quantitatively measured using a financial trend monitoring system. Last year, all financial trends were found to be positive with a favorable/caution rating assigned to the Expenditures per Capita and the Operating Position trends. The annual Financial Trend Analysis report for the year ending June 30, 2003 indicates that 20 of 21 indicators are favorable, with a warning flag for Revenues Per Capita. Two other trends, Population and Expenditures By Function have been assigned a "favorable/caution" rating. Only six indicators were considered favorable in 1993, the first year of the Long Term Financial Plan and trends generally have shown improvement.

...however, a "Warning" rating has been assigned to Revenues per Capita

Revenues Per Capita: This category was assigned a warning flag due to population increasing at a higher rate than operating revenues. This downward trend signals that operational revenues may not be able to support additional services required by increased population.

Population: This category was assigned a favorable/caution flag due to a 10.5% population growth from FY 2001-02 to FY 2002-03. Although the exact relationship between population change and other economic and demographic factors is uncertain, sudden increases in population can create immediate pressures for new capital expenditures and higher levels of service. This pressure from growth is already materializing in a higher demand for youth athletic fields.

Long Term Financial Plan

Expenditures By Function: This category was assigned a favorable/caution flag due to changes in the City's make-up from FY 1998-99 to FY 2002-03. This new indicator shows the functional make-up of the City. Community Development expenditures grew 87% to accommodate new development within City limits and newly annexed County land. Beaches, Parks and Recreation expenditures grew 81% due to the addition of eleven added positions, two newly added parks and increased or enhanced maintenance.

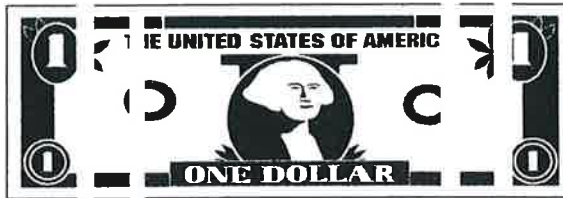
A detailed review of the indicators is contained in the Financial Trend section of this report. A summary of indicators is provided below:

| Indicator | 2004 | 2003 | 2002 | 2001 | 2000 | 1999 | 1998 | 1997 | 1996 | 1995 |
|-----------------------------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|
| Revenues Per Capita | W | F | F | F | F | F | F | F | F | U |
| Property Tax Revenues | F | F | F | F | F | F | F | U | U | U |
| Property Values | F | F | F | F | F | F | F | U | U | U |
| Population Elastic | F/C | F | F | F | F | F | F | F | F | F |
| Revenues Sales Tax | F | F | F | F | F | F | F | F | F | F |
| Revenues Licenses & Permits | F | F | F | F | F | F | F | F | F | F |
| Comm. Develop. Charges | F | F | F | F | F | F | U | F | F | F |
| Inter-governmental Revenues | F | F | F | F | F | F | F | U | U | U |
| One-Time Revenues | F | F | F | F | F | F | F | F | F | F |
| Revenue Overage | F | F | F | F | F | F | F | F | F | F |
| Expenditures Per Capita | F | F/C | F | F | F | F | F | F | F | F |
| Expenditures by Function | F/C | N/A | N/A | N/A | N/A | N/A | N/A | N/A | N/A | N/A |
| Employees Per Capita | F | F | F | F | U | U | F | F | F | F |
| Fringe Benefits | F | F | F | F | F | F | F | F | F | W |
| Capital Outlay | F | F | F | F | F | F | F | F | F | U |
| Operating Positions | F | F/C | F | F | F | F | F | F | F | W |
| Debt Service Compensated Absences | F | F | F/C | F/C | F/C | F | F | F | F | F |
| Fund Balance Liquidity Ratio | F | F | F | F | F | F | F | F | F | F |

Executive Summary

The trend report also includes a section as regards the distribution of the property tax dollar. As indicated below, the City currently receives 11% of the property tax dollar and the remainder is distributed as shown.

| | | | | |
|------|--------|---------|-----|----------------------|
| City | County | Schools | RDA | Special Districts |
| 11% | 7% | 64% | 7% | 11% |



Revenue growth is projected at 4.5%

Five Year Financial Forecast

The five-year forecast for the General Fund has been revised to combine the elements of the fiscal impact model into the forecast assumptions to produce a forecast that reflects the impacts of new development upon City finances, as well as the likely impacts of the economy upon the City of San Clemente's finances.

City revenues are anticipated to grow by an annual average increase of 4.5% a year. Property taxes increase by \$11.3 million or 6.2% over the five-year period due to new residential homes and resale activity. Sales taxes increase by \$4.39 million over the forecast period, primarily from sales taxes generated from the Marblehead retail facility. However, any delays to development projects included in the forecast will change the financial outlook substantially.

Expenditures will increase 4.8%

Expenditures are projected to increase at an average rate of 4.8%. The majority of this growth is due to increases in staffing levels and contractual services. Known increases to the Police and Fire contracts have been included in the forecast. Increased costs for park and beach maintenance and recreation staffing is also included due to the construction and acceptance of six parks, a new senior center and a community center complex.

Operating position and fund balances are examined in the financial forecast

In developing the Five Year Financial Forecast, two primary areas are examined to determine the City's projected future financial position - *operating position* and *fund balances*.

Operating position refers to the City's ability to match revenues to expenditure levels, i.e. if revenues exceed expenditures, the City will have an operating surplus. If the opposite is true, an operating deficit will occur. Operating position does not take carry-over fund balances into account.

Fund balances include the accumulation of available resources from year to year to determine the City's financial position, e.g. if an operating surplus is carried over from year to year, fund balances will increase; however, if an operating deficit occurs, fund balances will decline.

Long Term Financial Plan

The City's projected operating position is positive in all five years of the forecast period

2004 LTFP forecast - operating position

The City's projected fund balance averages \$8.8 million over the forecast period

Operating Position

Based on current expenditure and revenue trends, the financial forecast predicts a positive operating position in all five years of the forecast period. Results of the forecast with respect to operating position (operating receipts less operating disbursements) are shown in the following graph:

2004 Forecast Summary (LTFP)*

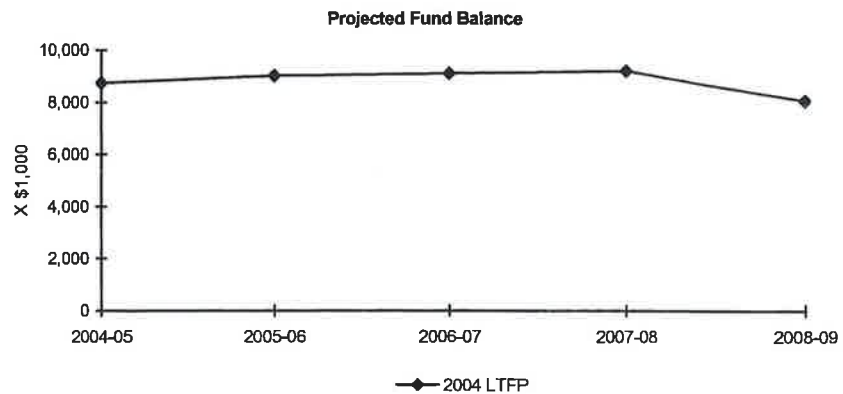
Amounts in \$1,000

| | 2004-05 | 2005-06 | 2006-07 | 2007-08 | 2008-09 |
|---------------------------|----------|----------|----------|----------|----------|
| Operating receipts | \$39,304 | \$41,214 | \$44,493 | \$45,416 | \$45,865 |
| Operating disbursements | 37,417 | 39,008 | 42,312 | 43,334 | 44,959 |
| Projected surplus/deficit | \$1,887 | \$2,206 | \$2,180 | \$2,082 | \$906 |

*One-time revenues and expenditures have been excluded. One-time revenues include grants and development fees from the Talega Joint Powers Authority. One-time expenditures include transfers to other funds, capital outlay and special projects such as the La Pata/Vista Hermosa study.

Fund Balances

Healthy fund balances, averaging \$8.8 million over the forecast period, are projected. However, if revenues are reduced or do not materialize as anticipated in the forecast, fund balances will decline. Fiscal policy does not allow for the development of new park acreage if the General Fund can not afford to provide on-going maintenance. However, current agreements with Talega and Marblehead *require* the construction of parks once certain pre-established building thresholds are met. Thus, the City will be forced to accept these parks and provide on-going maintenance. As a result, develop of other parks may be delayed until the City's financial position improves enough to handle on-going maintenance.



Executive Summary

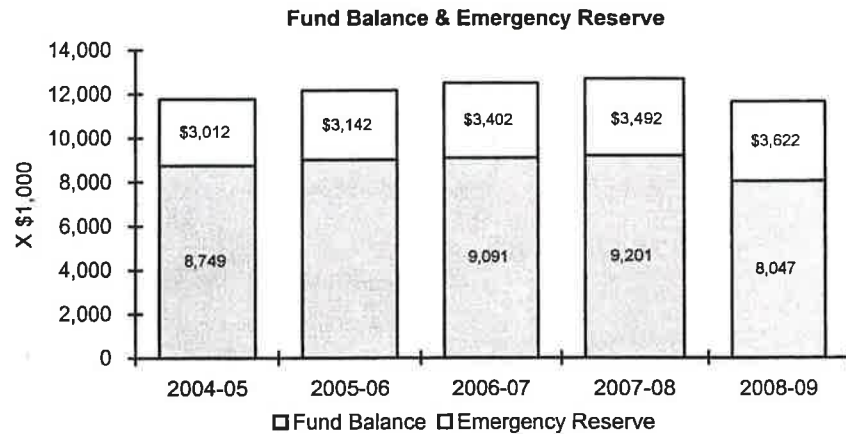
Fund balances are projected to be positive

As shown on the following table and graph, the projected ending fund balance over the five year forecast period will be positive. Emergency reserve levels have been maintained at the required 8% level.

Fund Balance & Emergency Reserve

| Amounts in \$1,000 | 2004-05 | 2005-06 | 2006-07 | 2007-08 | 2008-09 |
|-------------------------|---------|---------|---------|---------|---------|
| Fund Balance | \$8,749 | \$9,012 | \$9,091 | \$9,201 | \$8,047 |
| Emergency Reserves (8%) | \$3,012 | \$3,142 | \$3,402 | \$3,492 | \$3,622 |

Fund balances and emergency reserves



Conclusion & Projected Financial Condition

The Financial Summary section has provided an overview of the City's current financial condition and presented the City's five year financial forecast if current fiscal trends were to continue.

A minimum number of funding requests have been submitted

Based on the issue papers contained in the 2004 Long Term Financial Plan, there are a minimal number of new funding requests. General Fund transfers to maintain reserve levels are recommended. The major problems mentioned earlier in the City Manager Transmittal Letter still remain outside of our control and probably will not be resolved before the development of the City's FY 2004-05 budget.

It should be noted that programs prioritized by the City Council as a part of the Vital Few Priority process are not included in the financial forecast. Other program needs will be identified through the annual Vital Few Priority process.

The City of San Clemente has become a model for prudent fiscal management as a result of holding the line and adhering to a set of strict financial policies designed to maintain a positive fiscal balance, while meeting the basic needs of our community. An essential element in that effort is our continued focus on maintaining a *positive annual operating position*.

Long Term Financial Plan

This section provides an updated fund balance forecast if LTFP financial recommendations are adopted by the City Council and potential outside financial impacts are implemented. The first table summarizes current projected fund balances prior to the adoption of 2004 LTFP recommendations:

Current projected fund balances

| Fund Balance | | | | | |
|--------------|-------------|-------------|-------------|-------------|-------------|
| | 2004-05 | 2005-06 | 2006-07 | 2007-08 | 2008-09 |
| Fund Balance | \$8,749,000 | \$9,012,000 | \$9,091,000 | \$9,201,000 | \$8,047,000 |

The following table indicates the impact on fund balances if recommendations contained in the 2004 Long Term Financial Plan are adopted by the City Council. The only items below which are not included as LTFP issue recommendations are the potential impacts from the State and others that may have a financial effect upon the City.

Projected fund balances including 2004 LTFP recommendations & potential state and legal actions

| Fund Balance | | | | | |
|--|--------------------|--------------------|--------------------|--------------------|--------------------|
| | 2004-05 | 2005-06 | 2006-07 | 2007-08 | 2008-09-08 |
| <i>Projected Ending Fund Balance</i> | \$8,749,000 | \$5,860,620 | \$4,730,620 | \$3,600,620 | \$2,470,620 |
| Operating deficit | 0 | 0 | 0 | 0 | 0 |
| General Liability ¹ | -121,380 | 0 | 0 | 0 | 0 |
| Accrued Leave Reserve ² | -145,000 | 0 | 0 | 0 | 0 |
| Facilities Maintenance Capital Asset Fund ³ | -100,000 | 0 | 0 | 0 | 0 |
| State ERAF shift ⁴ | -522,000 | -522,000 | -522,000 | -522,000 | -522,000 |
| Poole case ⁵ | -2,000,000 | -608,000 | -608,000 | -608,000 | -608,000 |
| <i>Revised Ending Fund Balance</i> | <i>\$5,860,620</i> | <i>\$4,730,620</i> | <i>\$3,600,620</i> | <i>\$2,470,620</i> | <i>\$1,340,620</i> |

¹ \$721,230 transfer proposed in FY 2004-05. The amount shown above is the net difference between last year's contribution and the proposed contribution for FY 2004-05.

² \$145,000 recommended in Reserve paper to fully fund the Accrued Leave Reserve.

³ \$100,000 recommended in Reserve paper to fully fund the Facilities Maintenance Capital Asset Fund.

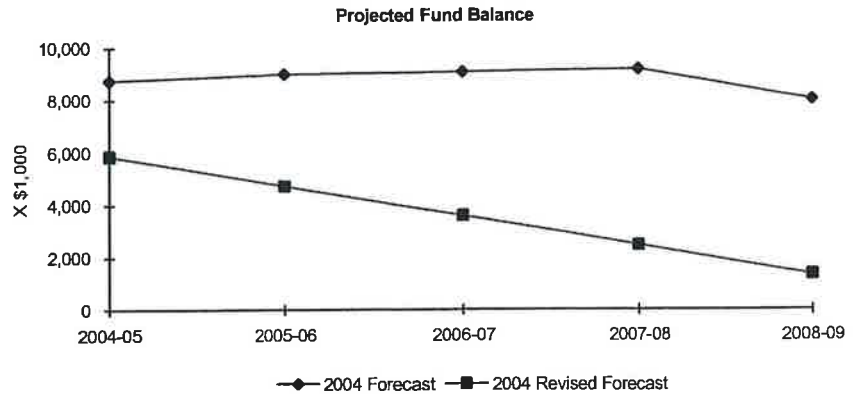
⁴ Impact on City's General Fund of State's proposed 2004-05 budget which shifts \$1.3 billion from local governments. Because prior ERAF shifts have continued annually, the \$522,000 has been projected in the forecast to remain an on-going diversion of local revenue.

⁵ Impact of \$2.0 million refund and \$608,000 on-going reduction of property tax revenue if Poole case is not appealed.

The following graph shows the impact of adopting the 2004 LTFP recommendations on projected fund balances:

Executive Summary

Impact on fund balance with LTFP recommendations



As illustrated, the overall impact of adopting LTFP recommendations and recognizing potential State and legal actions reduces the projected fund balance significantly; however, fund balances are still positive over the next 5 years but are extremely low in comparison to prior years. Any new program increases or decreases will, of course, impact the projected fund balance but this analysis provides the City Council with a baseline forecast recommendations are adopted and funds are shifted to the State (ERAF) and taxpayers (Pool case).

Summary of Long Term Financial Plan recommendations

Recommendations

This section summarizes the recommendations contained in the 2003 Long Term Financial Plan. It is recommended that the City Council endorse all recommendations as put forth by the City Administration.

A narrative description and rationale for each recommendation is contained in the individual issue papers under separate tabs in this document.

Forecast

1. None.

Reserves

1. Budget sufficient funds for FY 2004-05 in order to bring the emergency reserve to the 8% level of projected General Fund operating expenditures. Based on the Financial Forecast, this would amount to \$330,000; however, expenditures may be less.
2. Recommend that \$376,120 (which represents 1% of the estimated General Fund operating expenditures) be set aside in fiscal year 2004-05 to fund the Council Contingency Reserve.
3. Increase the specified reserve in the General Liability Self-Insurance Fund from the current reserve of \$546,000 to \$625,000 for the fiscal year 2004-05. The reserve includes three times the self-insurance retention (\$300,000), plus the average of the previous five years of claims costs not covered by the insurance pool (\$325,000).
4. Charge existing worker's compensation rates for fiscal year 2004-05.

Long Term Financial Plan

5. Transfer \$145,000 from the General Fund to the Accrued Leave Reserve for fiscal year 2004-05.
6. Transfer \$100,000 from the General Fund to the Facilities Maintenance Capital Asset Reserve for fiscal year 2004-05.
7. Budget \$5,000 from the Water Operating Fund in FY 2004-05 in order to bring the emergency reserve to \$395,000, which will maintain the 8% of projected Water Fund operating expenditures level.
8. Budget an additional \$200,000 transfer from the Water Operating Fund to the Water Depreciation Fund for Fiscal Year 2004-05.
9. Defer policy changes until the completion of the Water and Sewer System Asset Study.
10. Budget \$27,000 from the Sewer Operating Fund in FY 2004-05 in order to bring the emergency reserve to \$465,000, which represents 8% of the projected Sewer Fund operating expenditures level.
11. Defer policy changes until the completion of the Sewer System Asset Study.
12. Budget \$9,000 from the Storm Drain Operating Fund for FY 2004-05 in order to bring the emergency reserve to \$64,000, which will maintain the 8% of projected Storm Drain Fund operating expenditures level.
13. Defer policy changes until the completion of the Storm Drain System Asset Study.
14. Based on the Financial Forecast, no contribution is necessary for FY 2004-05 in order to maintain the emergency reserve at \$11,000, which represents 8% of the projected Solid Waste Fund operating expenditures level.
15. Based on the Financial Forecast, no contribution is necessary for FY 2004-05 in order to maintain the emergency reserve at \$161,000, which represents 8% of the projected Golf Course Operating Fund operating expenditures level.
16. Revise the City's Fiscal Policy to specifically include the Golf Course Depreciation Reserve. "The City will establish a Golf Course Depreciation Reserve for costs associated with the replacement of equipment/physical plant and course improvements as they become unserviceable, obsolete, or reach a predetermined service life. The reserve will be maintained at a level at least equal to the projected five-year Golf Course replacement costs."
17. Continue the annual transfer of \$160,000 from the Golf Course Operating Fund to the Golf Course Improvement Fund.

Street Improvement Program

1. Approve and authorize the allocation of a General Fund contribution of \$597,020 for the coming FY 2004/05.
2. Confirm the City Council's continuing commitment to the fiscal policy requiring General Fund contributions to the program as resources become available.
3. Confirm the City Council's continuing commitment to the Major Street Maintenance Program and the Slurry Seal Program to provide a programmed preventive maintenance for the streets.

Executive Summary

4. Approve the Street Improvement Program schedule modification:
 - a. To accelerate ten street projects from FY 2004/05 within the Shorecliffs Area, and combine them with other street projects within the same area in FY 2003/04 due to the proximity of these streets.
 - b. To postpone four street projects in FY 2003/04 within the North Beach Area and combine them with other street projects within the same area in FY 2004/05 due to the proximity of these streets.
5. Approve the Street Improvement Program schedule modification to accelerate Calle Del Cerro from the FY 2009/10 to FY 2004/05.

Economic Development

1. Direct staff to continue to work closely with the Downtown Business Association, Chamber of Commerce and other stakeholders to implement public improvement projects and related programs for the Downtown area.
2. Working with the Downtown Business Association, provide appropriate staff support and assistance towards the objective of supporting and strengthening the Main Street Program. In this regard, also ensure coordination of the City's proposed Downtown Strategic Plan and Downtown Visioning process with the Downtown Business Association's Main Street Program efforts.
3. Continue to aggressively market and promote the recruitment and attraction of new business firms to the Rancho San Clemente Business Park and the Talega Business Park.
4. With respect to older commercial shopping centers, direct staff to continue to provide appropriate assistance and support for the revitalization of these centers.
5. Continue to provide staff support for the Central Business District Transition Program and the Los Molinos Public/Private Partnership Program.
6. Continue to diligently provide business ombudsman and developer advocacy services to the business community and continue to coordinate resolution and response to complaints and requests for business related support services.
7. Continue to promote and support the development of a new grocery store for the area of South San Clemente.
8. In concert with the efforts of the City's Planning Division to undertake a Specific Plan process, coordinate marketing and promotion of appropriate and viable economic development initiatives and projects for the North Beach area.

Environmental Program Update

1. Receive and file with City Council making decisions as individual projects reach milestones.

Long Term Financial Plan

Golf Enterprise Fund Analysis

1. Staff considers fee increases, the historical method of raising Golf Course Operating Fund revenues, not to be appropriate in the near future. Staff believes that increasing fees will reduce rounds and ultimately reduce revenues due to the highly competitive nature of golf courses. Staff will be recommending to the Golf Course Committee a number of revenue enhancements and expenditure reductions for the Committee's evaluation and recommendation to the City Council.

State Impact Financial Analysis

Staff recommends that City Council direct staff to:

1. Use the information discussed herein; work with other cities towards local control of local revenue and push for stable sources of tax money that will remain under local control -- revenue that the State will not be able to take away.
 2. Share this information with other cities and seek input in analyzing the impacts of State revenue shifts on their own jurisdictions.
 3. Provide impartial informational materials on the "Local Taxpayers and Public Safety Protection Act" initiative as may be lawfully provided by City representatives and share this paper as it relates to San Clemente's loss of local revenue.
 4. Report back to Council as progress is made.
-

Fiscal Policy

Objective

To review the City's Fiscal Policy on an annual basis in order to determine appropriate changes, additions or deletions.

Background

A review of the City Council adopted Fiscal Policy is conducted on an annual basis in conjunction with the preparation of the Long Term Financial Plan. This review is performed in order to document proposed new policies identified through the preparation of the Long Term Financial Plan. Additionally, as circumstances change, there is sometimes a need to modify existing fiscal policy statements.

Following are approved changes to the current Fiscal Policy:

1. **Reserve Policies:** This change adds language to specifically address the Golf Course Depreciation Reserve.

| <i>Current Policy Statement</i> | <i>Approved Policy Statement</i> |
|---------------------------------|--|
| None | The City will establish a Golf Course Depreciation Reserve for costs associated with the replacement of equipment/physical plant and course improvements as they become unserviceable, obsolete, or reach a predetermined service life. The reserve will be maintained at a level at least equal to the projected five-year Golf Course replacement costs. |

Recommendation

It is recommended that the City's Fiscal Policy be modified to include the changes outlined above.

Council Action

The recommendation was approved by the City Council by a vote of 5-0 on February 3, 2004.

Long Term Financial Plan

| Fiscal Policy Statement | Status | Comments |
|--|---------------|-----------------|
| General Financial Goals | | |
| To maintain a financially viable City that can maintain an adequate level of municipal services. | √ | |
| To maintain financial flexibility in order to be able to continually adapt to local and regional economic changes. | √ | |
| To maintain and enhance the sound fiscal condition of the City. | √ | |
| Operating Budget Policies | | |
| The City will adopt a balanced budget by June 30 of each year. | √ | |
| The City Manager will prepare a budget calendar no later than January of each year. | √ | |
| An annual base operating budget will be developed by verifying or conservatively projecting revenues and expenditures for the current and forthcoming fiscal year. | √ | |
| During the annual budget development process, the existing base budget will be thoroughly examined to assure removal or reduction of any services or programs that could be eliminated or reduced in cost. | √ | |
| Current revenues will be sufficient to support current operating expenditures. | √ | |
| Annual operating budgets will provide for adequate design, construction, maintenance and replacement of the City's capital plant and equipment. | √ | |
| The purchase of new or replacement capital equipment with a value of \$5,000 or more and with a minimum useful life of two years will require budget approval. | √ | |

Fiscal Policy

| Fiscal Policy Statement | Status | Comments |
|--|--------|----------|
| The City will project its equipment replacement and maintenance needs for the next five years and will update this projection each year. From this projection a maintenance and replacement schedule will be developed and followed. | √ | |
| The City will avoid budgetary and accounting procedures which balance the current budget at the expense of future budgets. | √ | |
| The City will forecast its General Fund expenditures and revenues for each of the next five years and will update this forecast at least annually. | √ | |
| Revenue Policies | | |
| The City will try to maintain a diversified and stable revenue system to shelter it from short-term fluctuations in any one revenue source. | √ | |
| Because revenues, especially those of the General Fund, are sensitive to both local and regional economic conditions, revenue estimates adopted by the City Council must be conservative. | √ | |
| The City will estimate its annual revenues by an objective, analytical process utilizing trend, judgmental, and statistical analysis as appropriate. | √ | |
| User fees will be adjusted annually to recover the full cost of services provided, except when the City Council determines that a subsidy from the General Fund is in the public interest. | √ | |
| One-time revenues will be used for one-time expenditures only. (Including capital and reserves). | √ | |

Long Term Financial Plan

| Fiscal Policy Statement | Status | Comments |
|---|--------|--|
| <p>Capital improvements will be financed primarily through user fees, services charges or developer agreements when benefits can be specifically attributed to users of the facility. The City will analyze the impact of capital improvements to ensure that operational and maintenance costs are balanced with on-going revenue to support the facilities.</p> | √ | |
| <p>The City will annually identify developer fees and permit charges received from “non-recurring” services performed in the processing of new development. Revenue from these sources will be used to meet peak workload requirements.</p> | √ | |
| <p>The City will annually review the General Fund operating position (operating revenues less operating expenditures) to determine if funds are available to operate and maintain future capital facilities. If funding is not available for operations and maintenance costs, the City will delay construction of the new facilities.</p> | √ | |
| Expenditure Policies | | |
| <p>The City will maintain a level of expenditures which will provide for the public well-being and safety of the residents of the community.</p> | √ | |
| Utility Rates and Fees Policies | | |
| <p>The City will set fees and user charges for each utility fund at a level that fully supports the total direct and indirect cost of the activity. Indirect costs include the cost of annual depreciation of capital assets and overhead charges.</p> | √ | <p>An annual review of the water and sewer rates was completed. Water rates will not change in FY 2004-05. Sewer rates will increase 3.7%.</p> |
| <p>Utility rates will be established for each of the next five years and this rate projection will be updated annually.</p> | √ | |
| Capital Improvement Budget Policies | | |
| <p>The City will make all capital improvements in accordance with an adopted and funded capital improvement program.</p> | √ | |

Fiscal Policy

| Fiscal Policy Statement | Status | Comments |
|--|--------|----------|
| The City will develop an annual five-year plan for capital improvements, including CIP design, development, implementation, and operating and maintenance costs. | √ | |
| The City will identify the estimated capital and on-going maintenance costs, potential funding sources and project schedule for each capital project proposal before it is submitted to Council for approval. | √ | |
| The City will use intergovernmental assistance to finance only those capital improvements that are consistent with the Capital Improvement Plan and City priorities, and whose operating and maintenance costs have been included in the budget. | √ | |
| The City will coordinate development of the capital improvement budget with the development of the operating budget. All costs for internal professional services needed to implement the CIP will be included in the operating budget for the year the CIP is to be implemented. | √ | |
| Cost tracking for components of the capital improvement program will be implemented and updated quarterly to ensure project completion within budget and established timelines. | √ | |
| The Council will review the Street Improvement Program each year at budget time and will transfer as much as possible from the General Fund and Gas Tax Fund to the Street Improvement Fund. The intention is to eventually eliminate the need for an assessment district. A public review process will be required, in order for the City Council to extend the Street Overlay and Replacement Assessment District beyond the bond maturity date (year 18). | √ | |
| The Park Acquisition & Development Fund and other special development impact funds may only be used to fund facilities included in the Master Plan for City Facilities. | √ | |

Long Term Financial Plan

| Fiscal Policy Statement | Status | Comments |
|--|--------|--|
| Short-Term Debt Policies | | |
| The City may use short-term debt to cover temporary or emergency cash flow shortages. All short-term borrowing will be subject to Council approval by ordinance or resolution. | √ | |
| The City may issue interfund loans rather than outside debt instruments to meet short-term cash flow needs. Interfund loans will be permitted only if an analysis of the affected fund indicates excess funds are available and the use of these funds will not impact the fund's current operations. The prevailing interest rate, as established by the City Treasurer, will be paid to the lending fund. | √ | |
| Long-Term Debt Policies | | |
| The City will confine long-term borrowing to capital improvements that cannot be funded from current revenues. | √ | |
| Where possible, the City will use special assessment, revenue, or other self-supporting bonds instead of general obligation bonds. | √ | |
| Proceeds from long-term debt will not be used for current ongoing operations. | √ | |
| Reserve Policies | | |
| The City will maintain General Fund Emergency reserves at a level at least equal to 8% of general fund operating expenditures. The primary purpose of this reserve is to protect the City's essential service programs and funding requirements during periods of economic downturn (defined as a recession lasting two or more years), or other unforeseen catastrophic costs not covered by the Contingency Reserve. | √ | Emergency Reserve = \$3,011,640, or 8% of General Fund operating expenditures for FY 2004-05 |

Fiscal Policy

| Fiscal Policy Statement | Status | Comments |
|--|--------|---|
| A Council Contingency Reserve will be established to provide for non-recurring unanticipated expenditures or to set aside funds to cover known contingencies with unknown costs. The level of the Council Contingency Reserve will be established as needed but will not be less than 1% of General Fund operating expenditures annually. | √ | Council Contingency Reserve = \$376,120 for FY 2004-05 |
| Council approval is required before expending General Fund Emergency or Contingency Reserves. | √ | |
| The City will establish an account to accumulate funds to be used for payment of accrued employee benefits for terminated employee. The level of this reserve will be maintained at a level at least equal to projected costs for employees who are eligible for retirement. | √ | Accrued Leave Reserve = \$270,700 for FY 2004-05 |
| Self-insurance reserves will be maintained at a level which, together with purchased insurance policies, adequately protects the City. The City will maintain a reserve of three times its self insurance retention for those claims covered by the insurance pool (of which the City is a member). In addition, the City will perform an annual analysis of past claims not covered by the insurance pool, and reserve an appropriate amount to pay for uncovered claims. | √ | General Liability Reserve = \$300,000 (Additional \$325,000 reserve for claims not covered by insurance pool) Workers Compensation Reserve = \$900,000 (Additional \$638,700 for claims not covered by insurance pool) |
| The City's enterprise funds will maintain a minimum reserve level at least equal to 8% of operating expenditures. The primary purpose of this reserve is to set aside funds to provide for unanticipated or emergency expenditures that could not be reasonably foreseen during the preparation of the budget. | √ | Water \$395,000 Sewer \$465,000 Solid Waste \$11,000 Golf \$161,000 Storm Drain \$64,000 |
| The City will establish a Capital Equipment Replacement Reserve for the accumulation of funds for the replacement of worn and obsolete equipment other than vehicles. The reserve will be maintained at a level at least equal to the projected five-year capital asset replacement costs. | √ | Capital Equipment Reserve = \$856,230 for FY 2004-05 |

Long Term Financial Plan

| Fiscal Policy Statement | Status | Comments |
|--|--------|---|
| <p>The City will establish a Facilities Maintenance Capital Asset Reserve for costs associated with the maintenance of all City facilities. The reserve will be maintained at a level at least equal to the projected 5-year facilities maintenance costs.</p> | -- | <p>Facilities Maintenance Reserve = \$620,000 for FY 2004-05</p> |
| <p>The City will maintain an Employee Computer Purchase Program Reserve for the purpose of providing no-interest loans to employees for the purpose of acquiring or enhancing the employee's personal computer system. This reserve will be reviewed annually to determine if reserve balances are adequate to cover estimated loan balances.</p> | √ | <p>Employee Computer Purchase Reserve = \$75,000 for FY 2004-05</p> |
| <p>The City will establish a Fleet Replacement Reserve for costs associated with the replacement of vehicles and other rolling stock (such as trailers, compressors or other equipment on wheels) as they become unserviceable, obsolete or reach a predetermined service life. The reserve will be maintained at a level at least equal to the projected five-year fleet replacement costs.</p> | √ | <p>Fleet Replacement Reserve = \$3,031,930 for FY 2004-05</p> |
| <p>The City will establish a Golf Course Depreciation Reserve for costs associated with the replacement of equipment/physical plant and course improvements as they become unserviceable, obsolete, or reach a predetermined service life. The reserve will be maintained at a level at least equal to the projected five-year Golf Course replacement costs.</p> | √ | <p>Golf Depreciation Reserve = \$669,000 for FY 2004-05</p> |
| <p>The City will establish a Golf Course Improvement Reserve for costs associated with capital improvements budgeted in the Golf Course Fund. The reserve will be maintained at a level at least equal to the projected five-year costs.</p> | -- | <p>Golf Course Improvement Reserve = (417,000) for FY 2004-05</p> |
| <p>Investment Policies</p> | | |
| <p>The City Treasurer will annually submit an investment policy to the City Council for review and adoption.</p> | √ | |

Fiscal Policy

| Fiscal Policy Statement | Status | Comments |
|--|--------|--|
| The City Treasurer will invest the City's monies in accordance with applicable laws and adopted investment policies and direct the investment of bond or note monies on deposit with a trustee or fiscal agent in accordance with the applicable indenture or issuance document. | √ | |
| Accounting, Auditing & Financial Reporting Policies | | |
| The City's accounting and financial reporting systems will be maintained in conformance with generally accepted accounting principles and standards of the Government Accounting Standards Board. | √ | |
| A fixed asset system will be maintained to identify all City assets, their condition, historical cost, replacement value, and useful life. | √ | A Fixed Asset physical inventory was conducted for GASB34 conversion |
| Quarterly financial reports will be submitted to the City Council and will be made available to the public. | √ | |
| Full and continuing disclosure will be provided in the general financial statements and bond representations. | √ | |
| Maintain a good credit rating in the financial community. | √ | Standard & Poor's = AA |
| | | This change reflects an upgrade in the City's credit rating from AA- to AA in December 2002. |
| An annual audit will be performed by an independent public accounting firm with the subsequent issue of an official Comprehensive Annual Financial Report, including an audit opinion. | √ | |
| Maintain a liquidity ratio of at least 1:1 | √ | |

Legend:

√ Budget Complies with Fiscal Policy Standard

-- Fiscal Policy Standard is not met in Budget

Long Term Financial Plan

Debt Policy



Long Term Financial Plan

Debt Policy

| Debt Policy Statement | Status | Comments |
|--|--------|----------|
| Purposes and Uses of Debt | | |
| Debt will be issued for a capital project only in the case of emergency. Debt will only be undertaken when the City believes that the project revenues or specific resources will be available to service the debt over its life. | √ | |
| The City will consider long-term financing for the acquisition, maintenance, replacement, or expansion of physical assets (including land) only if debt will not be issued for periods exceeding the useful life or average useful lives of the projects to be financed. | √ | |
| The City will issue general obligation bonds only for the purpose of acquiring, improving or constructing real property. | √ | |
| The City may use lease revenue debt or financing leases for those projects which must be financed at a time, or in a manner which do not permit the use of general obligation bonds. | √ | |
| The City may sponsor conduit financings for those activities that have a general public purpose and are consistent with the City's overall service and policy objectives. | √ | |
| The City will approve conduit financing only for those projects that demonstrate a "significant public benefit." | √ | |
| The City will consider conduit debt financing only for those applicants which are credit-enhanced or guaranteed so as to attain a rating of at least "A" from any one of the three major credit rating agencies. | √ | |

Long Term Financial Plan

| Debt Policy Statement | Status | Comments |
|--|--------|-------------------------|
| Credit Worthiness Objectives | | |
| The City of San Clemente seeks to maintain the highest possible credit ratings for all categories of short- and long-term direct debt that can be achieved without compromising delivery of basic City services and achievement of adopted City policy objectives. | √ | Standard & Poor's = AA. |
| Official statements accompanying debt issues, Comprehensive Annual Financial Reports, and continuous disclosure statements will meet the standards articulated by the Municipal Standards Rulemaking Board (MSRB), the Government Accounting Standards Board (GASB), the National Federation of Municipal Analysts, the Securities and Exchange Commission (SEC), and generally accepted accounting principles (GAAP). | √ | |
| To enhance creditworthiness and prudent financial management, the City of San Clemente is committed to systematic capital planning, intergovernmental cooperation and coordination, and long-term financial planning. | √ | |
| The City will keep outstanding debt within the limits prescribed by State statute and at levels consistent with its creditworthiness objectives. | √ | |
| Debt Standards and Structure | | |
| Debt will be structured for the shortest period consistent with a fair allocation of costs to current and future beneficiaries or users which will generally require that debt be issued only for a time period that is consistent with the life span of the project for which the debt was issued. | √ | |
| Debt will be structured to achieve the lowest possible net cost to the City given market conditions, the urgency of the capital project, and the nature and type of security provided. | √ | |
| In the case of issues structured with term bonds, the City will use a sinking fund to retire the term bonds. | √ | |

Debt Policy

| Debt Policy Statement | Status | Comments |
|---|---------------|-----------------|
| The City will not issue debt that commences principal payment beyond the fiscal year in which the financed asset is completed or is substantially available to the City. | √ | |
| The City will seek to structure debt with level principal and interest costs over the life of the debt. | √ | |
| The City may choose to issue securities that pay a rate of interest that varies according to a predetermined formula or results from a periodic remarketing of the securities, consistent with state law and covenants of pre-existing bonds, and depending on market conditions. | √ | |
| The City shall issue subordinate lien debt only if it is financially beneficial to the City and is consistent with the City's creditworthiness objectives. | √ | |
| The City will consider the use of non-traditional financial products on a case by case basis and consistent with state law and financial prudence. | √ | |
| Periodic reviews of all outstanding debt will be undertaken to determine refunding opportunities. | √ | |
| Use of short-term borrowing, such as bond anticipation notes (BANs), tax and revenue anticipation notes (TRANs), tax-exempt commercial paper and other similar short-term borrowing vehicles will be undertaken only if the transaction costs plus interest of the debt are less than the cost of internal financing, or available cash is insufficient to meet working capital requirements. | √ | |
| Credit enhancement will be used to the extent that net debt service on the bonds is reduced by more than the costs of the enhancement, measured in present value terms. | √ | |
| Debt Administration and Process | | |
| No City Department, agency, or sub-unit shall incur long-term debt without the approval of the City Council. | √ | |

Long Term Financial Plan

| Debt Policy Statement | Status | Comments |
|--|---------------|-----------------|
| All General Fund supported and revenue bond proceeds shall be invested in accordance with bond covenants, unless otherwise specified by law. Investments will be consistent with those authorized by existing state law and by the City's investment policies. | √ | |
| All costs and fees related to issuance of bonds will be paid out of bond proceeds. | √ | |
| In general, City debt will be issued through a competitive bidding process. | √ | |
| Negotiated sales of debt will be considered in circumstances when the complexity of the issue requires specialized expertise, when a change of underwriter may result in losses, when the negotiated sale would result in substantial savings in time or money, or when market conditions or City credit are unusually volatile or uncertain. | √ | |
| For all debt sales, the City will require that the action taken by the City Council to incur the debt will be taken as a regular business item, and at a regular or special City Council meeting, consistent with state law. | √ | |
| Underwriters, Consultants and Counsel | | |
| For all competitive and negotiated sales, underwriters will be required to demonstrate sufficient capitalization and experience related to the debt. | | |
| City payments for underwriter's counsel in negotiated sales will be authorized on a case by case basis depending on the nature and complexity of the transaction. | | |
| The City will retain external bond counsel for all debt issues. All debt issued by the City will include a written opinion by bond counsel affirming that the City is authorized to issue the debt, stating that the City has met all statutory requirements necessary for issuance, and determining the federal income tax status of such debt. | | |

Debt Policy Statement

Status **Comments**

The City may choose to engage the services of a disclosure counsel for the purposes of assisting in the various aspects of the preparation of an official statement, private placement memorandum or other form of offering, disclosure or continuing disclosure document to be disseminated in connection with the sale of the City's debt or conduit debt

The utilization of a financial advisor for particular bond sales will be at the discretion of the Finance and Administrative Services Department on a case by case basis and pursuant to a written financial advisory service contract.

The Finance and Administrative Services Department will utilize a fiscal agent, paying agent or trustee on all City indebtedness.

Compensation for bond counsel, underwriter's counsel, disclosure counsel, financial advisors, trustees, and other financial service providers will be consistent with industry standards.

The City Council shall make all final determinations of selection for underwriters, bond counsel, and financial advisors.

The City Council shall have the authority to periodically select other service providers as necessary to meet legal requirements and minimize net City debt costs.

Other Policies

The Finance and Administrative Services Department shall maintain a system of recordkeeping and reporting to meet the arbitrage rebate compliance requirements of the Federal Tax Code.

Any unsolicited financing proposal shall be referred to the Finance and Administrative Services Department for review by the City's Debt Management Team prior to submittal to the City Council for consideration.

Long Term Financial Plan

Debt Policy Statement

Status Comments

Provided that sufficient resources are available, liquidity will not be impaired, and a defined source of repayment is available, the City will generally favor internal borrowings over external borrowings for short-term liquidity purposes.

Legend:

- √ Budget Complies with Debt Policy Standard
- Debt Policy Standard is not met in Budget

Financial Trend Analysis

Financial Trend Analysis

Indicators measure the fiscal health of the City of San Clemente

Introduction

Utilizing the International City Management Association's (ICMA) guidelines contained in "Evaluating Financial Condition", a number of financial indicators have been analyzed for this report. The analysis of these indicators is designed to measure the fiscal health of the City of San Clemente.

Background

As part of the long term financial planning process, the City's financial trends have been analyzed for the past ten years. Many factors are utilized in order to analyze the financial condition of the City of San Clemente. These factors include:

- The economic condition of the City and the surrounding region;
- Types and amounts of revenues and whether they are sufficient and the right mix to support the population as it continues to grow;
- Expenditure levels and whether these expenditures are sufficient to provide the citizens of San Clemente with the desired level of services currently and as the City continues to grow;
- Fund balances and reserve levels and whether they are sufficient to protect the City against an economic downturn;
- Debt levels and their impacts upon current City financial resources.

Financial indicators are analyzed in accordance with the City's fiscal policy

This report examines these issues and others in determining the current financial condition of the City of San Clemente. The City's adopted fiscal policies, as well as other national standards, have been considered in analyzing these financial indicators.

The annual financial trend analysis focuses on the City's General Fund. The past ten trend reports have identified strengths and weaknesses of the City's financial condition. Many key recommendations have come out of this financial planning process and have been implemented by the City Council and Administration.

Trend data is as of June 30, 2003

Data used in developing this financial trend report was primarily drawn from the City's Comprehensive Annual Financial Reports for fiscal year 1998-99 through fiscal year 2002-03. Consequently, all trends are based on data available as of June 30, 2003, and do not incorporate any changes that have occurred since that time.

Summary of Trend Analysis

The financial trends that follow provide City Council and Administration with insight into the overall financial position of the City by analyzing the City's General Fund. This analysis makes it possible to identify specific areas where new policies should be implemented or existing ones revised. One of the following ratings has been assigned to each indicator:

Long Term Financial Plan

| | |
|---------------------|---|
| Favorable: | This trend is positive with respect to the City's goals, policies, and national criteria. |
| Unfavorable: | This trend is negative , and there is an immediate need for the City to take corrective action. |
| Warning: | This rating indicates that a trend has changed from a positive direction and is going in a direction that may have an adverse effect on the City's financial condition. This rating is also used to indicate that, although a trend may appear to be favorable, it is not yet in conformance with the City's adopted fiscal policies. |
| Caution: | This rating indicates that a trend, currently in compliance with adopted fiscal policies, may change from a positive direction in the future. |

A summary of indicators and the rating assigned to each is listed below. This comparative data is provided to illustrate any positive or negative changes noted in the trends over the past ten years.

All indicators are favorable with the exception of Revenues Per Capita, which received a warning

| Indicator | 2004 | 2003 | 2002 | 2001 | 2000 | 1999 | 1998 | 1997 | 1996 | 1995 |
|----------------------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|
| Revenues Per Capita | W | F | F | F | F | F | F | F | F | U |
| Property Tax Revenues | F | F | F | F | F | F | F | U | U | U |
| Property Values | F | F | F | F | F | F | F | U | U | U |
| Population | F/C | F | F | F | F | F | F | F | F | F |
| Elastic Revenues | F | F | F | F | F | F | F | F | F | F |
| Sales Tax Revenues | F | F | F | F | F | F | F | F | F | F |
| License & Permit Revenues | F | F | F | F | F | F | U | F | F | F |
| Comm. Develop. Charges | F | F | F | F | F | F | U | U | U | U |
| Intergovernmental Revenues | F | F | F | F | F | F | F | F | F | F |
| One-Time Revenues | F | F | F | F | F | F | F | F | F | F |
| Revenue Overage | F | F | F | F | F | F | F | F | F | U |
| Expenditures Per Capita | F | F/C | F | F | F | F | F | F | F | F |
| Expenditures By Function | F/C | N/A | N/A | N/A | N/A | N/A | N/A | N/A | N/A | N/A |
| Employees Per Capita | F | F | F | F | U | U | F | F | F | F |
| Fringe Benefits | F | F | F | F | F | F | F | F | F | W |
| Capital Outlay | F | F | F | F | F | F | F | F | F | U |
| Operating Position | F | F/C | F | F | F | F | F | F | F | W |
| Debt Service | F | F | F | F | F | F | F | F | F | F |
| Compensated Absences | F | F | F/C | F/C | F/C | F | F | F | F | F |
| Fund Balance | F | F | F | F | F | F | F | F | F | F |
| Liquidity Ratio | F | F | F | F | F | F | F | F | F | F |

Favorable/Caution rating has been assigned to Population and Expenditures By Function

Financial Trend Analysis

The improved local economy and long-term financial planning have contributed to City's fiscal health

Overview of the City's Financial Condition

The improved fiscal health of the City evidenced on the previous page is not only the result of external factors, such as an improved local economy, but also the direct result of a conscious effort and continual planning on the part of City Council and staff. This planning began in 1992 with a series of fiscal policies that are periodically revised and the preparation of an annual Long Term Financial Plan.

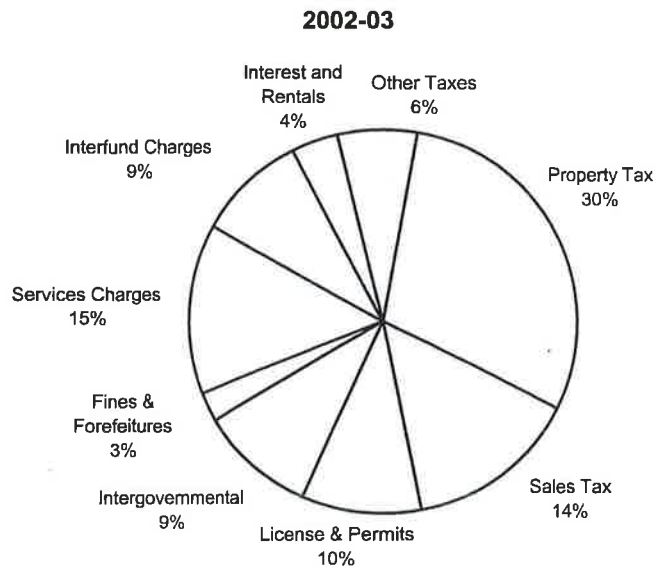
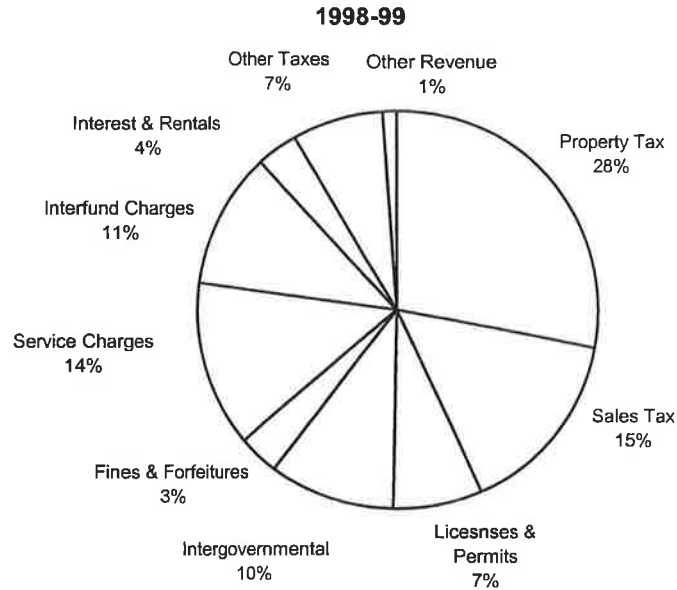
The 2004 Long Term Financial Plan again includes the analysis of twenty-one trends. The current year being analyzed shows every indicator receiving a *favorable* rating except for Revenues Per Capita. This is much improved over 1995 where only half of the indicators showed favorable signs.

Because of the commitment to implementing recommendations submitted as a result of the City's annual financial planning process, the City's financial condition improved dramatically. The City's improving fiscal position is the result of financial planning, funding of necessary reserves, the improved local and regional economy, and the cost reductions and streamlining efforts made by many of the City's departments over the past several years.

The following sections provide an overview of the indicators listed in the table above.

Long Term Financial Plan

Comparison of Revenues by Source 1998-99 vs. 2002-03



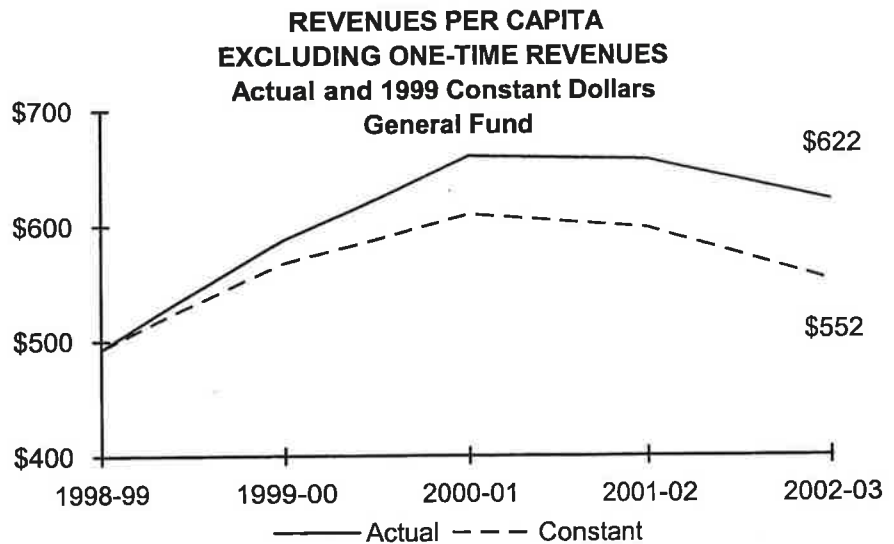
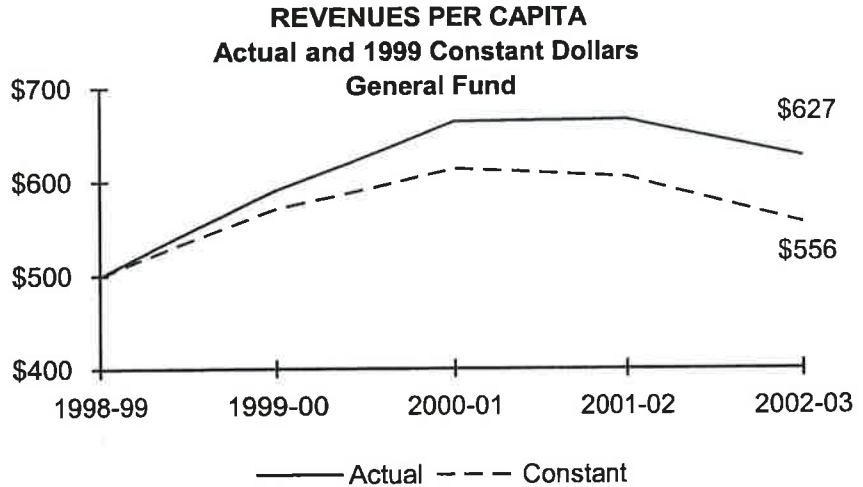
License and Permit revenues increased from 7% in 1998-99 to 10% in 2002-03

Comments: These charts indicate that most revenue sources, as a percentage of the total General Fund revenues, have remained stable with the exception of License and Permits. License and Permits increased from 7% in FY 1998-99 to 10% in FY 2002-03 due to an increase in business license and construction-related permits.

Financial Trend Analysis

Revenues

Revenues Per Capita



Revenues per capita show a downward trend

Finding: **Warning.** Revenues per capita (excluding one-time revenues) reflect a slight decrease when analyzing both actual and constant dollars for FY 2002-03. According to the ICMA guidelines, decreasing revenues per capita in constant dollars suggest a warning trend.

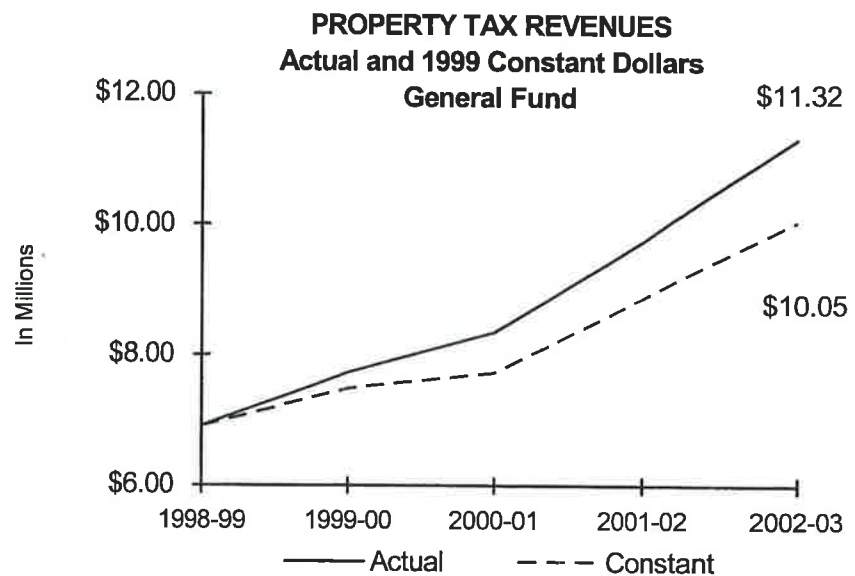
Comments: The first chart above shows a slightly downward trend for constant dollars due to population increasing at a higher rate than operating revenues. However, total revenues for FY 2002-03 increased as the city's major revenue category, property tax went up by \$1,578,000. Other revenue categories actually decreased, as expected, due to development activity tapering off. License and permit revenues decreased over the prior fiscal year by \$155,800.

Long Term Financial Plan

The second chart (which excludes one-time revenues) shows a decrease in both actual and constant dollars for FY 2002-03. The approach of excluding one-time revenues is a realistic approach to analyzing revenues since the City only applies one-time revenues against one-time expenditures, including reserve transfers, in accordance with the City's Fiscal Policy. While General Fund revenues remain stable, a warning trend is issued as the trend has changed from a positive direction.

Property Tax Revenues

Property tax revenues increased by 16.2%, the seventh consecutive increase



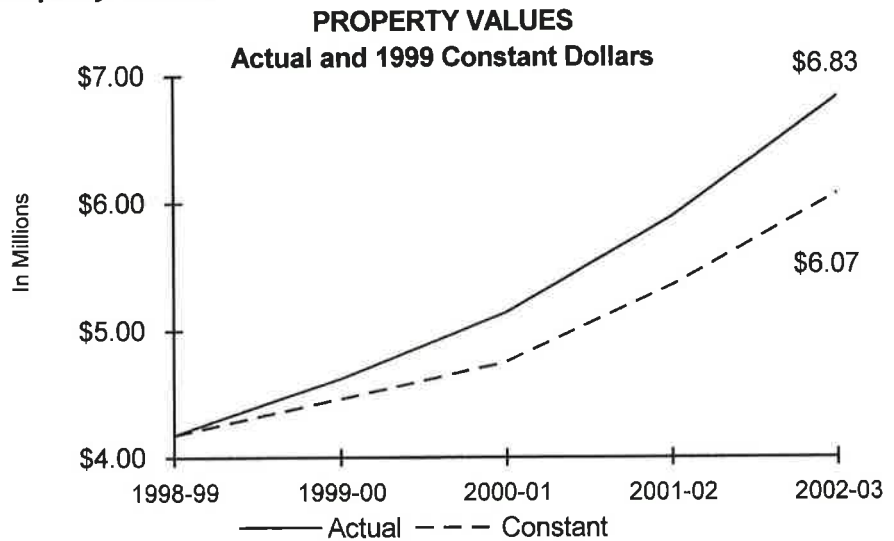
Finding: **FAVORABLE**. Property tax revenues showed a significant increase for FY 2002-03, continuing the positive trend which began six years earlier.

This increase amounted to \$1,578,000

Comments: Property tax revenues increased by \$1,578,000 or 16.2% in actual dollars, and show a 13.5% increase in constant dollars, ending the year \$1,191,700 above the prior fiscal year. This increase demonstrates solid property valuations and new home sales within the City. This indicator receives a favorable rating for the seventh consecutive year.

Financial Trend Analysis

Property Values



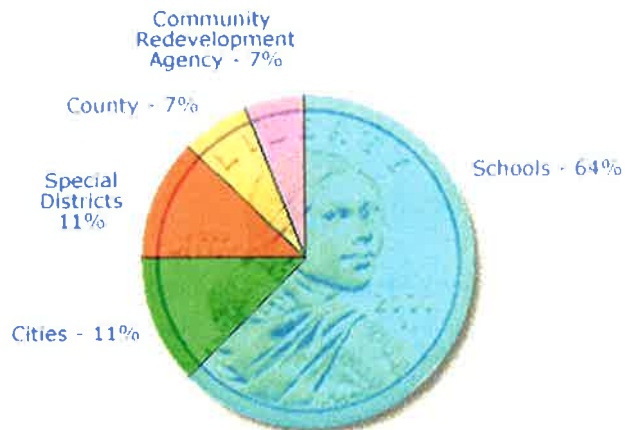
A positive growth rate in property values was observed for the seventh consecutive year

Finding: **FAVORABLE.** Property values showed a positive growth rate for the seventh consecutive year in FY 2002-03.

Comments: The growth rate in property values as a percentage rate from the previous year shows an increase of 16.1%. This is the seventh consecutive year where a positive trend has emerged. As a result of the positive changes, this indicator remains favorable. It should be noted, however, that this indicator needs to be continually monitored due to the impact of property tax revenues on the General Fund.

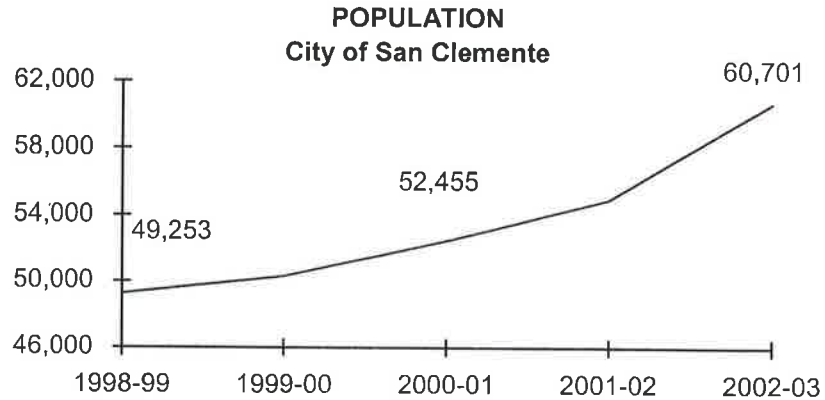
Where the Typical Orange County Property Tax Dollar Goes

(Locally Assessed 1% Basic Levy)



Long Term Financial Plan

Population



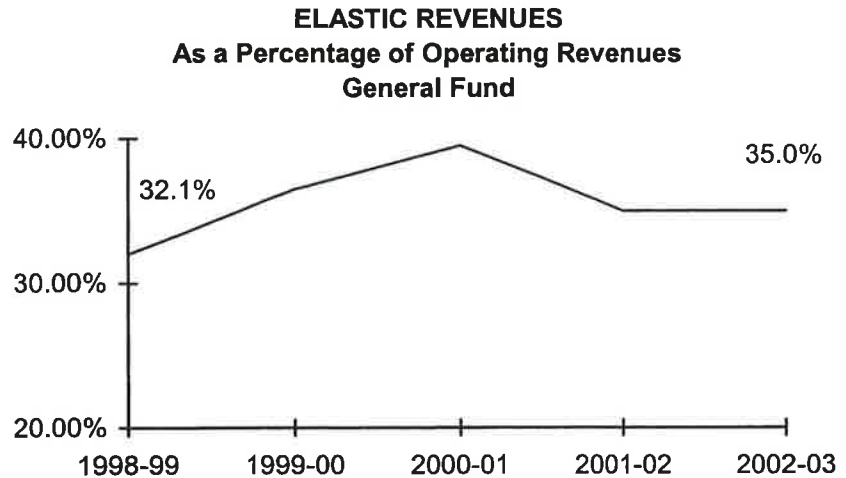
**5.4% average growth
over the last five years**

Finding: *FAVORABLE/CAUTION*. The City's population growth, an average of 5.4% over the last five years, is considered favorable because this growth has been planned and controlled. However, since the growth from FY 2001-02 to FY 2002-03 was 10.5% a caution has been added.

Comments: The exact relationship between population change and other economic and demographic factors is uncertain. However, a sudden increase in population can create immediate pressures for new capital expenditures and higher levels of service. Conversely, a rapid decline in population allows for a smaller tax base for spreading City costs that cannot be reduced in the short run. The planned growth is allowing the City the opportunity to ensure that the cost of servicing new residents does not exceed the City's ability to generate new revenues, that the level of business activity grows along with the increase in residential development, and that the growth does not strain the sewer system capacity, traffic circulation, and off-street parking. The City is also aware that increased population generates increased expenditures over time such as public safety (i.e. additional fire stations, increased police, etc.).

Financial Trend Analysis

Elastic Revenues

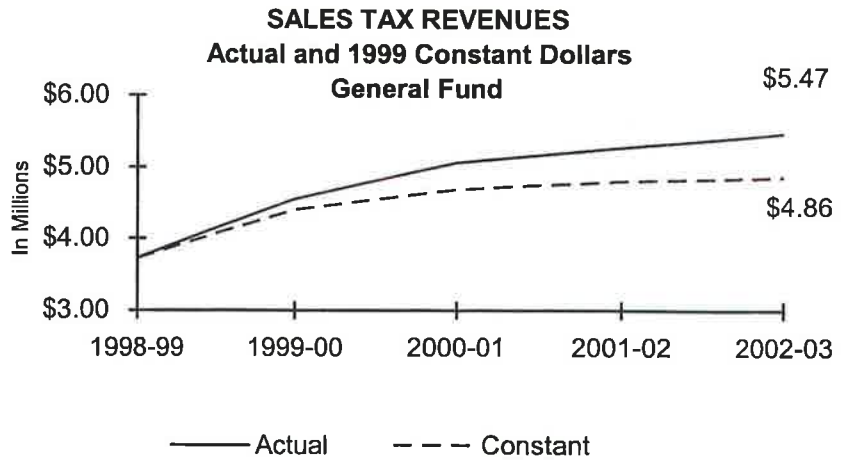


Elastic revenues remained constant when calculated as a percentage of total revenues

Finding: **FAVORABLE**. Elastic revenues, as a percentage of total revenues, were unchanged in FY 2002-03. Actual elastic revenues increased \$522,100, while total revenues increased by \$1,483,800.

Comments: The City's largest elastic revenue source, sales tax revenue, was up 3.8%, or \$198,800. License and permit revenues decreased \$155,800 and community development service charges came in \$517,100 over the previous year. Elastic revenues, as a percentage of total revenues, remained constant in FY 2002-03 due to the increase in both elastic and total revenues. This rating is unchanged from prior year. Details concerning each major elastic revenue source can be found in the following five pages.

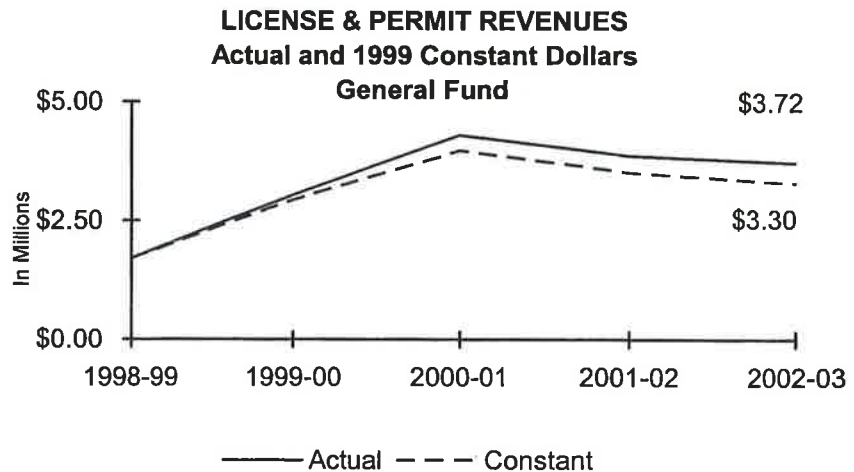
Long Term Financial Plan



Sales tax revenues increased \$198,800 in FY 2002-03

Finding: *FAVORABLE*. As summarized in the chart above, sales tax revenues showed a slight increase of \$198,800, or 3.8%, in actual dollars over the prior fiscal year. In constant dollars, the increase amounted to , \$63,300, or 1.3%.

Comments: As summarized in the chart, sales tax revenues have gradually increased over the past five years in actual dollars. In fact, actual dollars increased 46.9% from sales tax revenues recorded in FY 1998-99. These increases boost sales tax revenue to a fourteen-year high in actual dollars and the result is a favorable rating.



License and permit revenues decreased for the second year

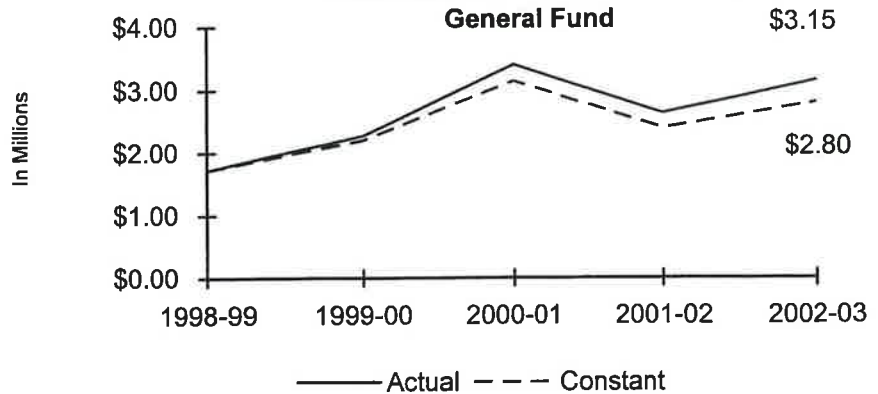
Finding: *FAVORABLE*. As anticipated, license and permit revenues decreased for the second time in five years in FY 2002-03. The decrease in actual dollars amounted to \$155,800, or 4.0%, below the prior fiscal year. The constant dollar decrease registered \$221,500, or 6.3%, under fiscal year 2001-02.

Financial Trend Analysis

Business license revenue increased while construction permit revenue declined

Comments: While business license revenue increased \$224,700, or 25% over the past year, construction activity decreased from the prior year. Included in this decrease are construction permit revenues, consisting of building, electrical, mechanical, plumbing, and grading permits, which decreased \$379,100, or 13.4%. This indicator displays a decrease due to completion of planned development in Talega and Forster Highlands. A favorable rating has been assigned based on the development activity continuing as planned and the increase noted in business licenses.

COMMUNITY DEVELOPMENT SERVICE CHARGES Actual and 1999 Constant Dollars



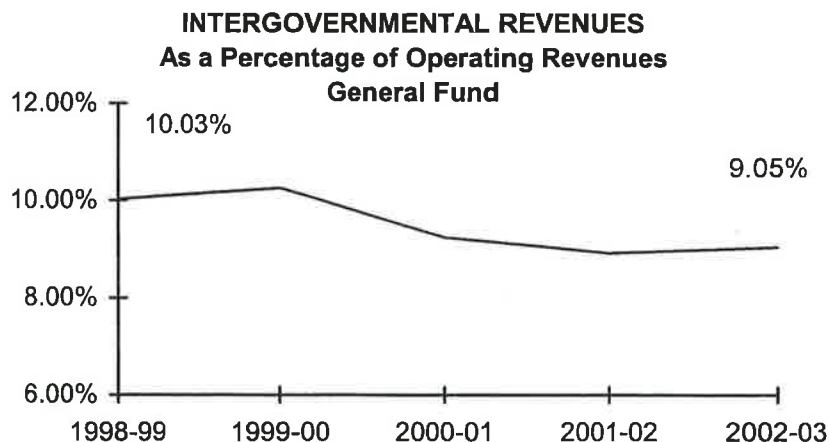
Finding: **FAVORABLE.** Total community development service charges increased by 19.6%, or \$517,100 from the prior year. This revenue source shows an increase over the previous year and is more comparable to the revenues received two years prior. This trend is anticipated to decline as development within the City slows down.

Community Development Service Charges recorded an increase of \$517,100

Comments: Construction inspection fees increased by \$620,900 and improvement plan check fees increased \$184,200. Specific revenue sources showing decreases include Talega JPA revenues of \$240,800, grading plan check fees of \$65,500 and other planning service fees of \$34,500. This indicator has been assigned a favorable rating in light of the increase shown over the past year.

Long Term Financial Plan

Intergovernmental Revenues



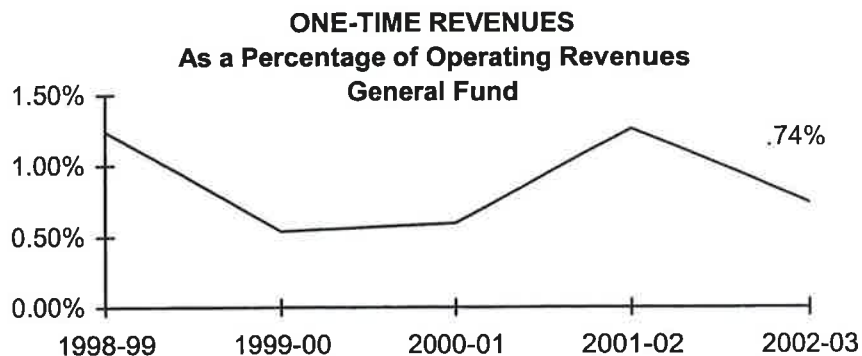
Intergovernmental revenues show a fairly level trend

Finding: ***FAVORABLE***. General Fund Intergovernmental revenues, as a percentage of operating revenues, showed a fairly level trend for the eighth consecutive year.

Comments: By analyzing these revenues as a percentage of operating revenues, the City can determine the extent of its dependence upon resources from other governments. Excessive dependence on this type of revenue can be detrimental to the financial health of the City as the factors controlling their distribution are beyond the City's control. The city's largest intergovernmental revenue is motor vehicle tax which makes up 93% of the total intergovernmental category.

Financial Trend Analysis

One-Time Revenues

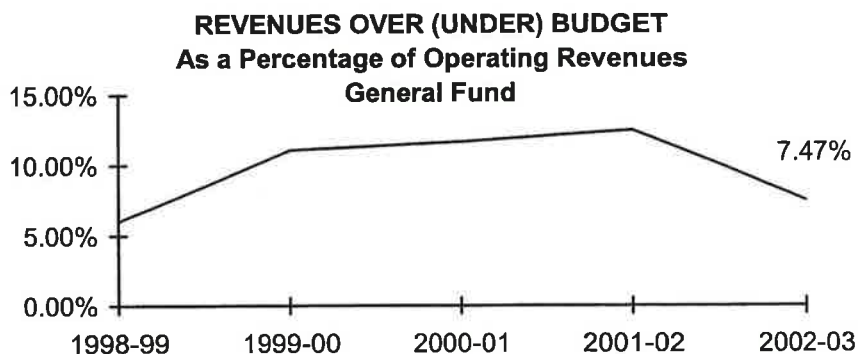


Finding: **FAVORABLE**. One-time revenues, as a percentage of total General Fund revenues, equaled .74% in FY 2002-03, lower than the prior year.

In accordance with fiscal policies, one-time revenues are used to fund one-time expenditures

Comments: One-time revenues have decreased from the prior fiscal year by \$177,200, or 38.7%. FY 2002-03 one-time revenues, totaling \$280,560, includes a state grant for sand replenishment and other miscellaneous reimbursements. In accordance with the City's Fiscal Policy, one-time revenues are not utilized for operating expenditures. Therefore, this indicator maintains a favorable rating.

Revenue Overage/Shortage



Finding: **FAVORABLE**. Actual revenues exceeded budget by \$2,840,900 for fiscal year 2002-03 and ends with a positive revenue position over budget by 7.47%. The City experienced increases in many categories, including

Long Term Financial Plan

The City experienced increases in many revenue categories

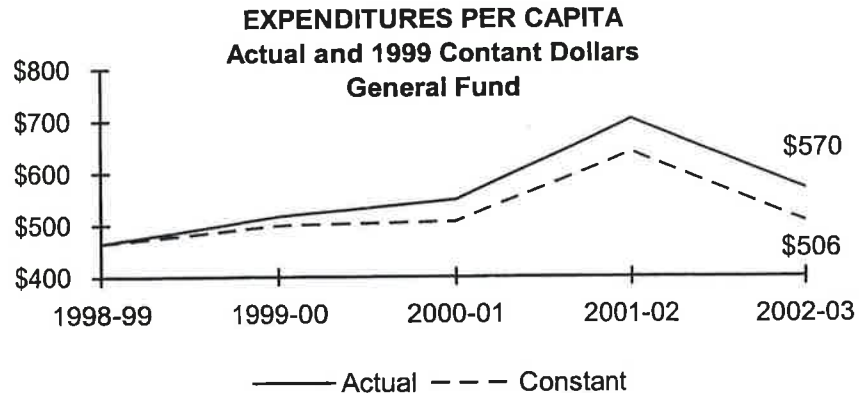
service charges (\$1,081,200), license and permit revenues (\$664,600), property taxes (\$629,500), intergovernmental revenues (\$171,400), and interest and rental income (\$165,000). This trend continues to receive a favorable rating as it maintains a level above the ICMA basis of a shortage of 5% or more for an unfavorable rating.

Comments: This trend began the five-year analysis with a positive revenue position of 6.01% and ended FY 2002-03 at 7.47%. The City continues to monitor its revenues through the annual budget and long term financial planning processes in order to more accurately forecast its revenues. It should be noted that the City projects developmental revenues, such as license and permit fees, conservatively as the timing of projects entering the building permit stage cannot always be predicted. In addition, the City does not budget unrealized gains or losses on investments as this is a reporting requirement and does not reflect actual revenue.

Financial Trend Analysis

Expenditures

Expenditures Per Capita



Finding: **FAVORABLE**. Expenditures per capita decreased in both constant and actual dollars for the past fiscal year when compared to the prior year.

General Fund expenditures decreased \$4,065,000 in FY 2002-03

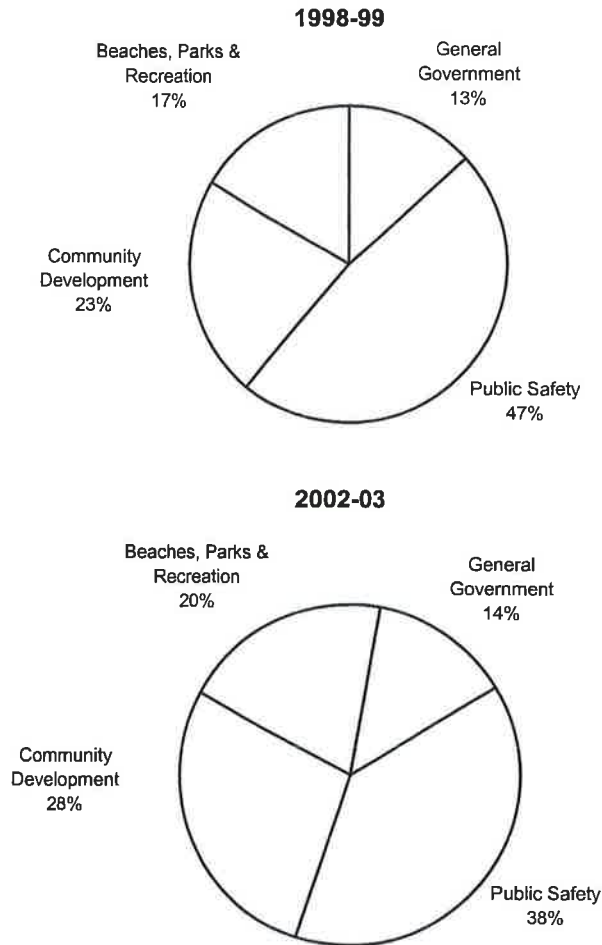
Comments: In FY 2002-03, expenditures decreased in actual dollars by \$4,065,000 when compared with FY 2001-02, and \$4,438,700 in constant dollars for the same time period. This is mainly due to one-time transfers in FY 2001-02 of over seven million dollars. Had the City not made the one-time transfers, actual and constant expenditures per capita for FY 2001-02 would have been \$592 and \$528, respectively. This is in line with the gradual incline of the graph charted above.

Actual expenditures include interfund transfers. For example, FY 2002-03 General Fund expenditures included transfers to the Facilities Maintenance Reserve (\$663,940), Street Improvement Fund (\$562,750), Capital Equipment Replacement Reserve (\$260,100), Workers' Compensation Fund (\$170,100), and Accrued Leave Reserve (\$115,680). These transfers help to ensure that the other funds have adequate reserves to meet emergency needs and complete priority projects.

With the exception of FY 2001-02, expenditures per capita in constant dollars shows a relatively flat expenditure level throughout the five-year period. While actual expenditures have increased from FY 2001-02 to FY 2002-03, the rate at which population has increased is higher. Thus, reflecting a decrease in actual and constant dollars due to both the prior year one-time transfers and population increase. A favorable rating is assigned and this indicator will be closely monitored to ensure that expenditure levels are maintained to provide a consistent and adequate level of service without depleting fund balances.

Long Term Financial Plan

Comparison of Expenditures by Function 1998-99 vs. 2002-03



Expenditures by function is a newly added trend

Finding: FAVORABLE/CAUTION. Expenditures by function, as a percentage of the total General Fund expenditures (excluding debt service, interfund transfers, and capital outlay), varied greatly in three out of the four areas noted. While this is cause for concern, this is the first year in which this trend has been evaluated and many changes occurred in the City's make-up between FY 1998-99 and FY 2002-03 which explain the changes.

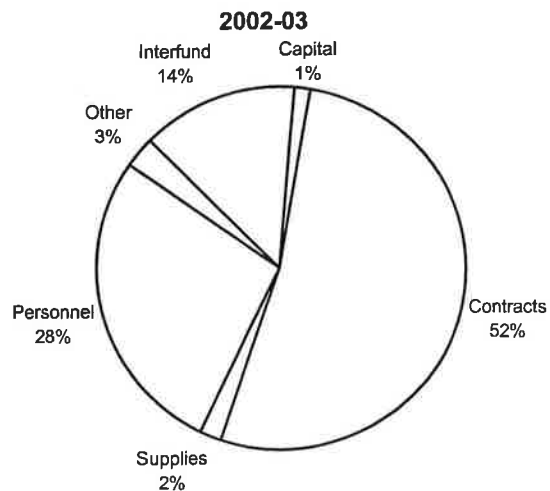
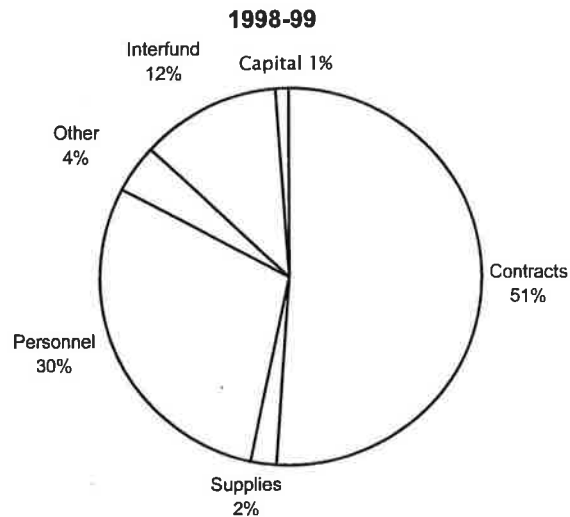
Comments: While a 9% decrease of the percentage of expenditures in Public Safety is depicted, this is directly related to the percentage of actual dollars increased from FY 1998-99 to FY 2002-03 in Community Development and Beaches, Parks and Recreation expenditures. Actual Public Safety expenditures increased \$2.4 million, or 23%, while actual Community Development expenditures increased 87% and Beaches, Parks and Recreation increased 81% from FY 1998-99 to FY 2002-03. These large increases are due to increased development in the Talega and Forester Highland areas of the City and increased expenditures for eleven added

Financial Trend Analysis

recreation positions, two newly added parks, increased or enhanced park and beach maintenance and other operational expenditure increases.

The City has recorded increased revenues to offset the development costs. This is not the case with the beaches, parks and recreation expenditures. Due to Proposition 218 the lighting and landscape expenditures, which were once paid for through special assessment revenues, were cut back drastically in 1997-98 and absorbed by the General Fund. Thus, many of the increased expenditures were needed to reinstate or restore previous services funded through the special district. This trend will be closely monitored to insure that adequate funding is available to continue supporting beach and park maintenance and recreation programs.

Comparison of Expenditures by Category 1998-99 vs. 2002-03



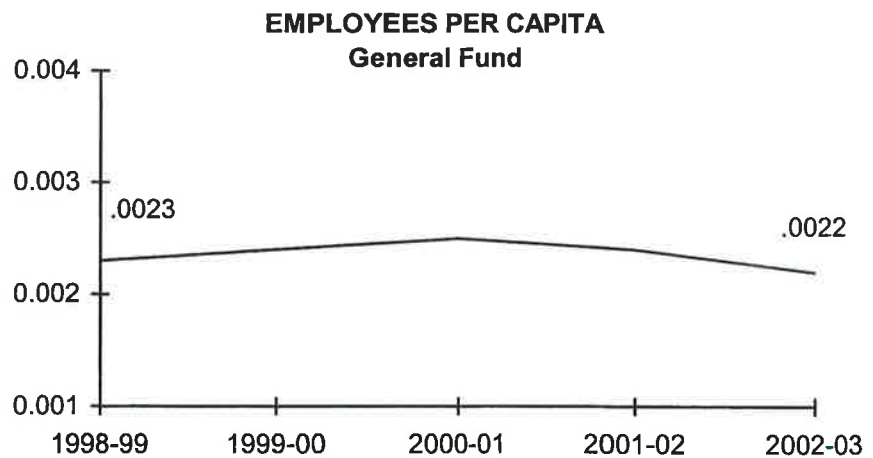
Long Term Financial Plan

All expenditure categories were relatively unchanged from FY 1998-99 to FY 2002-03

Comments: These charts indicate that all expenditure categories, as a percentage of the total General Fund expenditures, were relatively unchanged from FY 1998-99 to FY 2002-03.

During the time period illustrated, some personnel-related costs have been replaced with contractual services and other costs have been replaced with interfund costs.

Employees Per Capita



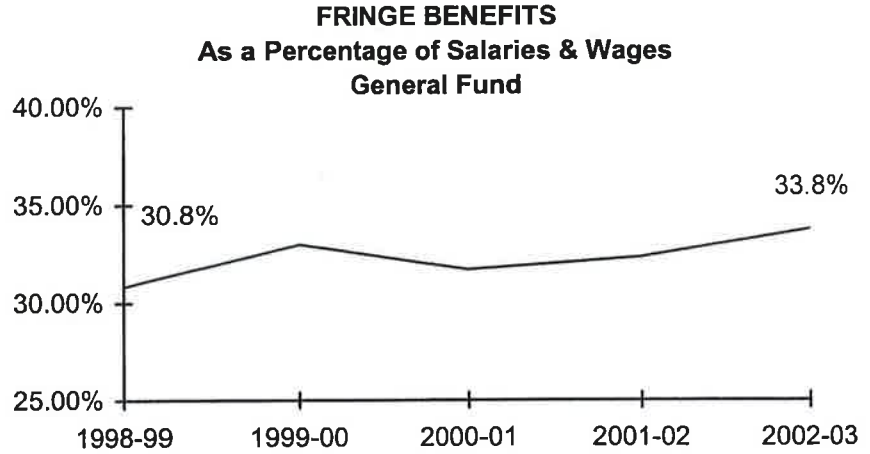
Finding: **FAVORABLE**. Employees per capita has remained stable over the last five years as both population and the number of employees have increased.

FTE's keep up with service level demands

Comments: This indicator is awarded a favorable rating for the fourth consecutive year due to the increase in FTE's to keep up with service level demands. This trend will be closely monitored to insure the City's ability to support current and future service levels.

Financial Trend Analysis

Fringe Benefits



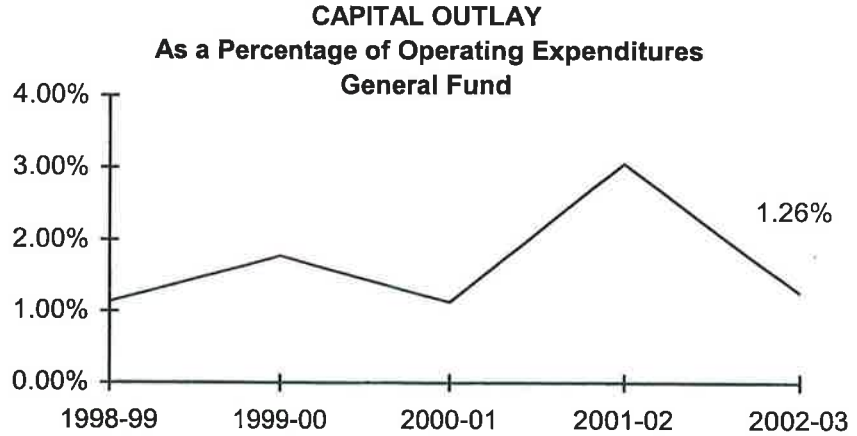
**Benefit costs are up
1.4% over the prior year**

Finding: **FAVORABLE**. Fringe benefits, as a percentage of General Fund salaries and wages, have increased slightly from 32.4% to 33.8%.

Comments: The slight increase is the result of medical benefits for part-time employees. A favorable rating has been assigned for FY 2002-03, since this trend remains between thirty and thirty-five percent of salaries and wages.

Long Term Financial Plan

Capital Outlay



Finding: **FAVORABLE**. Capital outlay expenditures decreased by \$745,500, or 63.1%, from the prior fiscal year. Major capital projects included in FY 2002-03 were Beach Maintenance (\$231,600) and Park Maintenance (\$179,850).

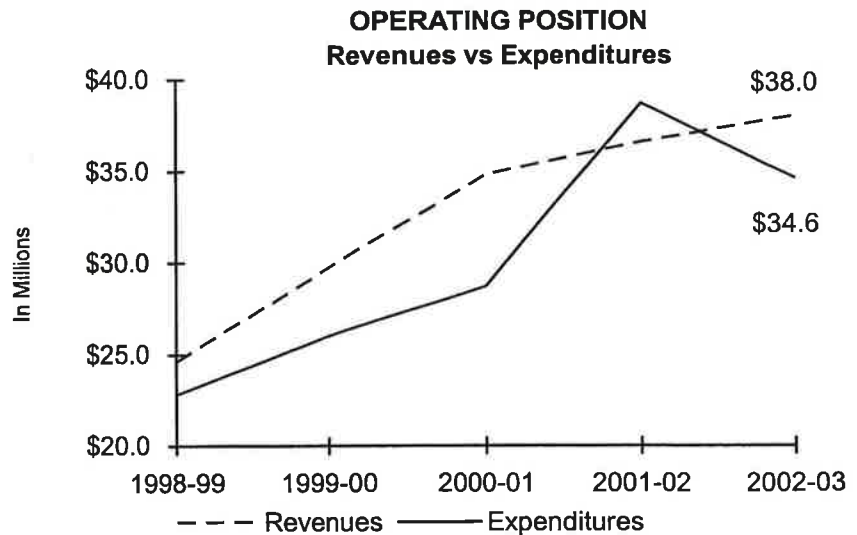
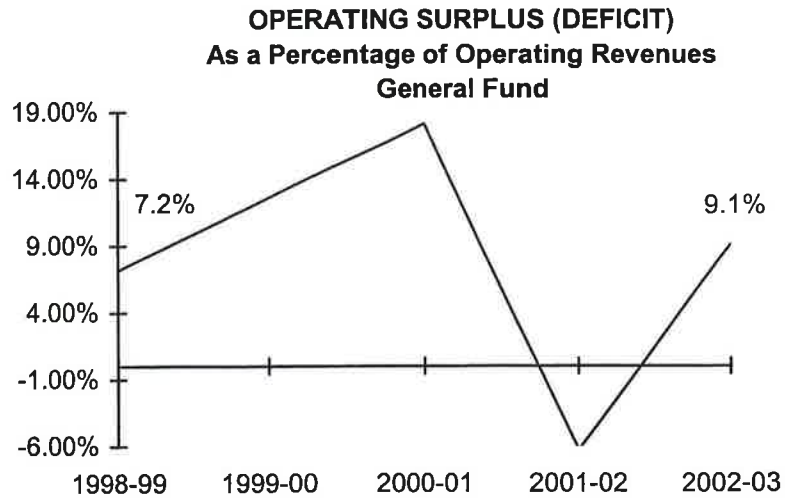
Comments: With the exception of FY 2001-02, spending on capital outlay has been relatively constant. While the City saw a decline from the prior year, the ICMA deems this as favorable. A warning would be issued if the City had seen a three or more year decline in capital outlay, as a percentage of operating expenditures.

City continues to fund the capital equipment replacement program

The Capital Equipment Replacement Reserve was established in FY 1994-95 and the General Fund contributed \$260,100 in FY 2002-03 to fund this reserve. This reserve fund will ensure that obsolete and worn equipment is replaced in accordance with the City's preventive maintenance program. This trend receives a favorable rating for the ninth consecutive year because of the renewed commitment to upgrading fixed assets, which improves the efficiency of City operations.

Financial Trend Analysis

Operating Position



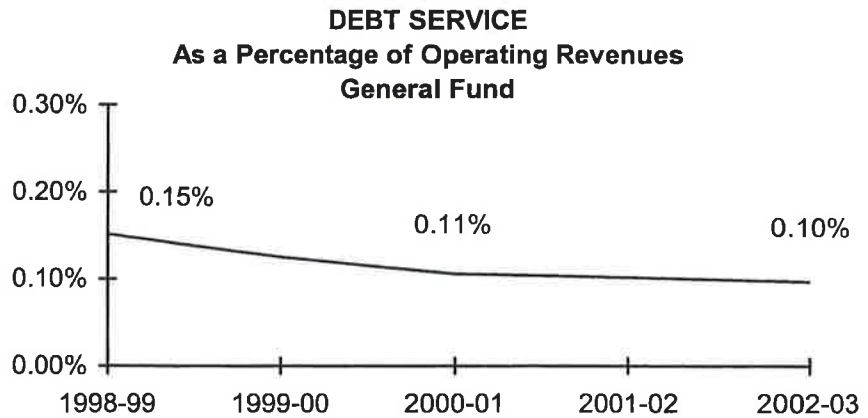
Finding: **FAVORABLE**. FY 2002-03 finished with an operating surplus of 9.1% when calculated as a percentage of General Fund revenues.

FY 2002-03 finished with an operating surplus

Comments: The City has seen a positive turnaround from FY 2001-02 as it ended FY 2002-03 with an operating surplus. This rebound was due mainly to the planned, one-time transfers booked in FY 2001-02. The operating surplus has come as a result of cost-saving measures implemented by the City Council and Administration. Therefore, a favorable rating has been assigned.

Long Term Financial Plan

Debt Service



General Fund's debt service remains at less than 1% of total revenues

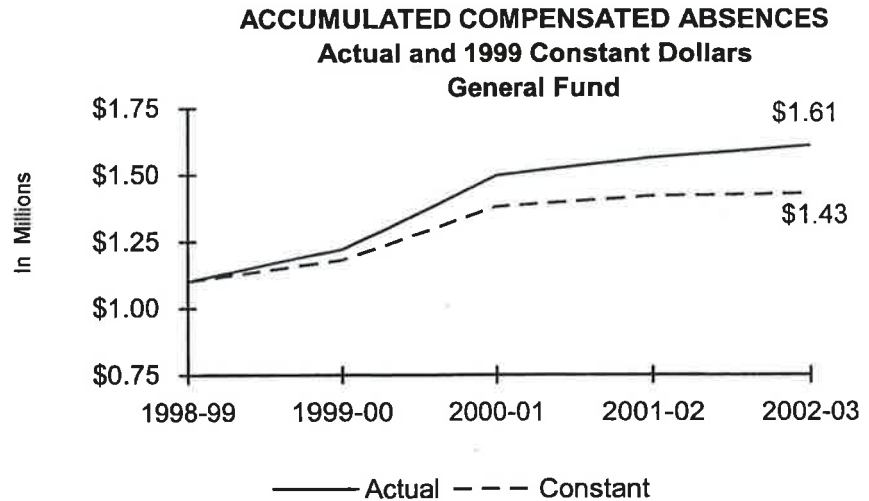
Finding: **FAVORABLE**. General Fund debt service receives a favorable rating as it has remained immaterial (less than 1%) in comparison to total revenues over the last nine years. Credit rating firms generally view debt service as unfavorable if debt service payments exceed 20% of net operating revenues. Standard & Poors, an independent firm that issues ratings, upgraded the City of San Clemente's credit rating from AA- to AA in December 2002.

Comments: The City has a capitalized lease with City National Bank for the purchase of energy efficiency equipment for several City buildings. This lease includes heating, ventilating and air conditioning units and all related control devices. The General Fund will make debt service payments on this ten-year lease until 2006.

Additionally, it should be noted that the debt service for the Negocio Building bonds is in a separate fund, as well as the City's street assessment bonds, and are not part of this analysis.

Financial Trend Analysis

Accumulated Compensated Absences



Contingent liabilities for accrued leave receives favorable rating

Finding: **FAVORABLE**. This indicator receives a favorable rating, consistent with the prior year. The City's average annual payments for terminated employees accumulated compensated absences amount to one-fourth of the reserve. While the accumulated compensated absences have shown increases over the last four years, the reserve is continually funded to insure an adequate reserve, as discussed in the Long Term Financial Plan's Reserve section.

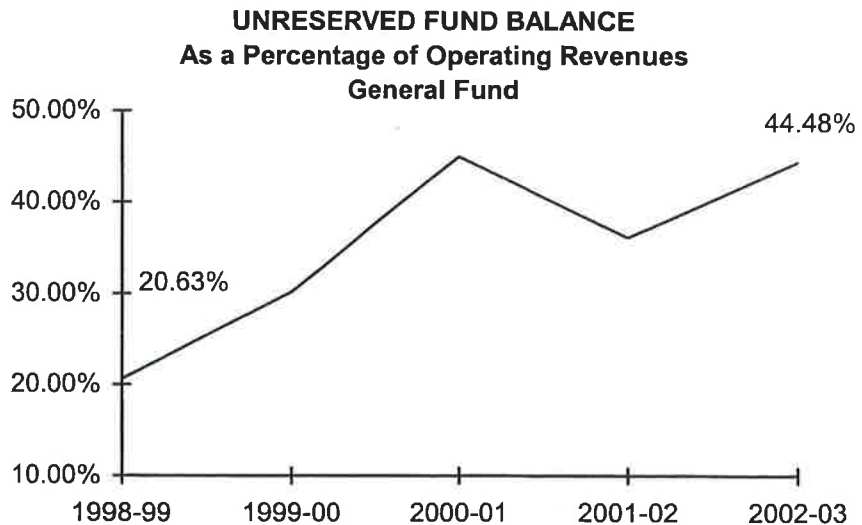
The balance of the liability for compensated absences is \$1,608,810

Comments: At June 30, 2003, the balance of the liability for compensated absences was \$1,608,810 consisting of \$755,490 for vacation, \$782,360 for sick leave, and \$70,960 for compensatory time. This is an increase of \$43,970, or 2.8% from the prior year's liability of \$1,564,840. City employees received a 3% cost of living increase in FY 2002-03, thus explaining the increase in the compensated absences liability.

In FY 1994-95, an Accrued Leave Reserve was established with a \$75,000 transfer from the General Fund. In FY 2002-03, the General Fund continued its annual contribution of \$115,680 for the payment of accrued leave for terminated employees. As of June 30, 2003 the Accrued Leave Reserve balance was \$224,150.

Long Term Financial Plan

Fund Balance



Finding: **FAVORABLE**. Unreserved fund balance refers to those dollars available for use in the event of a financial emergency, short-term revenue fluctuations or an economic downturn. The City attempts to operate each year at a surplus to ensure the maintenance of adequate reserve levels.

Unreserved fund balances increased to 44.48% in FY 2002-03

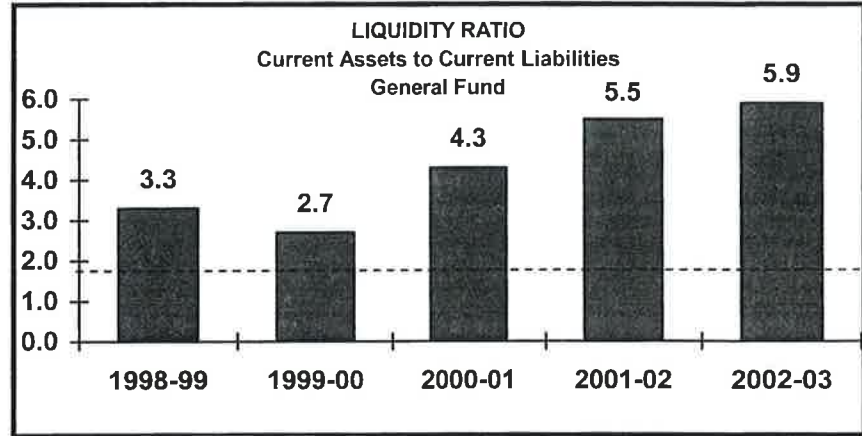
Comments: Unreserved fund balance, as a percentage of total revenues, rose 8.4% in FY 2002-03 as a result of an increase in unreserved fund balance of \$3,716,000. The increase in fund balance is due to an operating surplus of \$3,458,500. The stable position of the City's General Fund is displayed by years of large unreserved fund balances as a percentage of operating revenues.

General Fund Emergency Reserve = \$2,511,600

The City Council adopted a fiscal policy requiring that emergency reserves be set at 8% of General Fund operating expenditures. Included within the total FY 2002-03 unreserved fund balance of \$16.9 million is undesignated funds of \$14.4 million and designated funds of \$2.5 million for the General Fund Emergency Reserve. The annual contribution to the emergency reserve is discussed in detail in the Reserve Analysis section of the LTFP.

Financial Trend Analysis

Liquidity Ratio



Finding: **FAVORABLE**. In FY 2002-03, the City's liquidity ratio remains high at 5.9:1. Credit rating firms consider a ratio of 1:1 favorable. The City's 5.9:1 current asset to current liability ratio is considered excellent.

Liquidity is measured by comparing current assets to current liabilities.

Comments: Liquidity measures the City's ability to meet short term obligations. Liquidity is measured by comparing current assets to current liabilities. Current assets include cash, short-term investments, accounts receivable and other assets that can be readily converted to cash. Current Liabilities included accounts payable, accrued wages, accrued expenses and all obligations that can be immediately demanded for payment.

Long Term Financial Plan

Financial Forecast

Financial Forecast

The five-year financial forecast for the General Fund has been revised to more accurately reflect the financial future of the City. Prior forecasts were more conservative, in that potential revenue from new development projects were not included. Similarly, expenditures such as landscape maintenance for new parks were not included even though the parks were scheduled for completion during the forecast period. This forecast combines the elements of the fiscal impact model into the forecast assumptions to produce a forecast that reflects the impacts of new development upon City finances, as well as the likely impacts of the economy upon the City of San Clemente.

The forecast provides a frame of reference for evaluating the City's financial condition as a basis for decision making

Development of the Financial Forecast

The objective of the financial forecast is to provide a frame of reference for evaluating the City's financial condition as a basis for decision making. The forecast is updated annually as a part of the Long Term Financial Plan process and after the administration's proposed budget is prepared.

The forecast is developed using the present level of services provided by the City. Inflation and historical growth rates are used to predict expenditure patterns while revenues are projected by trend or by specific circumstances as the case warrants. Revenues and expenditures are also increased for growth from development that will occur within the five-year forecast timeframe. For instance, property taxes and sales taxes for the Marblehead development are included in the forecast. Increased contractual costs for police and fire services, if known, are also included. Maintenance costs from new facilities scheduled for completion in the City's Master Plan for City Facilities are also included.

Cal State Fullerton's Economic Forecast is the basis for economic indicators

Information regarding economic indicators and the performance of the economy as a whole over the forecast period was taken from Cal State Fullerton's College of Business and Economics, October 2003 Economic Forecast for Southern California and Orange County. The forecast predicts that, "we are at an early phase of a period of sustained and moderate economic expansion." However, they warn that "California's changing business and political climate add further complexity to the mix."¹

Revenue growth rates will average 4.5%

Forecast Summary & Results

Over the five year forecast period, the City's revenues are anticipated to grow by an annual average increase of 4.5% a year. Property taxes increase by \$11.3 million over the five-year period due to new residential homes that will be sold in the Reserve, Talega and Marblehead and resale activity throughout the city. Sales taxes increase by \$4.39 million over the forecast period, primarily from sales taxes generated from the Marblehead retail facility.

¹ Cal State Fullerton, College of Business and Economics, Economic Forecast, October 2003.

Long Term Financial Plan

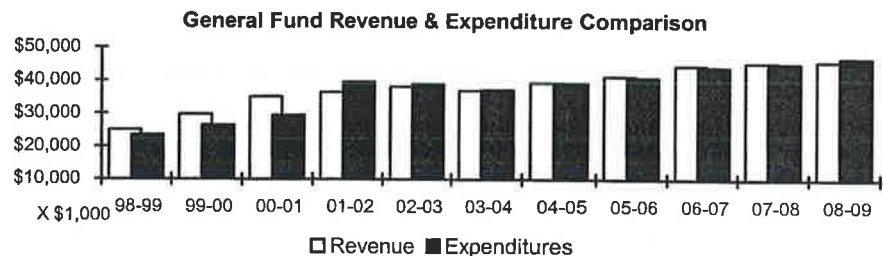
Expenditure growth rates will average 4.8%

Expenditures are projected to increase at an average rate of 4.8%. The majority of this growth is due to increases in staffing levels and contractual services.

- Known increases to the police services contract include a \$46,000 increase in the current fiscal year and a \$69,000 increase in FY 2004-05 for negotiated medical insurance and holiday costs for sworn deputies. Another \$193,250 increase will be realized in FY 2004-05 for the reinstatement of cost for positions that were unfilled for most of FY 2003-04. The contract currently credits the City for the actual cost of unfilled positions or workers' compensation vacancies. Many positions were unfilled for a period of time due to planned retirements or unplanned leave due to injuries. Over the forecast period, the police services budget is anticipated to increase 24% from the current budget.
- Fire services costs are also anticipated to rise during the forecast period. The addition of a fourth firefighter on Engine 59 is included in the forecast beginning in FY 2004-05. The cost of this firefighter is included in the existing "cap" on the contract². The cap increases in FY 2005-06 to 4% for the remainder of the forecast period. This is a one-half percent increase from the current 3.5% cap. Costs for the fourth firefighter on Engine 60 are not within the contract cap until FY 2006-07.
- Costs for park and beach maintenance and recreation staffing also increase due to construction and acceptance of six parks, a new senior center and a community center/gym/pool complex within the forecast period. In total, costs are estimated to increase by \$2.6 million over the forecast period.
- These increases to General Fund expenditures can be absorbed if revenues increase as anticipated. The forecast currently predicts a positive operating position in all five years of the forecast.

Historical and projected revenues and expenditures

The following chart provides a visual comparison of *historical* and *projected* revenue and expenditure growth:



² San Clemente and OCFA have a "cash contract" agreement. The City pays quarterly for the cost of fire and paramedic services, along with appropriate overhead, based upon the basic service costs. There are seven cities (Buena Park, Placentia, San Clemente, Seal Beach, Stanton, Tustin and Westminster) with cash contract agreements with OCFA. The remaining cities have a portion of property taxes shifted to OCFA. These cities are considered "structural fire fund" cities and the amount contributed through property taxes is not directly related to the cost of services provided by the Fire Authority.

Financial Forecast

Beginning in FY 2006-07 expenditures increase 8.2% due to the addition of \$2.1 million in costs for new facilities. The staffing and maintenance costs for the Community Center/Gym/Pool complex are estimated to amount to \$1.5 million. Maintenance costs for the Marblehead sports park and the La Pata/Vista Hermosa park are also included beginning in FY 2006-07. These are on-going operational expenditures that reduce fund balances.

Operating Position

Based on current expenditure and revenue trends, the financial forecast predicts a positive operating position in all five years of the forecast period. Results of the forecast with respect to operating position (operating receipts less operating disbursements) are shown in the following graph.

2004 Forecast Summary (LTFP)*

Amounts in \$1,000

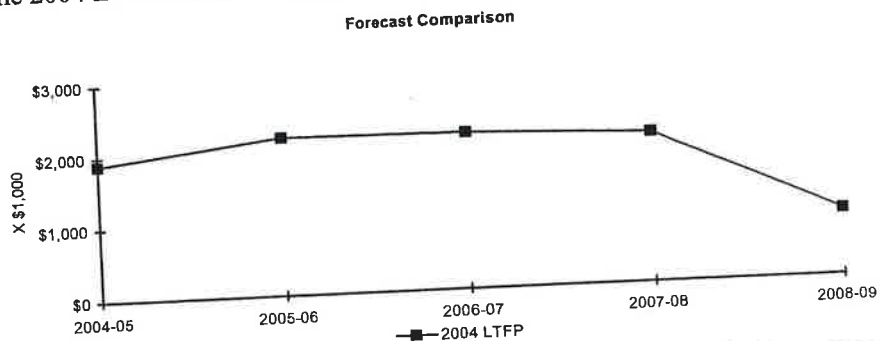
| | 2004-05 | 2005-06 | 2006-07 | 2007-08 | 2008-09 |
|---------------------------|----------|----------|----------|----------|----------|
| Operating receipts | \$39,304 | \$41,214 | \$44,493 | \$45,416 | \$45,865 |
| Operating disbursements | 37,417 | 39,008 | 42,312 | 43,334 | 44,959 |
| Projected surplus/deficit | \$1,887 | \$2,206 | \$2,180 | \$2,082 | \$906 |

2004 LTFP forecast - operating position

*One-time revenues and expenditures have been excluded. One-time revenues include state or federal grants and development fees from the Talega Joint Powers Authority. One-time expenditures include transfers to other funds, capital outlay and special projects such as the La Pata/Vista Hermosa study.

General Fund Operational Position 2004 LTFP Forecast

The following chart shows the City's General Fund operational position for the 2004 LTFP forecast as projected.



The forecast predicts a positive operating position in all five years

The positive operating position for all five years of the forecast is dependent upon sustained growth in revenue from property taxes and sale taxes. The City's General Fund operating position could also change dramatically if the State decides to enact legislation to reduce local revenues in order to balance their budget.

If revenues are reduced or do not materialize as anticipated in the forecast, a negative operating position would create a financial situation that requires

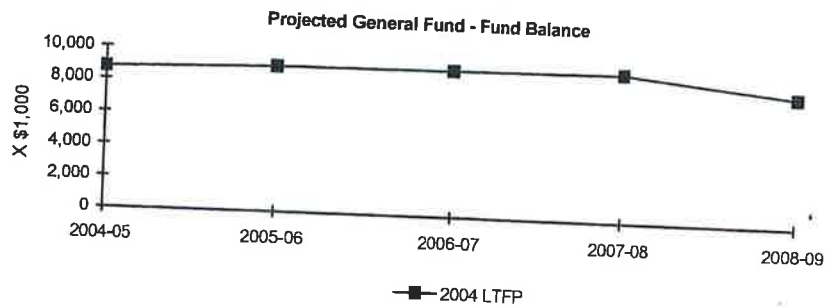
Long Term Financial Plan

tough choices. Fiscal policy does not allow for the development of new park acreage if the General Fund can not afford to provide on-going maintenance. However, current agreements with Talega and Marblehead require the construction of parks once certain pre-established building thresholds are met. These parks will be constructed and accepted by the City and on-going maintenance will be the responsibility of the City. Consequently, development of other parks may be delayed until the City's operating position improves enough to handle on-going maintenance.

The City's projected fund balance in the General Fund averages \$8.8 million over the forecast period

Fund Balance

The chart below illustrates projected fund balances in the General Fund for the 2004 Long Term Financial Plan forecast.



Fund balances average \$8.8 million over the forecast period.

General Fund - Fund Balance and Emergency Reserve

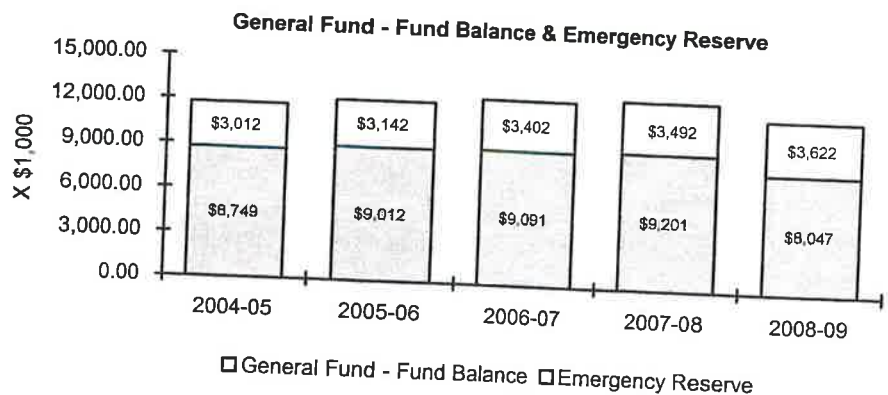
General Fund - Fund Balance and Reserves

One of the main goals of the City Council, as defined in the City's Fiscal Policy, is to ensure that adequate resources will be available to fund emergency reserves and maintain a healthy fund balance. As shown on the following table and graph, the projected ending fund balance over the five year forecast period will be positive. Emergency reserve levels have been maintained at the required 8% level.

General Fund - Fund Balance & Emergency Reserve

| Amounts in \$1,000 | 2004-05 | 2005-06 | 2006-07 | 2007-08 | 2008-09 |
|-------------------------|---------|---------|---------|---------|---------|
| Fund Balance | \$8,749 | \$9,012 | \$9,091 | \$9,201 | \$8,047 |
| Emergency Reserves (8%) | \$3,012 | \$3,142 | \$3,402 | \$3,492 | \$3,622 |

Fund balance is projected to be positive in all five years of the forecast



Financial Forecast

The following cash flow table provides a review of Beginning Fund Balances, Receipts, Disbursements, and Ending Fund Balances over the five-year forecast period.

**Cash inflows
and outflows
by year**

General Fund - Cash Inflows and Outflows By Year

Amount in 1,000's

| | 2004-05 | 2005-06 | 2006-07 | 2007-08 | 2008-09 |
|-------------------------------|---------------|---------------|---------------|---------------|---------------|
| Beginning Fund Balance | 8,961 | 8,749 | 9,012 | 9,091 | 9,201 |
| Receipts | | | | | |
| Taxes | 22,074 | 23,500 | 25,983 | 27,210 | 28,889 |
| Licenses & Permits | 3,688 | 3,722 | 3,817 | 3,889 | 1,635 |
| Intergovernmental | 3,775 | 3,923 | 4,069 | 4,183 | 4,250 |
| Service Charges | 3,947 | 4,064 | 4,434 | 3,881 | 4,761 |
| Fines & Forfeitures | 737 | 766 | 795 | 818 | 830 |
| Interest & Rents | 1,528 | 1,584 | 1,646 | 1,790 | 1,859 |
| Interfund Transfers | 3,556 | 3,655 | 3,747 | 3,645 | 3,640 |
| Total GF Receipts | 39,304 | 41,214 | 44,493 | 45,416 | 45,865 |
| Disbursements | | | | | |
| City Council | 61 | 62 | 63 | 65 | 66 |
| City Manager | 441 | 454 | 466 | 479 | 492 |
| City General | 2,919 | 3,003 | 3,065 | 3,142 | 3,227 |
| Finance & Admin. Services | 302 | 312 | 320 | 329 | 338 |
| City Clerk | 539 | 556 | 571 | 587 | 603 |
| Finance | 1,299 | 1,339 | 1,376 | 1,414 | 1,453 |
| Human Resources | 441 | 455 | 468 | 480 | 494 |
| Police Services | 9,178 | 9,481 | 9,920 | 10,371 | 10,837 |
| Fire Services | 5,168 | 5,401 | 5,610 | 5,834 | 6,067 |
| Comm Dev. Admin. | 255 | 263 | 270 | 277 | 285 |
| Building | 2,127 | 2,193 | 2,254 | 2,016 | 2,071 |
| Planning | 1,076 | 1,109 | 1,139 | 1,170 | 1,202 |
| PWAdmin/Economic Dev. | 570 | 588 | 604 | 621 | 639 |
| Engineering | 3,643 | 3,752 | 3,856 | 3,664 | 3,765 |
| PW Maintenance Services | 2,837 | 2,926 | 3,009 | 3,093 | 3,181 |
| B, P & R Admin. | 435 | 448 | 461 | 473 | 486 |
| Recreation | 2,107 | 2,173 | 3,310 | 3,401 | 3,495 |
| Beach & Park Maintenance | 4,253 | 4,560 | 5,429 | 5,615 | 5,779 |
| Marine Safety | 1,037 | 1,069 | 1,098 | 1,128 | 1,159 |
| New Employees | 165 | 336 | 511 | 692 | 877 |
| Negotiated Increases | 333 | 343 | 353 | 364 | 374 |
| Total GF Disbursements | 39,185 | 40,822 | 44,154 | 45,216 | 46,888 |
| Emergency Reserve | 330 | 130 | 260 | 90 | 130 |
| Ending Fund Balance | 8,749 | 9,012 | 9,091 | 9,201 | 8,047 |

The following table provides a summary of the projected disbursements by category over the forecast period.

| Disbursements by Category | 2004-05 | 2005-06 | 2006-07 | 2007-08 | 2008-09 |
|---------------------------|---------------|---------------|---------------|---------------|---------------|
| Salaries & wages | 8,147 | 8,508 | 9,521 | 9,840 | 10,222 |
| Employee benefits | 3,323 | 3,467 | 4,014 | 4,151 | 4,307 |
| Supplies | 809 | 836 | 861 | 886 | 912 |
| Contractual services | 21,410 | 22,348 | 23,953 | 24,375 | 25,315 |
| Other charges | 832 | 859 | 885 | 911 | 937 |
| Capital outlay | 301 | 311 | 321 | 330 | 340 |
| Interdepartmental charges | 2,904 | 2,996 | 3,085 | 3,176 | 3,269 |
| Interfund transfers | 1,457 | 1,492 | 1,510 | 1,541 | 1,579 |
| Total | 39,185 | 40,822 | 44,154 | 45,216 | 46,888 |

Long Term Financial Plan

Financial Forecast - Assumptions

Economic and demographic assumptions affect projections

The forecast predicts Orange County's economy is beginning to slowly recover

Economic and Demographic Assumptions

Economic and demographic assumptions used in the forecast measure the anticipated changes in economic activity and population growth and affect many of the revenue and expenditure projections. The economic assumptions utilized in this forecast are based primarily on the annual Economic Forecast developed by Cal State Fullerton and published in October 2003. Additionally, data is provided by various City of San Clemente departments.

The Fullerton forecast predicts that Orange County's economy is beginning to slowly recover from the economic downturn in 2001. The County unemployment growth forecast reflects a 1.3% growth rate in 2004 and 2.2% percent growth expected in 2005, with the majority of the jobs in the service providing industries. Business and professional services, education and health and retail trade services will also contribute to the gain in employment growth. Personal income is forecasted to average 4.7%, compared to 2.9% in the prior year. Taxable sales are anticipated to grow at an annual average rate of 4.6%. Housing appreciation for resale homes is predicted to increase an average of 3.4%.

Population projections provided by the City's Planning and Building divisions are based upon a reasonable rate of absorption for the number of housing units approved through the development review process. It is presumed, for forecasting purposes, that 2.5 persons will occupy each housing unit, which is the average household size in San Clemente.

A summary of the parameters utilized in the 2004 Financial Forecast to project the various revenue and expenditures categories are delineated below:

Summary of forecast parameters

| Par # | Description | 2004-05 | 2005-06 | 2006-07 | 2007-08 | 2008-09 | Average |
|-------|--------------------------|---------|---------|---------|---------|---------|---------|
| 1 | Inflation | 2.6% | 3.3% | 3.0% | 3.0% | 3.0% | 3.0% |
| 2 | Population | 2.5% | 2.4% | 2.4% | 1.4% | 0.2% | 1.8% |
| 3 | Assessed Valuation | 3.7% | 3.6% | 3.2% | 3.2% | 3.2% | 3.4% |
| 4 | Personal Income | 4.7% | 5.8% | 4.4% | 4.4% | 4.4% | 4.7% |
| 5 | Taxable Sales | 4.9% | 6.0% | 4.1% | 4.1% | 4.1% | 4.6% |
| 6 | Property Taxes | 3.7% | 3.6% | 3.2% | 3.2% | 3.2% | 3.4% |
| 7 | Trans. Occup. Tax | 2.6% | 3.3% | 3.0% | 3.0% | 3.0% | 3.0% |
| 8 | Franchise Taxes | 2.6% | 3.3% | 3.0% | 3.0% | 3.0% | 3.0% |
| 9 | Prop. Transfer Tax | 2.6% | 3.3% | 3.0% | 3.0% | 3.0% | 3.0% |
| 10 | Construction Permits | 2.5% | 2.4% | 2.4% | 1.4% | 0.2% | 1.8% |
| 11 | State Subventions | 3.8% | 4.1% | 3.9% | 2.9% | 1.6% | 3.2% |
| 12 | Service Charges | 2.6% | 3.3% | 3.0% | 3.0% | 3.0% | 3.0% |
| 13 | Interest Earnings | 4.9% | 5.8% | 5.3% | 5.3% | 5.3% | 5.3% |
| 14 | Pier & Beach Concessions | 2.6% | 3.3% | 3.0% | 3.0% | 3.0% | 3.0% |
| 15 | Interfund Charges | 2.6% | 3.3% | 3.0% | 3.0% | 3.0% | 3.0% |
| 16 | Salaries & Wages | 2.6% | 3.0% | 2.7% | 2.7% | 2.7% | 2.7% |
| 17 | Employee Benefits | 2.6% | 3.0% | 2.7% | 2.7% | 2.7% | 2.7% |
| 18 | Supplies | 2.6% | 3.3% | 3.0% | 3.0% | 3.0% | 3.0% |
| 19 | Services/Other Charges | 2.6% | 3.3% | 3.0% | 3.0% | 3.0% | 3.0% |
| 20 | Capital Outlay | 2.6% | 3.3% | 3.0% | 3.0% | 3.0% | 3.0% |

Following is a description of key indicators used in developing the financial forecast:

Financial Forecast

Inflation is projected to average 3.0%

- *Consumer Price Index (Inflation):* Inflation is the measure of the increase in cost of goods and services. Inflation impacts many revenue and most expenditure categories throughout the five-year forecast and is projected to average 3.0% per year.

Population estimates average 1.8% over the forecast period

- *Population:* Population size is the primary basis for the allocation of Motor Vehicle taxes; one of the City's larger revenue sources (8% of total General Fund revenue) and is also reflective of the scale of residential and commercial development within the City. In addition, year-to-year population growth is a useful factor in predicting increases in several other revenue categories, such as Franchise Fees and Business Licenses. Population estimates developed by the City's Planning Division project growth to average 1.8% over the forecast period.

| 2004-05 | 2005-06 | 2006-07 | 2006-07 | 2007-08 |
|---------|---------|---------|---------|---------|
| 62,200 | 63,700 | 65,200 | 66,100 | 66,200 |
| 2.5% | 2.4% | 2.4% | 1.4% | 0.2% |

Assessed Valuation is projected to grow by an average of 3.4%

- *Assessed Valuation:* This is the value placed on residential and commercial property by the County Tax Assessor. It is an indicator of the value of property that drives the City's major revenue source, Property Tax. Assessed Valuation is projected to increase by an average of 3.4%.

Personal Income is projected to increase an average of 4.7%

- *Personal Income:* As a measure of consumer purchasing power, this indicator reflects on elastic revenues such as Sales Tax, concession revenues and Transient Occupancy Taxes. Personal income is projected to increase by an average of 4.7% per year.

Taxable Sales in Orange County are projected at 4.6%

- *Taxable Sales:* Taxable sales are a measure of the total retail sales in Orange County. This indicator has a direct relationship with the City's retail sales tax revenue, which is 1% of taxable sales in San Clemente. Taxable sales in Orange County for 2004-05 are projected at 4.9% and 4.6% forecasted over the five-year period.

Financial Forecast Assumptions

Beyond the economic and growth/trend factors described above, information specific to San Clemente is included in the forecast:

Forecast assumptions includes contributions to reserves, and staffing projections

- For forecast purposes only, it is presumed that cost of living increases will be granted at 90% of inflation beginning in FY 2004-05.
- The forecast projections assume two new positions are added per year for a total of 10 positions. In addition, \$670,530 in personnel costs has been added to the forecast for staffing the Community Center/Gym/Pool Complex. The anticipated staffing level will consist of a combination of full-time and part-time employees and it is unknown at this time how many positions this will equate to in full-time equivalents.

Long Term Financial Plan

- The Police Services budget includes one new contract position per year beginning in FY 2006-07. In total, three new contract positions are added during the forecast period. Previous forecasts included one new contract position per year, for a total of five contract positions.
- Contract staffing levels and contractual agreements for development related activities are reduced beginning in FY 2007-08, along with corresponding revenue. This includes contract engineering inspectors, contract building inspectors, contract plan checking and administrative support staff in the Building, Planning and Engineering divisions.
- Actual expenditures are projected at 0.5% less than budget for all five years of the forecast. This is conservatively based on the projected actual expenditures versus budgeted expenditures.
- Actual revenue is projected to exceed budget by 0.5% in all five years based on current revenue projections and conservative estimating techniques.
- One-time expenditures in the base year (FY 2003-04) have been excluded from the forecast. For example, the City's budget includes \$100,000 for the La Pata/Vista Hermosa study, \$25,000 for the Steed Park management study and various reserve transfers including a \$277,000 transfer to the Workers' Compensation reserve. There are no one-time revenues in the base year of the forecast.
- Capital Outlay amounts to \$179,000 in FY 2003-04 of the forecast for one-time capital improvements and capital equipment. Approximately \$322,000, which is the average amount spent over the last five years, is included in each year of the forecast thereafter.
- Negotiated increases approved by City Council for the Orange County Fire Authority (OCFA) contract are included for all five years of the forecast. The contract is capped at a total increase of 3.5% until FY 2005-06. The contract cap increases to 4% for the remaining five years of the contract.

The cap, however, does not apply to the cost of the fourth person added to each shift on Engine 60. These positions are filled by overtime in FY 2003-04. Beginning in FY 2004-05, one full-time position per year is added to the contract cost. By the fourth year of the forecast, the positions are all filled with permanent OCFA staff. The contract does allow the City to revert back to a three person engine company upon thirty day notice to the Orange County Fire Authority.

- The cost of an additional firefighter to each shift on Engine 59 is included beginning in FY 2004-05, thus adding \$400,000 annually to the OCFA contract. The contract cap of 4% will apply to these costs beginning in FY 2005-06.

Financial Forecast

- Maintenance costs for Forster Ranch Park – Phase IIB, Talega Park II and Talega Park III are included in the base year of the forecast based upon operating costs provided by Beaches & Park Maintenance staff. Operations and maintenance costs for all other facilities included in the Master Plan for City Facilities have also been included in the forecast.
- The forecast includes, as operating transfers out of the General Fund, annual expenditures to fund reserves projected at \$672,780 for FY 2004-05:

| | 2004-05 | 2005-06 | 2006-07 | 2007-08 | 2008-09 |
|---------------------|------------------|------------------|------------------|------------------|------------------|
| Council Contingency | 376,120 | 392,100 | 427,590 | 437,910 | 454,290 |
| Emergency Reserve | 330,000 | 130,000 | 260,000 | 90,000 | 130,000 |
| Total | \$706,120 | \$522,100 | \$687,590 | \$527,910 | \$584,290 |

- Council Contingency Reserve is funded at 1% of operating expenditures in each of the forecast years, per the City's Fiscal Policy.
- The General Fund Emergency Reserve was fully funded in FY 2002-03, in accordance with City Fiscal Policies. Annual contributions are recommended in order to maintain the reserve at the required 8% level. (Also see the Reserve issue paper.)
- In addition to the allocations for reserves, funding has been included in the forecast for the Street Improvement Program, as well as debt service contributions. The General Fund contribution to the Street Improvement Program includes an annual 3% increase for inflation. (Also see the Street Improvement Program Update issue paper.)

Other transfers and debt payments

| | 2004-05 | 2005-06 | 2006-07 | 2007-08 | 2008-09 |
|-------------------------------------|--------------------|--------------------|--------------------|--------------------|--------------------|
| Street Program | \$597,020 | \$614,930 | \$633,380 | \$652,380 | \$671,950 |
| Energy Program ³ | 37,800 | 37,800 | 0 | 0 | 0 |
| Animal Shelter Land ⁴ | 32,000 | 32,000 | 32,000 | 32,000 | 32,000 |
| Utility Lifeline Rates ⁵ | 30,000 | 30,000 | 30,000 | 30,000 | 30,000 |
| Solid Waste Fund ⁶ | 52,260 | 54,090 | 55,980 | 57,940 | 59,970 |
| PERS Unfunded ⁷ | 339,000 | 339,000 | 339,000 | 339,000 | 339,000 |
| Total | \$1,088,080 | \$1,107,820 | \$1,090,360 | \$1,111,320 | \$1,132,920 |

³ Principal and interest payments on heating, air conditioning and lighting improvements. This is the last two years of a ten year commitment.

⁴ Principal and interest payments on land purchased for the animal shelter. This is a thirty year interfund loan from the Public Facilities Construction Fund.

⁵ Proposition 218 prohibited the use of Enterprise Funds for public benefit. Consequently, a General Fund transfer to the Water Fund subsidizes water fees to low income households.

⁶ Ten percent of the solid waste franchise fee is transferred to the Solid Waste Fund annually for household conservation efforts.

⁷ Current estimate by PERS of the City's unfunded liability for former fire and police personnel and current lifeguards in the CalPERS retirement system. This amount is an estimate and will be reviewed annually before payment is made.

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Forecast pertains to the General Fund only

No new or enhanced programs are included

Fire contract increases

Revenues are projected to increase an average of 4.5%

Property Tax revenue is projected to increase an average of 6.2%

Factors Not Included In The Forecast

- This forecast is based on the General Fund only.
- No new or enhanced programs are included in the forecast.
- Potential state impacts are not included in the forecast with the exception of the known loss of vehicle license fee backfill in FY 2003-04.
- The forecast does not include the establishment of any of the capital facilities (City Hall, beach replenishment, etc.) noted in the updated “Master Plan for City Facilities” beyond those already in the current CIP implementation plan.
- The forecast does not include the potential cost of recommendations from other Long Term Financial Plan issue papers.

General Fund Revenues

Over the forecast period, General Fund revenues are projected to increase at an average annual rate of 4.5%, compared to a historical five year growth rate of 11.3%.

- Property Tax revenue is projected to increase an average of 6.2% per year compared to an 11.5% average historical increase over the past five years.
- Construction permit revenue is projected to decrease from a historical average of 36.1% to an average of -15.8% for the forecast period, as revenues are reduced in the last year to reflect the anticipated level of decreased development activity.
- Service Charges are projected to average 5.0% in the forecast period, compared to a 21.0% average historical growth rate over the past five years.
- Fines are projected to increase an average of 3.2% per year compared to a 12.8% average historical growth rate over the past five years.

Financial Forecast

In each revenue and expenditure category an initial summary is provided that provides the following:

- **Historic Growth Rate:** Provides the average annual rate of growth for the past five years from FY 1998-99 to FY 2002-03.
- **2004 Projected Growth Rate:** Average annual rate of growth projected for the current five-year forecast.

General Fund Growth Rate

| | |
|----------------------------|-------|
| Historic Growth Rate | 11.3% |
| 2004 Projected Growth Rate | 4.5% |

Development activity will continue throughout the first four years of the forecast period

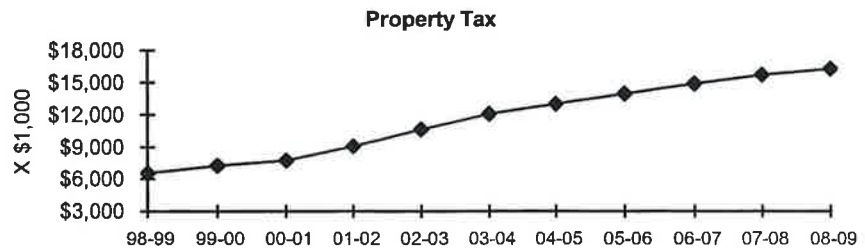
During the past five years, the General Fund revenue growth rate was 11.3% primarily due to steady increases in property values, sales taxes and development related fees and charges. The 2004 forecast rate of 4.5% anticipates that development activity will continue through the first four years of the forecast period with new residential and retail properties coming on-line. Property taxes and sales taxes are anticipated to increase due to this development, while permit fees and service charges will continue at a steady rate.

Property Tax

| | |
|----------------------------|-------|
| Historic Growth Rate | 11.5% |
| 2004 Projected Growth Rate | 6.2% |

Property Tax revenues will increase by an average of 6.2%

Property Tax has been the most relied upon local government revenue for decades. It continues to be the City's single largest revenue source and represents 33% of total General Fund budgeted revenue. As a result of rising home valuation, lower mortgage rates and new residential housing built during the last few years, property taxes have increased dramatically to a historical average of 11.5%. Property taxes for the forecast period have been increased using the Building and Planning divisions' projections for new housing units built over the forecast period. The Finance division then used an average price per development to project the City's share of property taxes.



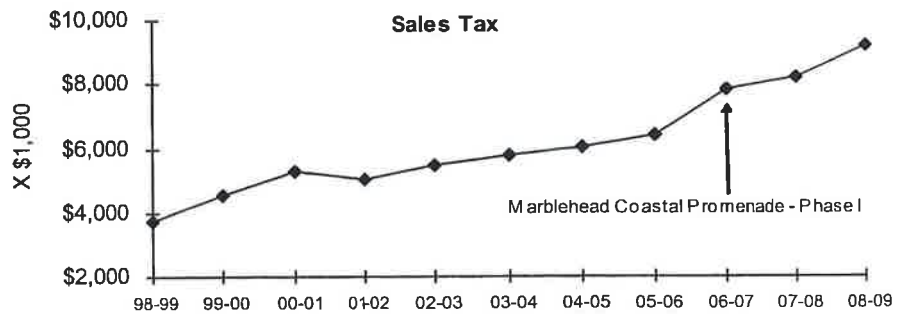
Long Term Financial Plan

Sales Tax

| | |
|----------------------------|-------|
| Historic Growth Rate | 8.0% |
| 2004 Projected Growth Rate | 10.0% |

Sales tax revenue is anticipated to grow an average of 10.0% in the forecast

Sales tax is one of the City's most economically sensitive revenue sources and is anticipated to grow an average of 10.0% in the forecast period due to projected growth from the Marblehead retail project. Increases are based upon the assumptions used in the 2004 Economic Development Update paper included in the 2004 Long Term Financial Plan. Sales tax revenue from phases I and II assume sales taxes will be generated from this project beginning in FY 2006-07 and FY 2008-09.



TOT is projected to increase an average of 3.0%

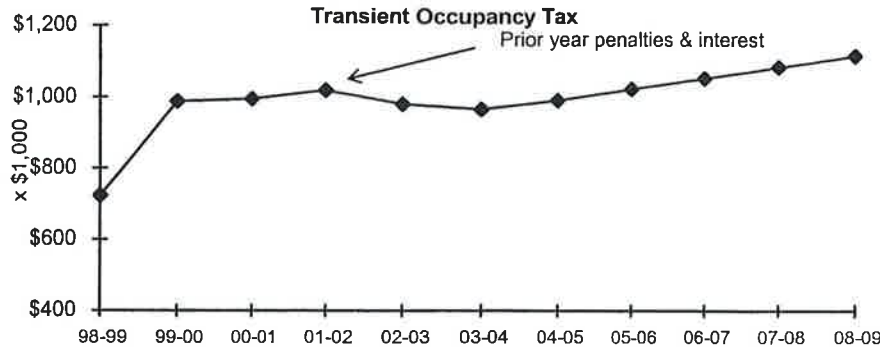
Transient Occupancy Tax

| | |
|----------------------------|------|
| Historic Growth Rate | 9.9% |
| 2004 Projected Growth Rate | 3.0% |

Transient Occupancy Tax is an added charge to room rates at local hotels. It is an elastic revenue source affected by swings in the economy. The historic growth rate of 9.9% includes an increase in TOT revenue, which began in FY 1999-00, and one-time penalties and interest on delinquent TOT accounts received in FY 1999-00 and FY 2001-02. Over the forecast period, the average growth is projected at 3.0% per year, and is based on the consumer price index projections for Orange County.

The forecast does not include \$398,000 in TOT revenue from the proposed use of 93,000 square feet of hotel and conference facility uses that is mentioned in the Economic Development Update paper. However, this increase in TOT revenue has been included in an "optimistic" version of the forecast that will be discussed later in this paper.

Financial Forecast



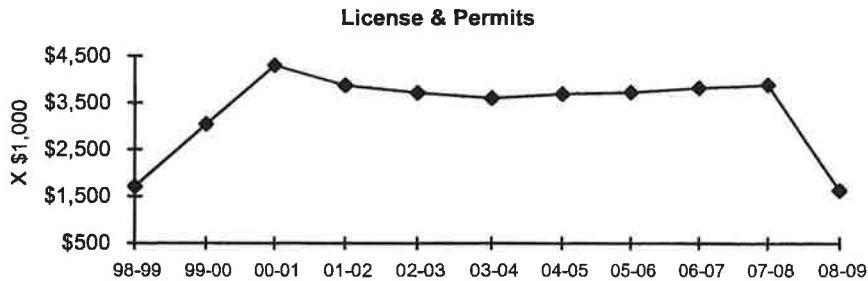
License and Permit

| | |
|----------------------------|--------|
| Historic Growth Rate | 25.4% |
| 2004 Projected Growth Rate | -10.0% |

License and Permit revenues include Business Licenses, Construction Permits and miscellaneous licenses and permits which are projected to decrease an average of -10.0%. For forecast purposes, revenue for development activity is considered “one-time” and is reduced in the last year of the forecast to reflect anticipated development activity.

License and Permit revenue from development activity will continue

Construction Permits, which includes building, electrical, mechanical, plumbing and grading permits, are projected to continue during the first four years of the forecast, with development activity continuing in Talega, the Reserve and new development activity starting in Marblehead. However, one-time development fees have been reduced in FY 2008-09, as the City reaches build-out.



Grants and Subventions

| | |
|----------------------------|-------|
| Historic Growth Rate | 10.1% |
| 2003 Projected Growth Rate | 7.5% |

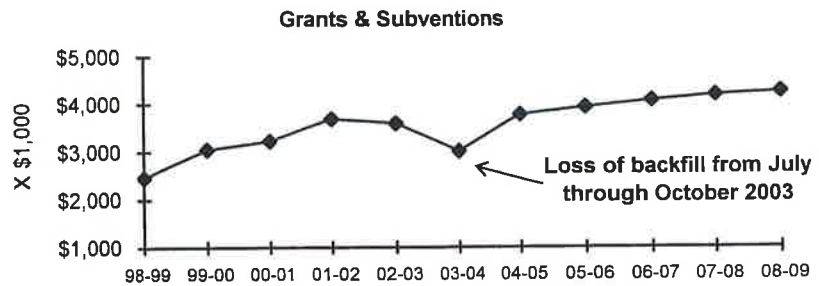
Motor Vehicle Tax, is projected to grow at a 13% rate

In total, Grant and Subvention revenues are projected to increase at a rate of 7.5% over the forecast period, compared to an historical growth rate of 10.1%. Motor Vehicle Tax revenues, which make up the majority of the revenue in this category, skews the projected growth rate due to the

Long Term Financial Plan

reinstatement of \$704,000 in vehicle license fees lost in FY 2003-04. This increase in the first year of the forecast amounts to 30%.

The base year of the forecast includes the reinstatement of the local government "backfill" for the remaining months of the 2003-04 fiscal year. Potential state impacts, such as the elimination of the backfill, have not been included in the forecast.

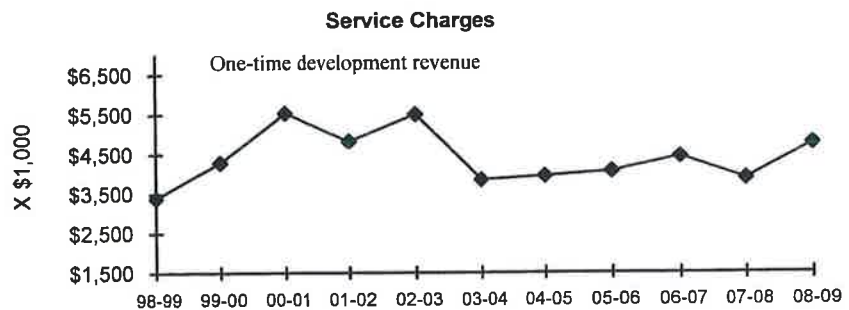


Service Charges

| | |
|----------------------------|-------|
| Historic Growth Rate | 21.0% |
| 2004 Projected Growth Rate | 5.0% |

Service Charges show a historic growth rate of 21.0%. Projected growth rate amounts to 5.0%

This category includes a variety of fees charged for specific services provided by the City. They include, for example, development fees, recreation program fees and ambulance service fees. For forecasting purposes, construction fees are considered "one-time" revenue and reduced in the last year of the forecast period. The projected growth in service charges over the forecast period is 5.0% due to continued development, primarily from Marblehead. On-going revenues, such as public safety service charges and ambulance fees, have been increased based on projected population changes. Recreation service charges are increased beginning in FY 2006-07 due to the opening of the Community Center/Gym/Pool complex. By the third year of operation, the operating costs for the complex are anticipated to be 50% supported by recreation service charges.



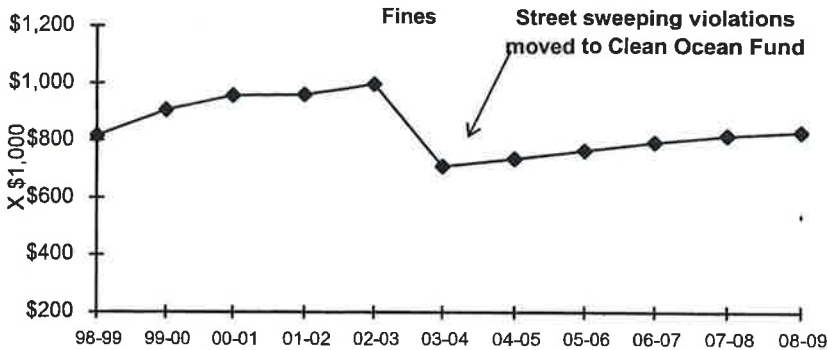
Financial Forecast

Fines

Revenue for Fines is projected to grow 3.2%

| | |
|----------------------------|-------|
| Historic Growth Rate | 12.8% |
| 2004 Projected Growth Rate | 3.2% |

The Fines category consists of all fines levied by the City for parking, vehicle code violations, alarms, and other fines. The 2004 projected growth rate of 3.2% is based population growth in the City. Fines from street sweeping parking violations reduced dramatically in FY 2003-04, since monies generated from this source are now reported in the Clean Ocean Fund.

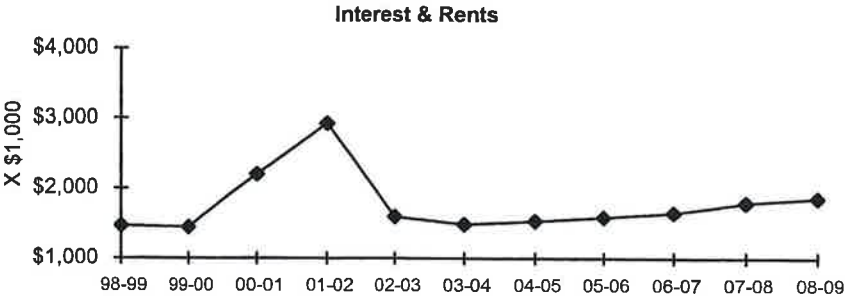


Interest And Rents

| | |
|----------------------------|------|
| Historic Growth Rate | 9.9% |
| 2004 Projected Growth Rate | 4.7% |

This revenue group includes interest earnings on invested funds and revenue from rental agreements and leases. Communications site lease projections have been increased by inflation. Interest earning increases are based upon 70% of the prime interest rate. In accordance with an existing agreement, the concession rate for the Fisherman’s Restaurant is capped at \$265,000 per year for the first three years. The cap is removed in FY 2007-08 and the City’s share will be 6% of gross revenues.

Interest & rents are projected to grow 4.7%



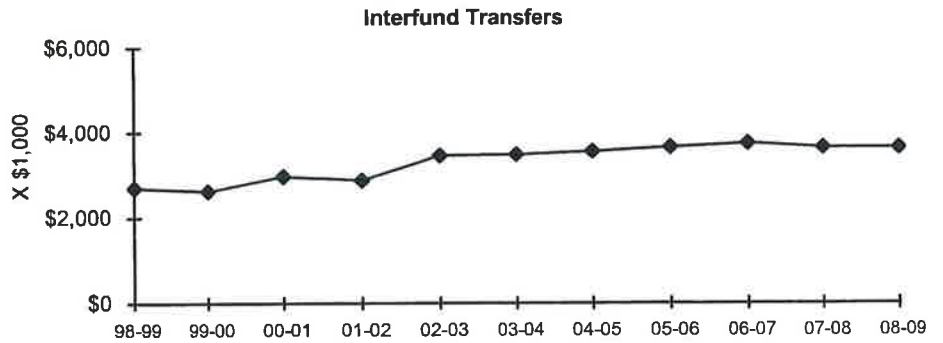
Long Term Financial Plan

Interfund Transfers

| | |
|----------------------------|------|
| Historic Growth Rate | 5.1% |
| 2004 Projected Growth Rate | 0.9% |

Interfund transfers include General Fund overhead charges and transfers

This revenue category is comprised predominantly of overhead charges assessed by the General Fund to other operating funds of the City that are self-supporting. Other revenues that make up this category include transfers from other funds, such as the Golf Fund and Gas Tax Fund. The transfer of \$425,000 annually from the Golf Fund is included in all five years of the forecast.



Financial Forecast

General Fund Expenditures

The average expenditure rate is projected at 4.8%

Projected expenditures presume that service levels approved in fiscal 2003-04 will remain constant

| | |
|----------------------------|-------|
| Historic Growth Rate | 12.4% |
| 2004 Projected Growth Rate | 4.8% |

Projected expenditures presume that service levels in effect in FY 2003-04 will remain constant. No new programs are assumed, with the exception of adding new facilities included in the Master Plan for City Facilities and the planned addition of a fourth fire fighter on each shift on Engine 59.

The 2004 projected growth rate assumes costs will increase due to inflation, added personnel, known operation and maintenance costs for new facilities and contractual costs for police and fire.

Salaries and Wages

Ten new positions are added during the forecast period

Total personnel costs are projected to average 5.5%

| | |
|----------------------------|------|
| Historic Growth Rate | 7.9% |
| 2004 Projected Growth Rate | 5.5% |

The forecast projections assume that two new positions are added each year, for a total of ten new positions added during the forecast period. In addition, \$670,530 in salaries and benefits are included for staffing the Community Center/Gym/Pool complex beginning in FY 2006-07. For forecast purposes only, an annual cost of living increase equal to 90% of the inflation rate is included. The Fullerton forecast anticipates minimal increases in the inflation rate and averages 3.0% over the forecast period.

The average annual growth rate for Salaries and Wages is 5.5% for the five-year projection.



Employee Benefits

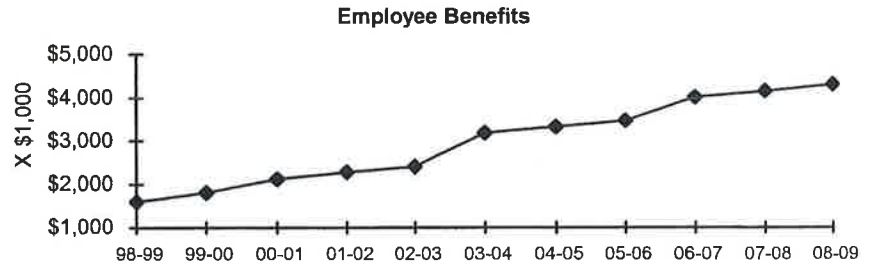
Employee Benefits are projected to increase by 6.3%

| | |
|----------------------------|------|
| Historic Growth Rate | 7.9% |
| 2004 Projected Growth Rate | 6.3% |

The employee benefits category reflects an average projected growth rate of 6.3% for the forecast period. This growth rate is the result of the addition of benefits for the ten new positions and for full and part-time staff anticipated

Long Term Financial Plan

to operate the community center/gym/pool complex beginning in FY 2006-07.



Contractual Services

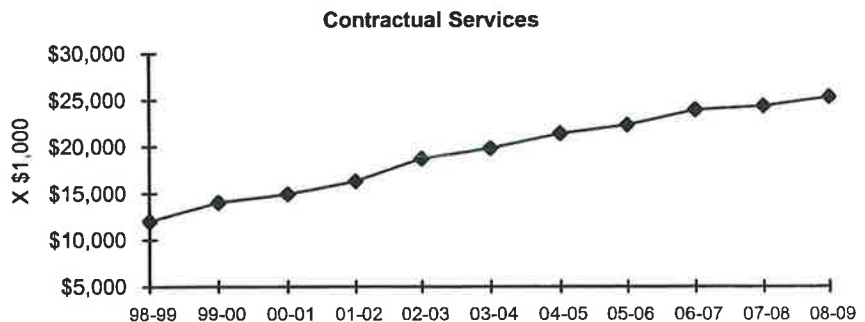
| | |
|----------------------------|-------|
| Historic Growth Rate | 11.3% |
| 2004 Projected Growth Rate | 5.0% |

Contractual Services are projected to increase 5.0%

Overall, this category is expected to experience an average annual increase of 5.0% over the forecast period, well below the historical average of 11.3%. Known increases in the police and fire contracts have been included in the forecast.

The Police Services budget includes two new deputy positions added in the fourth and fifth years of the contract. The first three years of the contract are increased by inflation. Overall, the contract will increase by 13.9% over the forecast period.

Contractual services for the major street maintenance program is included at \$550,000 in the current fiscal year and increased by inflation in the remaining years of the forecast. Contractual building and engineering inspection personnel, along with contractual Planning staff are reduced beginning in FY 2007-08 in anticipation of reduced development activity. Contractual services for all other major contracts such as park and beach maintenance have been increased by inflation and maintenance for new parks amounts to a total increase of \$1.5 million.



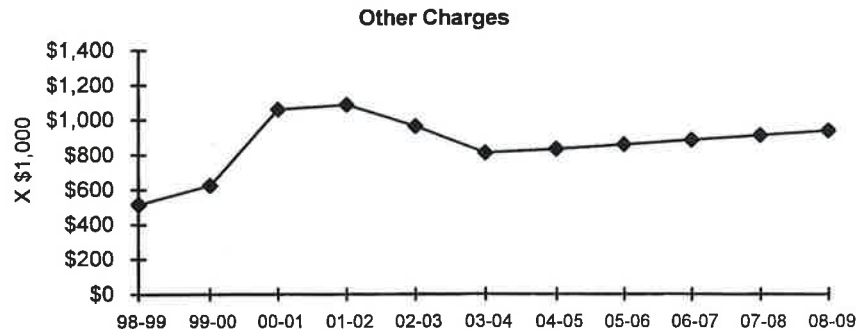
Financial Forecast

Other Charges

| | |
|----------------------------|-------|
| Historic Growth Rate | 23.1% |
| 2004 Projected Growth Rate | 3.0% |

Other Charges will increase by 3.0% over the forecast period

The Other Charges category provides for a wide variety of expenditures such as recreation program expenditures, dues and subscriptions and other items that do not fit within other expenditure categories. Also, this expenditure category includes funding for the Council Contingency reserve. The projected growth rate when averaged is misleading, in that funds are transferred out of the Council Contingency reserve to the operating division's budget for approved expenditures and the account is replenished with an annual contribution. The current policy requires replenishment of the Contingency reserve with no less than 1% of General Fund operating expenditures.

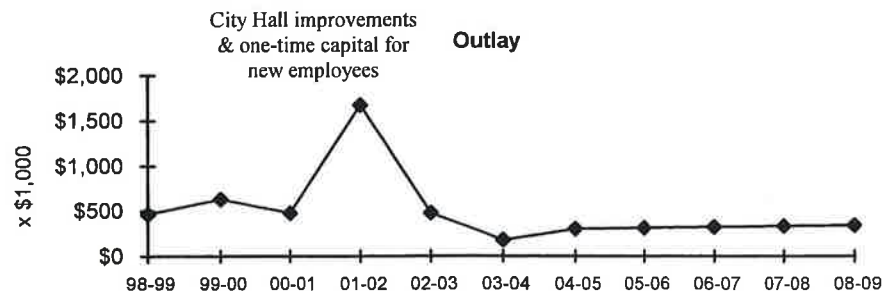


Capital Outlay

The projected growth rate for Capital Outlay is 16.2%

| | |
|----------------------------|-------|
| Historic Growth Rate | 77.4% |
| 2004 Projected Growth Rate | 16.2% |

The projected growth rate for Capital Outlay is 16.2%. One-time capital expenditures are excluded from the base year of the forecast. For purposes of this forecast, Capital Outlay includes funding of \$300,000 (increased by inflation) beginning in FY 2004-05 for facility improvements or new capital equipment.



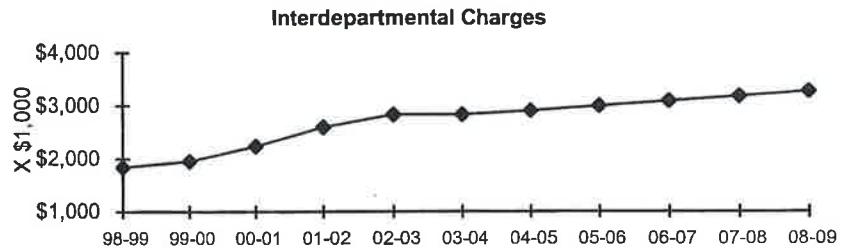
Long Term Financial Plan

Interdepartmental Charges

| | |
|----------------------------|------|
| Historic Growth Rate | 6.1% |
| 2004 Projected Growth Rate | 2.9% |

Interdepartmental Charges are projected to increase by 2.9%

Interdepartmental Charges are for services provided by other funds such as fleet, communications and information systems. This category is projected to average a 2.9% increase over the five year forecast and is based upon inflation.



Interfund Transfers

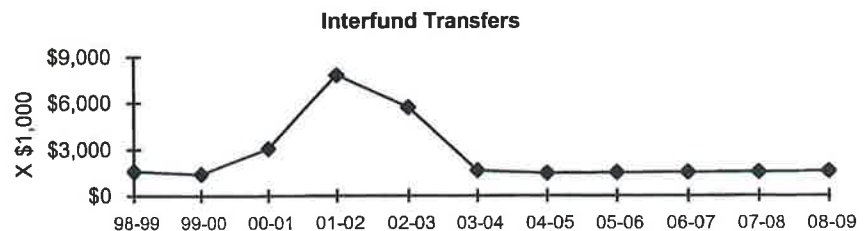
| | |
|----------------------------|--------|
| Historic Growth Rate | 108.8% |
| 2004 Projected Growth Rate | -0.4% |

Interfund Transfers will decrease by -0.4% over the forecast period

The Interfund Transfers category provides for the transfer of General Fund monies to other funds such as the Street Improvement Fund, Solid Waste Fund, Accrued Leave, Facilities Maintenance and Capital Equipment Replacement Reserves. The Interfund Transfer expenditure category is projected to experience an average annual decrease of -0.4%.

The Capital Equipment Replacement, Accrued Leave and Facilities Maintenance reserves were fully funded, however future transfers may be necessary to maintain the reserves at their desired levels. Transfers to the Street Improvement Fund and the Solid Waste Fund have been increased annually by inflation.

A total of \$1.7 million or \$339,000 per year, has been included in each year of the forecast for the City's estimated PERS unfunded liability for former employees that continue to be members of CalPERS retirement plan. This amount will be reviewed annually to determine if the City's contribution could be lowered based upon the actual valuation of the plan's assets.

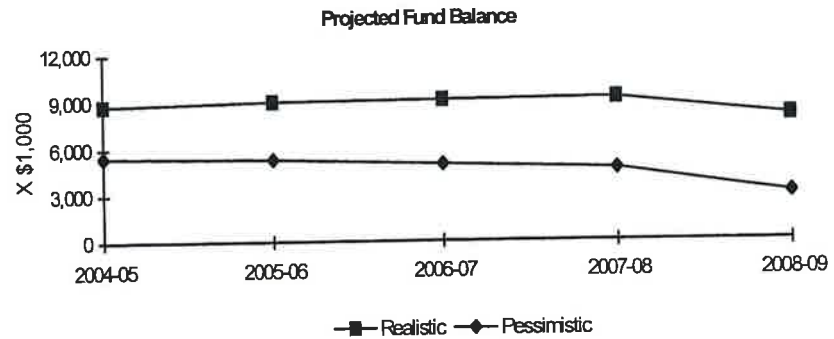


Financial Forecast

Variations on the 2004 Financial Forecast

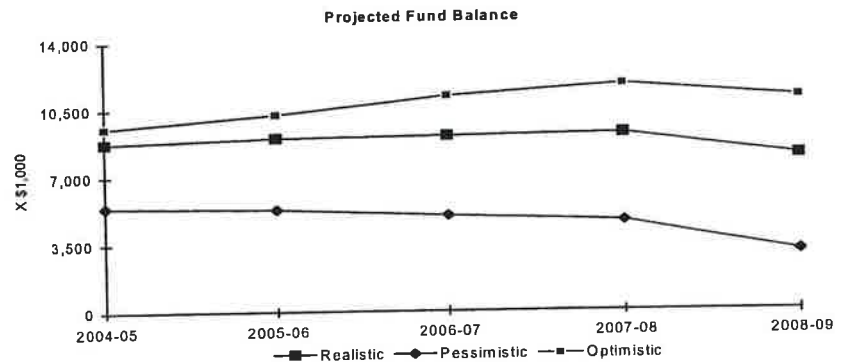
Financial forecasting depends upon making a number of reasonable assumptions over the five-year forecast period. As shown dramatically in 2001, economic conditions can change overnight and changed forecast assumptions can alter the outlook of City finances. The City's financial forecast begins with a basic forecast that is presented in detail. Then, "what if" scenarios are introduced to the model to see how possible changes in the economy or State impacts would affect City finances.

The graph below compares fund balances from the basic forecast or "realistic" forecast to a "pessimistic" forecast, in which the State removes the vehicle license fee (VLF) backfill for the entire 2004-05 fiscal year for a potential loss of \$2.6 million. Expenditures have not been changed from the basic forecast.



Any changes or delays to the development plans currently in place will also alter the City's fund balances, which could delay the construction of new parks or otherwise alter expenditures included in the forecast.

In contrast, projected fund balances could also increase with an upturn in the economy that increases revenues 1% more than the basic forecast. Also included in the "optimistic" forecast are transient occupancy tax (TOT) revenues from the proposed conference center in Marblehead. Expenditure levels have not been changed from the basic forecast.



Long Term Financial Plan

Water, Sewer, Storm Drain, Golf and Clean Ocean operating fund forecasts are included

Other Operating Fund Forecasts

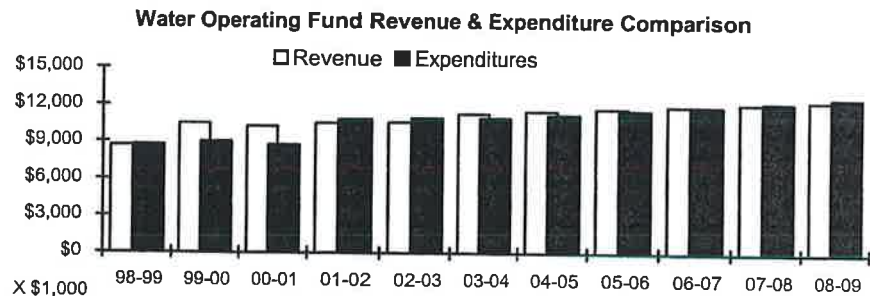
Five-year financial forecasts are also included for the Water, Sewer, Storm Drain, Golf and Clean Ocean operating funds. As with the General Fund forecast, the operating fund projections are developed using a baseline environment. Revenues are projected based upon growth or inflation factors, utilizing the fees and charges currently in place. Expenditures are based upon the present level of services provided by the City and increased by inflation.

Water Operating Fund Forecast

The Water Operating Fund receives revenue primarily from fees charged for water. Revenues have been increased over the forecast period by anticipated growth in the City, excluding the Talega development which is served by the Santa Margarita Water District. Expenditures have been increased by inflation.

The following chart provides a visual comparison of historical and projected revenue and expenditure growth.

The Water operating position is negative in the last two years of the forecast period



The Water Operating Fund's operational position (revenues less expenditures) is negative in the last two years of the forecast. However, net working capital balances are sufficient to sustain the fund. A formal review of the rate structure will be conducted in January 2004, to determine if rates should be adjusted. If adjustments are warranted, the proposed rates will be presented during the budget process.

8% of operating expenditures have been set aside for emergency reserves

The fund has been able to set aside the fiscal policy requirement of 8% of operating expenditures. Additional contributions over the next five years are required to maintain the 8% level.

The table below indicates the projected growth in the emergency reserve over the five-year period.

Emergency Reserve

| Amounts in \$1,000 | 2004-05 | 2005-06 | 2006-07 | 2007-08 | 2008-09 |
|-------------------------|---------|---------|---------|---------|---------|
| Emergency Reserves (8%) | \$395 | \$425 | \$450 | \$480 | \$505 |

Financial Forecast

The following cash flow table provides a review of Beginning Net Working Capital, Receipts, Disbursements and Ending Net Working Capital over the five year forecast period.

2004 FINANCIAL FORECAST

Water Operating Realistic Cash Flow based on FY 2003-04 Budget

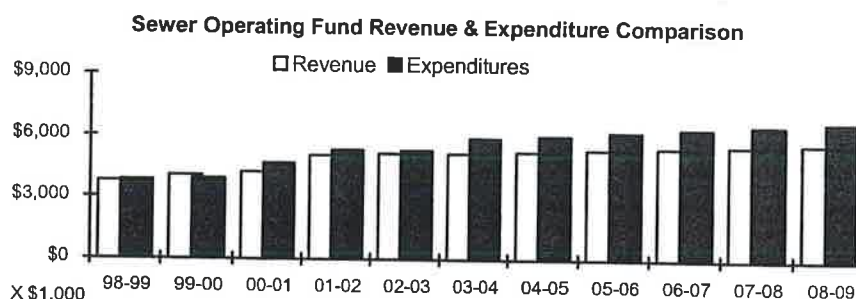
(Amounts in Thousands)

| | 2004-05 | 2005-06 | 2006-07 | 2007-08 | 2008-09 |
|-----------------------------------|---------|---------|---------|---------|---------|
| Beginning | | | | | |
| Net Working Balance | 5,372 | 5,641 | 5,742 | 5,734 | 5,598 |
| Receipts | | | | | |
| Service Charges | 318 | 327 | 336 | 345 | 353 |
| Water Charges | 10,889 | 11,087 | 11,288 | 11,490 | 11,692 |
| Miscellaneous Charges | 225 | 236 | 247 | 259 | 271 |
| Interfund Transfers | 31 | 32 | 33 | 34 | 35 |
| Total Receipts | 11,462 | 11,682 | 11,905 | 12,128 | 12,350 |
| Disbursements | | | | | |
| Water Administration | 842 | 870 | 895 | 921 | 947 |
| Water Production | 7,766 | 8,021 | 8,257 | 8,499 | 8,748 |
| Transmission | 2,072 | 2,137 | 2,198 | 2,260 | 2,324 |
| Conservation | 190 | 196 | 202 | 207 | 213 |
| Reclaimed Water | 317 | 327 | 337 | 346 | 356 |
| New Employees | 0 | 0 | 0 | 0 | 0 |
| Total Disbursements | 11,188 | 11,552 | 11,887 | 12,233 | 12,589 |
| Emergency Reserve | 5 | 30 | 25 | 30 | 25 |
| Ending Net Working Balance | 5,641 | 5,742 | 5,734 | 5,598 | 5,334 |

Long Term Financial Plan

Sewer Operating Fund Forecast

The Sewer Operating Fund receives revenue primarily from fees charged for wastewater collection and treatment. Revenues have been increased over the forecast period by anticipated growth in the City, excluding the Talega development which is served by the Santa Margarita Water District. Expenditures have been increased by inflation.



The Sewer operating position is negative throughout the forecast period

As shown on the chart above, the Sewer Operating Fund is projected to have a negative operating position over the forecast period and ending net working capital balances are negative in the last two years of the forecast period. A formal analysis of the Sewer rate structure will be conducted in January 2004. If adjustments are warranted, the proposed rates will be presented during the budget process.

2004 FINANCIAL FORECAST

Sewer Operating Realistic Cash Flow from 2003-04 Adjusted Budget

(Amounts in Thousands)

| | 2004-05 | 2005-06 | 2006-07 | 2007-08 | 2008-09 |
|-------------------------------|---------|---------|---------|---------|---------|
| Beginning Net Working Balance | 2,784 | 1,976 | 1,092 | 134 | -899 |
| Receipts | | | | | |
| Service Charges | 5,104 | 5,196 | 5,290 | 5,385 | 5,482 |
| Miscellaneous Charges | 133 | 140 | 147 | 155 | 163 |
| Interfund Transfers | 0 | 0 | 0 | 0 | 0 |
| Total Receipts | 5,237 | 5,336 | 5,437 | 5,540 | 5,645 |
| Disbursements | | | | | |
| Sewer Administration | 1,123 | 1,154 | 1,183 | 1,213 | 1,243 |
| Treatment | 2,848 | 2,939 | 3,022 | 3,109 | 3,197 |
| Collection | 2,047 | 2,113 | 2,175 | 2,238 | 2,303 |
| New Employees | 0 | 0 | 0 | 0 | 0 |
| Total Disbursements | 6,017 | 6,206 | 6,380 | 6,559 | 6,743 |
| Emergency Reserve | 27 | 15 | 14 | 14 | 14 |
| Ending Net Working Balance | 1,976 | 1,092 | 134 | -899 | -2,012 |

Financial Forecast

The emergency reserve is maintained at 8% of operating expenditures

The Sewer Operating Fund, however, does have the required 8% of operating expenditures in reserve. Contributions are necessary in all five years to maintain the 8% requirement.

Emergency Reserve

| Amounts in \$1,000 | 2003-04 | 2004-05 | 2005-06 | 2006-07 | 2007-08 |
|-------------------------|---------|---------|---------|---------|---------|
| Emergency Reserves (8%) | \$465 | \$480 | \$494 | \$508 | \$522 |

The forecast assumes that an average of 90,000 rounds per year will be played on the course

Golf Operating Fund

The Golf Operating Fund receives revenue primarily from green fees. The forecast utilizes the present fee structure and historical information to forecast revenues, thus the revenue remains constant throughout the forecast period. An average of 90,000 rounds per year is assumed. It should be noted that the multi-tiered fee structure and seasonal variances in play make forecasting revenue difficult. Expenditures presume the present level of services and have been increased based upon inflation.

2004 FINANCIAL FORECAST

Golf Fund Realistic Cash Flow from 2003-04 Adjusted Budget (Amounts in Thousands)

| | 2004-05 | 2005-06 | 2006-07 | 2007-08 | 2008-09 |
|--|---------|---------|---------|---------|---------|
| Beginning Net Working Capital Balance | -137 | -458 | -680 | -1,029 | -1,315 |
| Receipts | | | | | |
| Service Charges | 1,905 | 2,010 | 2,010 | 2,110 | 2,110 |
| Interest & Rents | 235 | 353 | 365 | 377 | 391 |
| Miscellaneous Income | 10 | 10 | 10 | 11 | 11 |
| Total Receipts | 2,150 | 2,373 | 2,385 | 2,498 | 2,512 |
| Disbursements | | | | | |
| GC Maintenance | 2,219 | 2,333 | 2,383 | 2,435 | 2,488 |
| Starter Operations | 192 | 198 | 204 | 209 | 215 |
| Depreciation | 60 | 60 | 136 | 136 | 136 |
| Total Disbursements | 2,471 | 2,592 | 2,723 | 2,780 | 2,839 |
| Emergency Reserve | 0 | 3 | 11 | 4 | 5 |
| Ending Net Working Capital Balance | -458 | -680 | -1,029 | -1,315 | -1,647 |

The Golf Operating Fund maintains a negative operating position for all five years of the forecast, thus reducing net working capital balances each year. The beginning net working capital balance is a negative \$458,000 for the current fiscal year and is projected to grow to a negative \$1.6 million.

Long Term Financial Plan

Options are presented in a separate Long Term Financial Plan issue paper

The Golf Course Operating Fund also has an outstanding debt to the General Fund of \$474,000 that is not scheduled to be repaid until a positive operating position has been obtained. This repayment amount is not included in the 2004 forecast. Options for changing the operating fund position are presented in a separate Long Term Financial Plan issue paper.

The Golf Course Operating Fund does have the required 8% of operating expenditures in reserve. Additional contributions are necessary to sustain the 8% level.

Emergency Reserve

| Amounts in \$1,000 | 2004-05 | 2005-06 | 2006-07 | 2007-08 | 2008-09 |
|-------------------------|---------|---------|---------|---------|---------|
| Emergency Reserves (8%) | \$161 | \$164 | \$175 | \$179 | \$184 |

Storm Drain Operating Fund

The Storm Drain Operating Fund receives revenue from storm drain fees. Revenues have been increased over the forecast period by anticipated growth in the City. Expenditures presume the present level of services and have been increased based upon inflation.

Storm Drain Operating Fund forecast

2004 FINANCIAL FORECAST
Storm Drain Fund Realistic Cash Flow from 2003-04 Adjusted Budget
 (Amounts in Thousands)

| | 2004-05 | 2005-06 | 2006-07 | 2007-08 | 2008-09 |
|--|--------------|--------------|--------------|--------------|--------------|
| Beginning Net Working Capital Balance | 96 | 368 | 647 | 929 | 1,202 |
| Receipts | | | | | |
| Service Charges | 1,078 | 1,104 | 1,131 | 1,147 | 1,148 |
| Interest & Rents | 5 | 6 | 6 | 6 | 6 |
| Miscellaneous Income | 0 | 0 | 0 | 0 | 0 |
| Total Receipts | 1,084 | 1,110 | 1,137 | 1,153 | 1,155 |
| Disbursements | | | | | |
| Storm Drain Administration | 577 | 596 | 614 | 631 | 650 |
| Storm Drain Maintenance | 226 | 233 | 239 | 246 | 253 |
| Trans. to Capital Improvement | 0 | 0 | 0 | 0 | 0 |
| Total Disbursements | 803 | 829 | 853 | 877 | 903 |
| Emergency Reserve | 9 | 2 | 2 | 2 | 2 |
| Ending Net Working Capital Balance | 368 | 647 | 929 | 1,202 | 1,452 |

Financial Forecast

Revenues are sufficient to sustain operating expenditures

The Storm Drain Operating Fund has a positive ending net working capital balance throughout the forecast period. Revenues are sufficient to sustain operating expenditures, maintenance and planned capital improvements.

A total of \$36,000 was set aside to meet the fiscal policy requirement of 8% of operating expenditures. Additional contributions in the next five years are required to maintain the 8% level.

Emergency Reserve

| Amounts in \$1,000 | 2004-05 | 2005-06 | 2006-07 | 2007-08 | 2008-09 |
|-------------------------|---------|---------|---------|---------|---------|
| Emergency Reserves (8%) | \$64 | \$66 | \$68 | \$70 | \$72 |

Clean Ocean Fund Forecast

Clean Ocean Operating Fund

The Clean Ocean Operating Fund receives revenue from the Urban Runoff Management fee. The Urban Runoff Management Fee was approved by San Clemente voters for a five year period and revenue from the fee is only included through the remaining three and a half years. Other revenues have been increased over the forecast period by anticipated growth in the City. Revenues from interest and fines are anticipated to continue in the last year of the forecast. Expenditures presume the present level of services and have been increased based upon inflation.

2004 FINANCIAL FORECAST

Clean Ocean Fund Realistic Cash Flow from 2003-04 Adjusted Budget (Amounts in Thousands)

| | 2004-05 | 2005-06 | 2006-07 | 2007-08 | 2008-09 |
|--|--------------|--------------|--------------|--------------|--------------|
| Beginning Net Working Capital Balance | 628 | 1,137 | 1,545 | 2,133 | 1,793 |
| Receipts | | | | | |
| Service Charges | 1,726 | 1,767 | 1,810 | 917 | 0 |
| Interest & Rents | 15 | 16 | 16 | 17 | 9 |
| Fines | 51 | 52 | 54 | 54 | 55 |
| Total Receipts | 1,792 | 1,835 | 1,880 | 989 | 64 |
| Disbursements | | | | | |
| Water Quality Inspection | 873 | 901 | 928 | 954 | 982 |
| Street Cleaning | 214 | 221 | 227 | 233 | 239 |
| Trans. to Capital Improvement | 195 | 305 | 137 | 142 | 635 |
| Total Disbursements | 1,283 | 1,427 | 1,291 | 1,330 | 1,857 |
| Emergency Reserve | 0 | 0 | 0 | 0 | 0 |
| Ending Net Working Capital Balance | 1,137 | 1,545 | 2,133 | 1,793 | 0 |

Long Term Financial Plan

All available balances are transferred to the Clean Ocean Improvement Fund for capital infrastructure projects. No reserve requirement has been established for the fund, since the Urban Runoff Management fee has only been approved for five years.

Reserve Analysis

Objective

To analyze and recommend appropriate levels of reserves to (a) ensure that they are adequate to provide for the needs of each fund program and (b) meet program needs without unnecessarily obligating scarce dollar resources.

Summary

The reserve funds analyzed include:

General Fund:

- General Fund – Emergency Reserve
- General Fund – City Council Contingency Reserve
- General Fund – Employee Computer Purchase Program Reserve

Internal Service Funds:

- General Liability Self-Insurance Fund
- Workers' Compensation Fund
- Fleet Replacement Reserve Fund

Special Revenue Funds:

- Accrued Leave Reserve
- Capital Equipment Replacement Reserve
- Facilities Maintenance Capital Asset Reserve

Enterprise Funds:

- Water Operating Fund – Emergency Reserve
- Water Fund Depreciation Reserve
- Sewer Operating Fund – Emergency Reserve
- Sewer Fund Depreciation Reserve
- Storm Drain Operating Fund – Emergency Reserve
- Storm Drain Fund Depreciation Reserve
- Solid Waste Fund – Emergency Reserve
- Golf Course Operating Fund – Emergency Reserve
- Golf Course Fund Depreciation Reserve
- Golf Course Fund Capital Improvement Reserve

Sound accounting and budgeting practices require that each fund maintain a positive fund balance and the appropriate level of reserve as dictated by the City's fiscal policy. The General Liability Self-Insurance Fund, Workers' Compensation Fund, and Fleet Replacement Reserve Fund are classified as internal service funds. These funds charge other City departments for services they provide and are adequate to fully recover the costs of providing the services. Additionally, these internal service funds should not carry large fund balances beyond what is necessary to fund reserves and recover costs. The Accrued Leave Reserve, Capital Equipment

Long Term Financial Plan

Replacement Reserve and Facilities Maintenance Capital Asset Reserve comprise the Reserve Fund which is classified as a special revenue fund. These reserves are supported by charges to other City departments and by transfers from the General Fund.

Background

The initial Long Term Financial Plan (LTFP) was completed in January 1993 and included a Reserve Analysis issue paper which has been updated on an annual basis. The 1993 LTFP made recommendations to fund negative fund balances existing in some of the internal service funds listed above. It also recommended that certain reserves be developed or expanded to appropriate levels (e.g. General Fund Emergency Reserve), and that other internal service funds be set up for the purpose of funding certain reserves that were deemed necessary at the time (Accrued Leave Reserve and Capital Equipment Replacement Reserve, which have since been moved to the Reserve Fund). The establishment of these reserve funds, along with reserve criteria, is contained in the City's Fiscal Policy. Please refer to the Fiscal Policy section of the LTFP for specific reserve criteria.

The following table summarizes the estimated balances of the various reserve and self-insurance funds through June 30, 2004.

| Reserves | Funding Source | Estimated Reserve Balances At June 30, 2004 | In Compliance With Fiscal Policy |
|---|------------------|--|--|
| General Fund Emergency Reserve | General Fund | \$2,681,640 | Yes |
| Council Contingency Reserve | General Fund | \$376,120 | Yes ¹ |
| Employee Computer Purchase Program | General Fund | \$18,525 | Yes |
| General Liability Self-Insurance | All Funds | \$1,837,930 | Yes |
| Workers' Compensation | All Funds | \$1,795,308 | Yes |
| Fleet Replacement | All Funds | \$3,142,382 | Yes |
| Accrued Leave | General Fund | \$175,520 | No |
| Capital Equipment Replacement | All Funds | \$856,230 | Yes |
| Facilities Maintenance Capital Asset | General Fund | \$468,700 | No |
| Water Operating Fund – Emergency Reserve | Water Fund | \$390,000 | Yes |
| Water Fund Depreciation | Water Fund | \$3,143,300 | N/A ² |
| Sewer Operating Fund – Emergency Reserve | Sewer Fund | \$438,000 | Yes |
| Sewer Fund Depreciation | Sewer Fund | \$7,472,900 | N/A ² |
| Storm Drain Operating Fund – Emergency Reserve | Storm Drain Fund | \$55,000 | No |

Reserve Analysis

| | | | |
|--|------------------|---------------------|------------------|
| Storm Drain Fund Depreciation | Storm Drain Fund | \$1,099,400 | N/A ² |
| Solid Waste Fund – Emergency Reserve | Solid Waste Fund | \$11,000 | Yes |
| Golf Course Operating Fund – Emergency Reserve | Golf Course Fund | \$161,000 | Yes |
| Golf Course Fund Depreciation | Golf Course Fund | \$506,700 | Yes |
| Golf Course Fund Improvement | Golf Course Fund | <u>\$1,314,200</u> | No |
| Total | | \$25,943,855 | |

¹ The Council Contingency Reserve is “zeroed out” at the end of each fiscal year, and re-established at the beginning of the next fiscal year.

² Currently, there is no target level established for these reserves.

The City implemented Government Accounting Standards Board (GASB) No. 34, at the end of fiscal year 2001-02. As part of the implementation, the City conducted a fixed asset physical inventory and an infrastructure valuation, which resulted in the recognition of a variety of assets in the City’s General Fund and Enterprise Funds, specifically, the Water, Sewer and Storm Drain Funds. Assets, such as the water, sewer and storm drain lines, which were not previously recognized on the City’s books, were capitalized, which increased depreciation expenses within these funds. Assets, such as the road network, which includes streets, sidewalks and curbs and gutters, were capitalized on the books of the General Fund. As a result of these two projects, annual depreciation expenses increased dramatically. However, the replacement reserves, which are comprised entirely of cash, did not increase at the time the assets were recognized and added to the City’s books. Current depreciation charges recognize the annual replacement costs for all assets, including the infrastructure assets added as a result of the GASB No. 34 conversion, but it is likely that the present depreciation reserves will not be adequate to replace the newly recognized assets at the time they require replacement.

To address the possible gap between the current depreciation reserves and the actual replacement costs of infrastructure assets, the City Engineering Department proposed a Water and Sewer System Asset Study during the FY 2002-03 budget process. That Study was approved and a Request For Proposal (RFP) was subsequently issued. The consulting firm of Brown and Caldwell was ultimately selected to conduct the Study, which is expected to be completed in June, 2004. This study will assess the current condition of the Water and Sewer System assets and determine the future replacement costs. Once the study has been completed, staff will provide recommendations to Council regarding asset replacement scheduling, reserve target levels and policies for funding the Water and Sewer System Assets. Staff will also provide recommendations to Council regarding asset replacement scheduling and reserve target levels for other funds affected by the infrastructure valuation project.

Each reserve listed on the first page of this report is detailed in the following sections along with the staff recommendations for the 2004-05 fiscal year.

Long Term Financial Plan

Analysis of the Funds/Reserves

The following guidelines have been used to analyze each fund or reserve:

- City Council Fiscal Policy
- Assessment of the current situation and conclusions
- Recommendations
- Fiscal impact of recommendations

General Fund - Emergency Reserve

City Council Fiscal Policy: Maintain an emergency reserve of no less than 8% of General Fund operating expenditures. The purpose of this reserve is to protect the City's essential service programs and funding requirements during periods of economic downturn, lasting two years or more, or other unforeseen catastrophic costs not covered by the Contingency Reserve. This reserve is to be accessed only upon the occurrence of serious conditions warranting emergency measures, and requires City Council approval prior to expenditure.

Assessment of the current situation/conclusions: Since the establishment of this reserve, no portion of it has been utilized. The current 8% reserve level is based on the City's aging infrastructure, history of naturally-caused damage (flooding, storms, etc.), potential recessionary or inflationary conditions and other such factors. Rating agencies generally acknowledge the need for a General Fund reserve of between 5-10%, depending on the factors indicated above. The Government Finance Officer's Association (GFOA) recommends a level equivalent to one month's operating expenditures, or 8.33%.

The current Financial Trend Analysis indicates that the City had an operating deficit in fiscal year 2001-02. This was the first operating deficit in the last eight years. Also, unreserved fund balance, as a percentage of operating revenues, decreased in FY 2001-02. It is therefore recommended that the emergency reserve be maintained at 8% of General Fund operating expenditures for FY 2004-05.

The following chart summarizes contributions made since the establishment of the emergency reserve and the percentage reached at the end of each fiscal year.

| | Contribution | Cumulative Total | Percentage |
|------------|---------------------|-------------------------|-------------------|
| FY 1992-93 | \$509,640 | \$509,640 | |
| FY 1993-94 | \$120,000 | \$629,640 | 3.30% |
| FY 1994-95 | \$150,000 | \$779,640 | 4.00% |
| FY 1995-96 | \$250,000 | \$1,029,640 | 5.02% |
| FY 1996-97 | -0- | \$1,029,640 | 5.00% |
| FY 1997-98 | -0- | \$1,029,640 | 4.97% |
| FY 1998-99 | \$ 40,000 | \$1,069,640 | 4.94% |
| FY 1999-00 | \$ 50,000 | \$1,119,640 | 5.05% |
| FY 2000-01 | \$500,000 | \$1,619,640 | 5.91% |

Reserve Analysis

| | | | |
|------------|-----------|-------------|--------------------|
| FY 2001-02 | \$682,000 | \$2,301,640 | 7.77% ² |
| FY 2002-03 | \$210,000 | \$2,511,640 | 7.66% |
| FY 2003-04 | \$170,000 | \$2,681,640 | 7.79% ³ |

¹ Fiscal Policy established reserve at 5% in FY 1996-97

² Fiscal Policy established reserve at 8% in FY 2001-02

³ At the time the 2003 LTFP was prepared, the \$170,000 contribution brought the emergency reserve up to the required 8% level. Due to subsequent budget adjustments during the year, the emergency reserve now represents 7.79% of projected General Fund operating expenditures.

Recommendations: Budget sufficient funds for FY 2004-05 in order to bring the emergency reserve to the 8% level of projected General Fund operating expenditures. Based on the Financial Forecast, this would amount to \$330,000; however, expenditures may be less.

Fiscal Impact of Recommendations: Projected General Fund expenditures over the next five years, as outlined in the Financial Forecast, will require total five-year contributions to the emergency reserve of \$1,070,000. The reserve will be maintained at the 8% level throughout the five-year forecast as General Fund operating expenditures increase.

General Fund - City Council Contingency Reserve

City Council Fiscal Policy: Maintain a reserve of no less than 1% of General Fund operating expenditures per year. The purpose of this reserve is to provide for non-recurring, unanticipated expenditures, or to set aside funds to cover known contingencies with unknown costs. This reserve requires City Council approval prior to expenditure.

Assessment of the current situation/conclusions: Unlike the General Fund Emergency Reserve, this reserve has been drawn upon annually to fund unanticipated expenditures as they have occurred over the past several years. It is anticipated that the need to draw upon this contingency reserve will continue in future years.

The table below shows the average expenditures from the Council Contingency Reserve for the past ten years and the year-to-date expenditures for FY 2003-04:

| | |
|--------------------------------|---------------------|
| Average expenditures –10 years | 195,512 |
| FY 2003-04 (through 11/15/03) | 86,386 ¹ |

¹ \$15,730 for review of Coastal Bluffs Canyons, \$14,282 for Marine Safety Bldg. assessment and repair, \$1,680 for City Flags, \$1,694 for match of LLEBG, \$18,000 for Crossing guard program, and \$35,000 for Beach Replenishment program.

Expenditures made from this reserve are analyzed annually during the LTFP process. Current fiscal policy for the Council Contingency Reserve, revised in fiscal year 1999-00, reads as follows, "...The level of the Council Contingency Reserve will be established as needed, but will not be less than 1% of General Fund operating expenditures annually". Based on this policy, it is recommended that the Council Contingency Reserve be set at \$376,120 for FY 2004-05.

Long Term Financial Plan

Recommendation: Recommend that \$376,120 (which represents 1% of the estimated General Fund operating expenditures) be set aside in fiscal year 2004-05 to fund the Council Contingency Reserve.

Fiscal Impact of Recommendation: General Fund expenditures for the Council Contingency Reserve for the five-year forecast period will total \$2,131,260.

General Fund – Employee Computer Purchase Program Reserve

City Council Fiscal Policy: Maintain a reserve for the purpose of providing no-interest loans to employees for the purpose of acquiring or enhancing the employee's personal computer system. The reserve will be reviewed annually to determine if the reserve balance is adequate to cover estimated loan balances.

Assessment of the current situation/conclusions: The Employee Computer Purchase Program was established in fiscal year 1990-91. This program is a partnership agreement between the City and employees whereby the City provides three-year, no-interest loans to employees for the purpose of acquiring or enhancing the employee's personal computer system. Each eligible employee can participate up to a maximum loan amount of \$3,000. Loans must be repaid over the three-year period through bi-weekly payroll deductions. This is a self-funding program by which available funds come from loan repayments from other employees. The program was initially established with a \$100,000 transfer from the General Fund in fiscal year 1990-91. The reserve was reduced to \$75,000 based on the Reserve Analysis conducted during the 2002 LTFP.

To be eligible to participate in this program, individuals must be a regular, full-time employee or a regular, part-time employee with more than one year of continuous service. Applications must demonstrate how the City would benefit by providing a computer loan. Computer loan requests are reviewed and approved by the City's Computer Action Team (CAT).

The table below shows the average number of employees participating and the amount loaned over the last five fiscal years:

| <u>Fiscal Year</u> | <u>Ave. Employees Participating</u> | <u>Ave. Amount Loaned</u> |
|----------------------|---|-------------------------------|
| FY 98-99 to FY 02-03 | 18 | \$41,770 |

To date, there has been adequate funding to support the Employee Computer Purchase Program. The reserve balance as of June 30, 2004 is estimated to be \$18,525. This balance plus loan repayments during the year is expected to be more than adequate to cover new loan approvals for FY 2004-05.

Reserve Analysis

Recommendation: None

Fiscal Impact of Recommendation: The Employee Computer Purchase Program Reserve is in a positive financial position with an estimated positive balance at the end of FY 2003-04.

General Liability Self-Insurance Fund

City Council Fiscal Policy: Maintain a reserve in the City's self-insurance fund which, together with purchased insurance policies, adequately protects the City. The City will maintain a reserve of three times its self-insurance retention (SIR). Additionally, this fund will be evaluated on an annual basis to document those claims which are not covered by the insurance pool to which the City belongs, and reserve an additional appropriate amount to pay for such uncovered claims.

Assessment of the current situation/conclusions: The City's SIR is currently \$100,000, which requires a reserve in this fund of \$300,000, or three times the SIR. The projected year-end fund balance in the General Liability Self-Insurance Fund for FY 2003-04 is \$1,291,900. This balance is in addition to the \$300,000 reserve for SIR losses, and the \$246,000 reserve established per the 2003 LTFP for uncovered claims losses.

There are several types of occurrences that are excluded from the liability insurance coverage purchased through the California Insurance Pool Authority (CIPA). These uncovered losses include: 1) breach of contract, 2) inverse condemnation, 3) eminent domain, 4) land subsidence, 5) earth movement, 6) employment-related issues, 7) release of toxic material, 8) punitive damages, 9) earthquakes, and 10) a \$250,000 deductible on floods. All uncovered claims losses for the past five years have been analyzed to determine the appropriate reserve requirement for these claims. The total cost for these claims was \$1,625,000, or a five-year average of \$325,000. This is an increase of \$79,000 from the prior year average of \$246,000. This would increase the total reserve for claims losses from \$546,000 to \$625,000.

In addition, there are currently some outstanding claims for unusually large amounts. In the annual confirmation letter that the City Attorney prepares for the auditors, it has been estimated that total outstanding claims not covered by insurance are in excess of \$10.3 million. This does not include the costs of defending these cases. While the City does not anticipate that the final cost of these claims will be this high, it is always prudent to set aside reserves to cover potential uncovered claims.

During fiscal year 2001-02, a transfer from the General Fund of \$1.5 million dollars was made to the General Liability Fund to cover the increased costs related to the legal defense of the uncovered claims referenced above and to bring the General Liability Fund reserve into Fiscal Policy compliance. In addition, a comprehensive analysis of the General Liability Fund was proposed and approved as recommended in the 2002 LTFP. That analysis will be conducted as part of a Risk Assessment Request For Quotation (RFQ) presently out to bid.

Charges to other funds are based on a five-year average of historical claims (25%), and also on an allocation basis to account for risk related to each fund. This second (75%) factor is based on

Long Term Financial Plan

prior year budgeted expenditures as a percentage of total budgeted expenditures. This methodology is based on standards recognized by the Insurance Institute of America regarding essentials of risk financing. The following table shows the calculations for charges to other funds for FY 2004-05:

| | % of Past Claims (25%) | % of Budgeted Expenditures (75%) | Total % of General Liability Charges (weighted average) | Total Charge for General Liability FY 2004-05 | Total Charge for General Liability FY 2003-04 |
|------------------------------|---|---|--|--|--|
| General Fund | 64.0% | 58.0% | 59.6% | \$ 721,230 | \$ 599,850 |
| Street Improvement Fund | 1.0% | 3.0% | 2.5% | 30,516 | 0 |
| Water Fund | 1.0% | 17.0% | 12.9% | 155,849 | 135,620 |
| Sewer Fund | 5.0% | 9.0% | 7.9% | 95,302 | 84,400 |
| Solid Waste Fund | 0.0% | 0.0% | 0.2% | 2,387 | 1,450 |
| Storm Drain Fund | 15.0% | 1.0% | 4.8% | 58,572 | 94,900 |
| Golf Course Fund | 14.0% | 4.0% | 6.3% | 75,805 | 52,010 |
| Clean Ocean Fund | 0.0% | 3.0% | 1.9% | 23,238 | 0 |
| Information Services Fund | 0.0% | 1.0% | 0.9% | 11,153 | 9,020 |
| Central Services Fund | 0.0% | 1.0% | 0.5% | 6,464 | 5,620 |
| Fleet Maintenance Fund | 0.0% | 1.0% | 1.0% | 11,905 | 8,620 |
| Redevelopment Agency | 0.0% | 2.0% | 1.5% | 18,528 | 46,920 |
| Total | 100.0% | 100.0% | 100.0% | \$1,210,949 | \$1,038,410 |

The total charge for General Liability will increase by \$172,538 from FY 2003-04 to FY 2004-05. The increase is largely a result of the increase of the five-year average of actual claims.

The General Fund's total percentage of liability charges increased from the previous year by 2% due to the increase of actual claims associated with the General Fund and the resulting increase in the percentage of past claims to total claims. The Street Improvement Fund experienced claims during the prior fiscal year. As a result, the fund, which paid no premiums for the current fiscal year, will receive an allocation of the liability premiums for the next fiscal year.

Recommendation: Increase the specified reserve in the General Liability Self-Insurance Fund from the current reserve of \$546,000 to \$625,000 for the fiscal year 2004-05. The reserve includes three times the self-insurance retention (\$300,000), plus the average of the previous five years of claims costs not covered by the insurance pool (\$325,000).

Reserve Analysis

Fiscal Impact of Recommendation: The General Liability Self-Insurance Fund is in a positive financial position with an estimated positive balance at the end of FY 2003-04 and its basic reserve requirement of \$300,000 fully funded. In addition, \$325,000 will be reserved for payment of those claims not covered by CIPA.

Workers' Compensation Fund

City Council Fiscal Policy: Maintain a reserve in the City's self-insurance fund which, together with purchased insurance policies, adequately protects the City. The City will maintain a reserve of three times its self-insurance retention (SIR). Additionally, this fund will be evaluated on an annual basis to document those claims which are not covered, and reserve an additional appropriate amount to pay for such uncovered claims.

Assessment of the current situation/conclusions: During fiscal year 2002-03, the City converted from a fully-insured to a self-insured program. Prior to 1995, the City had been self-insured. Two factors; the conversion of Police and Fire personnel to outside contract, and the favorable insurance market, led the City to convert to a fully-insured program in 1995. Unfortunately, the City experienced excessive rate increases, beginning in fiscal year 2000-01, as the market for Worker's Compensation insurance in California became uncompetitive. During this period the City's actual claims experience averaged only \$90,000 per year. As a result of these conditions, City Council authorized the City to self-insure for worker's compensation coverage through the California Public Insurance Agency (CIPA) in December 2002.

There are currently three components to the City's worker compensation exposure: 1) Outstanding claims prior to 1995 when the City was previously self-insured. The City currently pays a third-party administrator, and is responsible for paying the remaining "tail" of claims incurred when the City was self-insured. Most of these open, self-insured claims are related to police and fire services employees who are no longer City employees; 2) Claims for the period beginning in 1995 and ending December 1, 2002. These claims are fully insured and represent no liability to the City; and 3) Claims under the new self-insurance program which began December 1, 2002.

Annually, the City's third-party administrator calculates the outstanding liability of the remaining "tail" of claims incurred when the City was previously self-insured. As of November 30, 2003, these estimated claims total \$638,704. This is a reduction from last year's estimate of \$752,620 for these "tail" claims.

Since claims for the period from 1995 through December 1, 2002 are fully insured, there is no exposure to the City, and therefore, no reserve is recommended.

Under the self-insurance program adopted December 1, 2002, the City is responsible for a \$300,000 Self-Insurance Retention. CIPA provides pooled liability coverage for claims in excess of the \$300,000 SIR limit. The City's average annual claims amount paid for the prior five years

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is \$89,438. The reserve balance at the end of fiscal year 2002-03 totaled \$1,349,437 and is projected to increase to \$1,795,308 through June 30, 2004.

The City's fiscal policy, as noted above, requires three times the self-insurance retention, plus an amount equal to the total uncovered claims. This will require a reserve equal to \$900,000, plus the estimated total for the "tail" claims of \$638,704 noted above, for a total reserve of \$1,538,704. The estimated reserve balance at June 30, 2004 totals \$1,795,308 (currently comprised of \$752,620 set aside specifically for the "tail" claims and \$1,042,688 in general reserves). Based on this analysis, the reserve is projected to be fully funded as of June 30, 2004.

All City funds will continue to be charged for premiums and administrative costs paid by the Workers' Compensation Fund. The rates charged to these funds are based on each fund's employees' classifications and the type of work performed (e.g. manual labor, clerical, etc.). These rates will be held constant for the next fiscal year, that is, they will remain the same as currently charged.

Recommendation: Charge existing worker's compensation rates for fiscal year 2004-05.

Fiscal Impact of Recommendation: Existing rates charged to all funds will be sufficient to pay for all premium expenses and administrative expenses incurred by the Workers' Compensation Fund.

Fleet Replacement Reserve Fund

City Council Fiscal Policy: Maintain a reserve for costs associated with the replacement of vehicles and other rolling stock (such as trailers, compressors or other equipment on wheels) as they become unserviceable, obsolete or reach a predetermined service life. The reserve will be maintained at a level at least equal to the projected five-year fleet replacement costs.

Assessment of the current situation/conclusions: The City's Fiscal Policy was revised in the 2002 LTFP to include the Fleet Replacement Reserve. The reserve is reviewed annually to verify funding is adequate to cover projected replacement costs for the next five years. This reserve is fully funded with a projected ending balance of \$3,142,382 at June 30, 2004.

Recommendation: None.

Fiscal Impact of Recommendation: Contributions for the replacement of City fleet vehicles and equipment will continue to be charged to user funds. The FY 2004-05 budget will contain normal replacement charges to other funds of \$581,860.

Accrued Leave Reserve

City Council Fiscal Policy: Maintain an account to accumulate funds for the payment of accrued employee benefits to terminated employees. The level of this reserve will be maintained at a level at least equal to projected costs for employees who are eligible for retirement.

Reserve Analysis

Assessment of the current situation/conclusions: The accrued leave reserve was established in FY 1994-95 based on average annual General Fund expenditures for vacation and sick leave payoffs. The amount of this reserve fluctuates annually based upon the number of employees and the length of service (amount of accrued leave).

| | |
|------------------------|-----------|
| Average Annual Payoffs | \$ 54,950 |
|------------------------|-----------|

The projected ending balance for the Accrued Leave Reserve as of June 30, 2004 is \$175,520. At June 30, 2003, the total General Fund liability for accrued leave was \$862,930. Of this amount, \$270,625 represents the liability for employees who currently are age 55 or older or will be age 55 or older by June 30, 2005. While these employees may not all retire at once, it is recommended that \$145,000 be transferred from the General Fund to the Accrued Leave Reserve to ensure adequate funds are available for payment of potential liabilities.

Recommendation: Transfer \$145,000 from the General Fund to the Accrued Leave Reserve for fiscal year 2004-05.

Fiscal Impact of Recommendation: The Accrued Leave Reserve will be reviewed annually to determine additional transfers necessary to fund the on-going liabilities. For the five-year forecast, transfers to fund the Accrued Leave Reserve are estimated at \$345,000.

Capital Equipment Replacement Reserve

City Council Fiscal Policy: Maintain a Capital Equipment Replacement Reserve for the accumulation of funds for the replacement of worn and obsolete equipment other than vehicles.

Assessment of the current situation/conclusions: As of June 30, 2003, the General Fund capital equipment asset balance was \$1,092,000. Since the time of this fund's establishment in FY 1994-95, the General Fund has made transfers of \$960,100 to fund this reserve. The projected fund balance at June 30, 2004 is \$856,230. The reserve has been analyzed for the five-year forecast period, based on average historical costs adjusted for inflation. No transfer is required for FY 2004-05, as the reserve is fully funded for the projected five-year costs. Therefore, if the City were to hit an economic downturn and no funding was available for capital needs, the reserve would be available to cover those capital needs for the next five years without having to lower the City's standards on capital purchases.

As General Fund fixed assets are replaced, the capital expenditures are made from this fund. The replacement costs for these assets are charged to the benefiting General Fund program and transferred back to the Capital Equipment Replacement Reserve, thus accumulating funds to pay for future replacement of these assets.

Recommendation: None.

Long Term Financial Plan

Fiscal Impact of Recommendations: Contributions for the replacement of capital equipment will continue to be charged to user funds. The FY 2004-05 budget will contain normal replacement charges to other funds of \$108,200.

Facilities Maintenance Capital Asset Reserve

City Council Fiscal Policy: Maintain an account to cover the costs associated with the maintenance of all City facilities. The reserve should be maintained at a level at least equal to the projected five-year facilities maintenance costs.

Assessment of the current situation/conclusions: The City established the Facilities Maintenance Capital Asset Reserve in 2001. As City facilities age, maintenance expenditures become more critical. A reserve to fund these maintenance expenditures was established and covers costs such as flooring replacement, roof replacement, interior and exterior painting, HVAC replacement and parking lot seal coat/stripping for all City facilities, plus the compressor, speed drive and boiler for the City pool.

An analysis has been completed projecting out the facilities maintenance costs for the next five years, using estimated replacement cycles between seven and thirty years, depending upon the type of maintenance to be performed. The projected costs were then allocated over the term of the estimated replacement cycle. The projected cost for the next five years has been calculated as \$623,900. The reserve balance is projected to be \$468,700 as of the end of fiscal year 2003-04. The recommendation will be to transfer \$100,000 to the reserve annually for the next five fiscal years to fully fund the five-year projected costs. Annually, projected five-year costs for maintenance of all City facilities will be determined by the Maintenance Services Division and reviewed by the Finance Division.

Recommendations: Transfer \$100,000 from the General Fund to the Facilities Maintenance Capital Asset Reserve for fiscal year 2004-05.

Fiscal Impact of Recommendations: Projected General Fund expenditures over the next five years will require total five-year contributions to the reserve of \$500,000.

Water Operating Fund - Emergency Reserve

City Council Fiscal Policy: The City's Enterprise Funds will maintain a minimum reserve level at least equal to 8% of operating expenditures. The primary purpose of this reserve is to set aside funds to provide for unanticipated or emergency expenditures that could not be reasonably foreseen during the preparation of the budget.

Assessment of the current situation/conclusions: The following chart summarizes all contributions made since the establishment of this emergency reserve and the percentage reached at the end of each fiscal year.

Reserve Analysis

| | <u>Contribution</u> | <u>Cumulative Total</u> | <u>Percentage</u> |
|------------|---------------------|-------------------------|-------------------|
| FY 2000-01 | \$335,000 | \$335,000 | 8.00% |
| FY 2001-02 | \$10,000 | \$345,000 | 8.00% |
| FY 2002-03 | \$15,000 | \$360,000 | 8.00% |
| FY 2003-04 | \$30,000 | \$390,000 | 8.35% |

Recommendations: Budget \$5,000 from the Water Operating Fund in FY 2004-05 in order to bring the emergency reserve to \$395,000, which will maintain the 8% of projected Water Fund operating expenditures level.

Fiscal Impact of Recommendations: Projected Water Fund expenditures over the next five years, as outlined in the Financial Forecast, will require total five-year contributions to the emergency reserve of \$115,000. The reserve will be maintained at the 8% level throughout the five-year forecast as the Water Fund operating expenditures increase.

Water Depreciation Reserve

City Council Fiscal Policy: None.

Assessment of the current situation/conclusions: The Water Depreciation Reserve was established to set aside funds for the replacement of Water Fund equipment that has reached the end of its useful life and for major repairs to the water system infrastructure. The reserve is reviewed annually to verify funding is adequate to cover at least projected costs for the next five years. The projected ending balance at June 30, 2004 is \$3,143,300. The projected replacement costs for the next five-year period totals \$7,802,500. Based on this, the Depreciation Reserve is currently under funded by \$1,079,900.

Depreciation expenses have increased from \$690,000 to \$746,000 per year as a result of major capital projects completed and placed into service in the past year. As a result of the GASB 34 conversion, completed June 30, 2002, additional infrastructure was recognized by the City. The additional infrastructure was not addressed by the annual depreciation charges prior to June 30, 2002, and thus, has not contributed to the depreciation reserve in the past. In an effort to address this potential shortfall, the City's Engineering Department initiated a Water System Asset Study, which when completed, will provide recommendations regarding appropriate reserve levels, asset replacement scheduling and revised policies for funding the Water Depreciation Reserve.

Recommendations:

1. Budget an additional \$200,000 transfer from the Water Operating Fund to the Water Depreciation Fund for Fiscal Year 2004-05.
2. Defer policy changes until the completion of the Water and Sewer System Asset Study.

Long Term Financial Plan

Fiscal Impact of Recommendation: Annual depreciation charges will continue to be charged to the Water Operating Fund. The depreciation charges for the five-year forecast period are \$4,223,200. An additional \$1,000,000 will be required over the next five years to properly fund the Depreciation Reserve.

Sewer Operating Fund - Emergency Reserve

City Council Fiscal Policy: The City's Enterprise Funds will maintain a minimum reserve level at least equal to 8% of operating expenditures. The primary purpose of this reserve is to set aside funds to provide for unanticipated or emergency expenditures that could not be reasonably foreseen during the preparation of the budget.

Assessment of the current situation/conclusions: The following chart summarizes all contributions made since the establishment of this emergency reserve and the percentage reached at the end of each fiscal year.

| | <u>Contribution</u> | <u>Cumulative Total</u> | <u>Percentage</u> |
|------------|---------------------|-------------------------|-------------------|
| FY 1998-99 | \$310,000 | \$310,000 | 8.00% |
| FY 1999-00 | \$5,000 | \$315,000 | 8.00% |
| FY 2000-01 | \$69,000 | \$384,000 | 8.00% |
| FY 2001-02 | \$41,000 | \$425,000 | 8.00% |
| FY 2002-03 | \$13,000 | \$438,000 | 8.25% |
| FY 2003-04 | -0- | \$438,000 | 7.74% |

Recommendations: Budget \$27,000 from the Sewer Operating Fund in FY 2004-05 in order to bring the emergency reserve to \$465,000, which represents 8% of the projected Sewer Fund operating expenditures level.

Fiscal Impact of Recommendations: Projected Sewer Fund expenditures over the next five years, as outlined in the Financial Forecast, will require total five-year contributions to the emergency reserve of \$84,000. The reserve will be maintained at the 8% level throughout the five-year forecast as the Sewer Fund operating expenditures increase.

Sewer Depreciation Reserve

City Council Fiscal Policy: None.

Assessment of the current situation/conclusions: The Sewer Depreciation Reserve was established to set aside funds for the replacement of Sewer Fund equipment that has reached the end of its useful life and for major repairs to the sewer system infrastructure. The reserve is reviewed annually to verify funding is adequate to cover at least projected costs for the next five years. The projected ending balance at June 30, 2004 is \$7,472,900.

Reserve Analysis

Current depreciation charges amount to \$1,689,700 per year. There are a number of significant projects planned and in process, which will further increase the annual depreciation charges. As a result of the GASB 34 conversion, completed June 30, 2002, additional infrastructure was recognized by the City. The additional infrastructure was not addressed by the annual depreciation charges prior to June 30, 2002, and thus, has not contributed to the depreciation reserve in the past. As a result, the City's Engineering Department has initiated a Sewer System Asset Study, which when completed, will provide additional recommendations regarding appropriate reserve levels, asset replacement scheduling and revised policies for funding the Sewer Depreciation Reserve.

Recommendation: Defer policy changes until the completion of the Sewer System Asset Study.

Fiscal Impact of Recommendation: Annual depreciation charges will continue to be charged to the Sewer Operating Fund. The depreciation charges for the five-year forecast period are \$8,969,200.

Storm Drain Operating Fund - Emergency Reserve

City Council Fiscal Policy: The City's Enterprise Funds will maintain a minimum reserve level at least equal to 8% of operating expenditures. The primary purpose of this reserve is to set aside funds to provide for unanticipated or emergency expenditures that could not be reasonably foreseen during the preparation of the budget.

Assessment of the current situation/conclusions: The following chart summarizes all contributions made since the establishment of this emergency reserve and the percentage reached at the end of each fiscal year.

| | <u>Contribution</u> | <u>Cumulative Total</u> | <u>Percentage</u> |
|------------|---------------------|-------------------------|-------------------|
| FY 2001-02 | \$35,000 | \$35,000 | 8.00% |
| FY 2002-03 | \$1,000 | \$36,000 | 5.35% |
| FY 2003-04 | \$19,000 | \$55,000 | 6.92% |

Recommendations: Budget \$9,000 from the Storm Drain Operating Fund for FY 2004-05 in order to bring the emergency reserve to \$64,000, which will maintain the 8% of projected Storm Drain Fund operating expenditures level.

Fiscal Impact of Recommendations: Projected Storm Drain Fund expenditures over the next five years, as outlined in the Financial Forecast, will require total five-year contributions to the emergency reserve of \$17,000. The reserve will be maintained at the 8% level throughout the five-year forecast as the Storm Drain Fund operating expenditures increase.

Long Term Financial Plan

Storm Drain Depreciation Reserve

City Council Fiscal Policy: None.

Assessment of the current situation/conclusions: The Storm Drain Depreciation Reserve was established to set aside funds for the replacement of Storm Drain Fund equipment that has reached the end of its useful life and for major repairs to the storm drain utility system infrastructure. The reserve is reviewed annually to verify funding is adequate to cover at least projected costs for the next five years. This reserve is projected to have an ending balance of \$1,099,400 at June 30, 2004. Proposed capital project expenditures for the next five fiscal years total \$3,014,650.

Current annual depreciation expense amounts to \$353,000 per year. The City's Engineering Department has initiated a Storm Drain System Asset Study, which when completed, will provide recommendations regarding asset replacement scheduling and revised policies for funding the Storm Drain Depreciation Reserve.

Recommendation: Defer policy changes until the completion of the Storm Drain System Asset Study.

Fiscal Impact of Recommendation: Annual depreciation charges will continue to be charged to the Storm Drain Operating Fund. The depreciation charges for the five-year forecast period are \$1,902,575. Continuing transfers from the Storm Drain and Clean Ocean Operating Funds are projected to be \$700,000 and \$686,000 respectively over the five-year period.

Solid Waste Fund - Emergency Reserve

City Council Fiscal Policy: The City's Enterprise Funds will maintain a minimum reserve level at least equal to 8% of operating expenditures. The primary purpose of this reserve is to set aside funds to provide for unanticipated or emergency expenditures that could not be reasonably foreseen during the preparation of the budget.

Assessment of the current situation/conclusions: The following chart summarizes all contributions made since the establishment of this emergency reserve and the percentage reached at the end of each fiscal year.

| | <u>Contribution</u> | <u>Cumulative Total</u> | <u>Percentage</u> |
|------------|---------------------|-------------------------|-------------------|
| FY 2001-02 | \$10,000 | \$10,000 | 8.00% |
| FY 2002-03 | -0- | \$10,000 | 7.91% |
| FY 2003-04 | \$1,000 | \$11,000 | 8.80% |

The current reserve balance will maintain the required 8% level for the projected year-end of FY 2003-04. Therefore, no contribution will be needed for FY 2004-05.

Reserve Analysis

Recommendations: Based on the Financial Forecast, no contribution is necessary for FY 2004-05 in order to maintain the emergency reserve at \$11,000, which represents 8% of the projected Solid Waste Fund operating expenditures level.

Fiscal Impact of Recommendations: Projected Solid Waste Fund expenditures over the next five years, as outlined in the Financial Forecast, will require total five-year contributions to the emergency reserve of \$1,000. The reserve will be maintained at the 8% level throughout the five-year forecast as the Solid Waste Fund operating expenditures increase.

Golf Course Operating Fund - Emergency Reserve

City Council Fiscal Policy: The City's Enterprise Funds will maintain a minimum reserve level at least equal to 8% of operating expenditures. The primary purpose of this reserve is to set aside funds to provide for unanticipated or emergency expenditures that could not be reasonably foreseen during the preparation of the budget.

Assessment of the current situation/conclusions: The following chart summarizes all contributions made since the establishment of this emergency reserve and the percentage reached at the end of each fiscal year.

| | <u>Contribution</u> | <u>Cumulative Total</u> | <u>Percentage</u> |
|------------|---------------------|-------------------------|-------------------|
| FY 2001-02 | \$149,000 | \$149,000 | 8.00% |
| FY 2002-03 | \$4,000 | \$153,000 | 8.79% |
| FY 2003-04 | \$8,000 | \$161,000 | 8.57% |

Recommendations: Based on the Financial Forecast, no contribution is necessary for FY 2004-05 in order to maintain the emergency reserve at \$161,000, which represents 8% of the projected Golf Course Operating Fund operating expenditures level.

Fiscal Impact of Recommendations: Projected Golf Course Fund expenditures over the next five years, as outlined in the Financial Forecast, will require total five-year contributions to the emergency reserve of \$23,000. The reserve will be maintained at the 8% level throughout the five-year forecast as the Golf Course Fund operating expenditures increase.

Golf Course Depreciation Reserve

City Council Fiscal Policy: None.

Assessment of the current situation/conclusions: The Golf Course Depreciation Reserve was established to set aside funds for the replacement of Golf Course Fund equipment/physical plant that has reached the end of its useful life. The reserve is reviewed annually to verify funding is adequate to cover at least projected costs for the next five years. The projected ending balance at June 30, 2004 is \$506,700. Projected expenditures for the next five years total \$400,000.

Long Term Financial Plan

Recommendation: Revise the City's Fiscal Policy to specifically include the Golf Course Depreciation Reserve. "The City will establish a Golf Course Depreciation Reserve for costs associated with the replacement of equipment/physical plant and course improvements as they become unserviceable, obsolete, or reach a predetermined service life. The reserve will be maintained at a level at least equal to the projected five-year Golf Course replacement costs."

Fiscal Impact of Recommendation: Annual depreciation charges will continue to be charged to the Golf Course Operating Fund. The depreciation charges for the five-year forecast period are \$1,115,900.

Golf Course Improvement Reserve

City Council Fiscal Policy: The City will maintain a Golf Course Improvement Reserve for costs associated with capital improvements budgeted in the Golf Course Fund. The reserve will be maintained at a level at least equal to the projected five-year costs.

Assessment of the current situation/conclusions: The Golf Course Improvement Reserve was established to set aside funds for capital improvements budgeted in the Golf Course Fund. The reserve is reviewed annually to verify funding is adequate to cover projected costs for the next five years. The new clubhouse improvement project is assumed to be completed during fiscal year 2004-05. Based on the project costs indicated below, the Golf Course Improvement Reserve is projected to have an ending balance of \$1,314,200 at June 30, 2004. However, the reserve will have a negative balance at the end of fiscal year 2004-05 based on the projected costs of the new clubhouse. The reserve will require an additional contribution of \$400,000 to fully fund the clubhouse construction by the end of fiscal year 2004-05.

At the end of the five-year forecast, the reserve is projected to have a negative balance of (\$36,500) (assumptions include the continuance of the annual \$160,000 transfer from the Golf Course Operating Fund). The projects scheduled to be paid out of the reserve over the next five years are the new clubhouse improvement project (\$3,641,650) and relining of the golf course reservoir (\$200,000).

In order to fund the clubhouse construction and the other golf improvement projects, the following transfer is recommended: (1) an annual transfer of \$160,000 from the Golf Course Operating Fund to the Golf Course Improvement Reserve.

Recommendation: Continue the annual transfer of \$160,000 from the Golf Course Operating Fund to the Golf Course Improvement Fund.

Fiscal Impact of Recommendation: Annual transfers of \$160,000 will continue to be charged to the Golf Course Operating Fund. The transfer charges for the five-year forecast period are \$800,000.

Reserve Analysis

Council Action

All recommendations were approved by the City Council by a vote of 5-0 on February 3, 2004.

Long Term Financial Plan

Street Improvement Program Update

Objective

To provide an update of the City's Street Improvement Program and project short and long term funding requirements.

Background

The Street Improvement Program was adopted by the City Council in July 1995. This program is to restore about 60 miles or one-half of the City's street system over 18 years. The program is being funded by a combination of revenues from (1) Street Assessment District 95-1, which assesses all developed properties; (2) the General Fund; and (3) the Gas Tax Fund. In addition, the Water, Sewer, and Storm Drain Funds pay for work done to various underground facilities in conjunction with the street work.

Even though half the streets included in the Street Improvement Program were originally scheduled to be rehabilitated in the first six years, the City has accelerated the program. Bonds were sold in the second year versus the originally planned third year of the program. In addition, cost savings and grants obtained from the State have allowed several projects to be constructed a few years earlier than originally scheduled.

Program Status

Since the approval of the program in July 1995, one hundred and forty (140) street projects have been completed and three (3) projects are under construction. An additional thirty (30) projects are scheduled to be constructed within FY 2003/04 and FY 2004/05. Of the 173 street projects, 57 projects were accelerated from their original schedule. Forty-three (43) projects were accelerated within the first 10-year period and fourteen (14) street projects were accelerated from beyond the 10-year period.

- **Completed projects (totaling 40.83 miles):**

There are one hundred and forty (140) street projects. Approximately 68% of the program mileage has been completed since the Street Program approval. Exhibit "A" lists all the completed projects.

- **Projects under construction (totaling 1.41 miles):**

These projects are under construction. It is anticipated that the construction of these street projects will be completed prior to the end of FY 2003/04:

1. Avenida Salvador from Avenida San Juan to Avenida San Pablo.
2. Avenida Salvador from Calle Malaguena to Avenida San Juan.
3. Calle La Serna from Avenida San Pablo to cul-de-sac.

- **Projects scheduled for construction during FY 2003/04 & FY 2004/05 (totaling 4.88 miles):**

Long Term Financial Plan

The following thirty (30) street projects are scheduled to be constructed during FY 2003/04 and FY 2004/05:

1. Via Arboleda from Via Montego to Via Alegre.
2. Via Bandita from Via Montego to Via Alegre.
3. Via Verbena from Via Montego to Via Alegre.
4. Via Casa Loma from Via Montego to Via Alegre.
5. Via Lado from Via Montego to Via Alegre.
6. Via Montecito from Via Montego to Via Alegre.
7. Via Montezuma from Via Montego to Via Alegre.
8. Via Santo Tomas from Via Montego to Via Alegre.
9. Via Vistosa from Via Montego to Via Alegre.
10. Calle Alondra from Mira Costa to Quieta.
11. Calle Quieto from Calle Grande Vista to Calle Grande Vista.
12. Calle Guaymas from Calle La Veta to Camino Mira Costa.
13. Calle La Veta from Camino Mira Costa to cul-de-sac.
14. Grande Vista from Calle Quieto to Avenida Vaquero.
15. Via Nada from Calle Grande Vista to cul-de-sac.
16. Avenida Hacienda from Sacramento to Avenida Florencia.
17. Calle Las Bolas from Avenida Florencia to El Camino Real.
18. Boca De La Playa from cul-de-sac to El Camino Real.
19. Avenida Pico from El Camino Real to Boca De La Playa.
20. Calle Majorca from La Riviera to cul-de-sac.
21. Calle Monte Carlo from La Riviera to cul-de-sac.
22. Calle Monaco from La Costa to La Riviera.
23. Calle Monte Cristo from La Costa to La Riviera.
24. Plaza a La Playa from cul-de-sac to cul-de-sac.
25. Calle Capri from La Riviera to cul-de-sac.
26. Calle Las Palmas from La Costa to La Riviera.
27. Calle Madiera from La Riviera to cul-de-sac.
28. Avenida de la Riviera from Ola Vista to cul-de-sac.
29. Calle de Los Molinos from El Camino Real to the MO2 Channel.
30. Calle Valle from Calle De Los Molinos to Calle De Los Molinos.

Funding Status

The Street Improvement Program is funded from the City's General Fund, the Gas Tax Fund, and the City-wide Street Improvement Assessment District. The program proposed that approximately 60 miles of streets be resurfaced or reconstructed over an 18-year period at an estimated cost of \$43.1 million. An annual inflation factor of 3% was used to project the program's revenues and expenditures.

- **Short Term**

The Street Improvement Program's short term financial picture is mixed. On the positive side, the majority of the street projects awarded have cost less to build and result in a savings of about \$3,933,500 or about 16% of the original estimated street projects costs.

Street Improvement Program Update

| | |
|--|---------------------|
| Original estimated projects costs (FY 95/96 to FY 04/05) | \$24,497,200 |
| Actual projected projects costs (FY95/96 to FY04/05) | <u>\$20,564,700</u> |
| Projected savings (FY 95/96 to FY 04/05) | \$ 3,933,500 |
| Accelerated projects beyond first 10 years | <u>\$ 2,790,400</u> |
| Cash Balance due to savings | \$ 1,143,100 |

Engineering Division staff has been successful in applying for and receiving State Local Transportation Partnership Program (SLTPP) grants for eligible street projects. The grant amounts awarded have varied from 5% to 20% of the construction award costs. The City has received about \$1,741,600 in SLTPP funds for certain completed projects. Also, the City has received approximately \$422,845 in CDBG Grant Funds for certain completed street improvements. Engineering Division staff has been aggressively pursuing various grants for funding the arterial streets. The City has received AHRP grant approval for nine streets for an amount of approximately \$2,300,000.

On the negative side, the actual annual collected assessment is approximately \$1.325 million which is about \$175,000 less than the original projected amount. This is equivalent to a 12% reduction in the assessment. The reduction is due to an adjustment of about \$100,000 per year to private golf courses, plus adjustments to various parcels based on refined information from the Tax Assessor's office. Over the life of the Assessment District, the total revenues will be approximately \$3.15 million less than originally projected. This is equivalent to about seven (7) miles of street overlay projects. Additionally, some of the streets are failing at a rate faster than staff had predicted, so they will have to be reconstructed rather than overlaid. Street reconstruction costs are approximately twice those of overlay projects.

Table "A" describes the financial comparison between the actual and the original projected revenues for ten years of the program.

- **Long Term**

A long term financial forecast of the Street Improvement Program is difficult to project. There are several revenue sources being utilized to fund the Street Improvement Program. The City does not have complete control of outside funding sources, but does have a stable and known funding amount from the Street Assessment District. When the Street Improvement Program was originally presented, staff estimated a reasonable revenue and expenditure forecast based on current conditions. A 3% annual inflation rate was used for both revenues and expenditures.

Major sources of the Gas Tax Fund are 2106 State Gas Tax Funds, Proposition 111 and Measure M Turnback. The total annual Gas Tax Fund revenues are approximately \$1,000,000 as follows:

Long Term Financial Plan

| | |
|-----------------|----------------|
| 2106 Gas Tax | \$ 200,000 |
| Proposition 111 | 300,000 |
| Measure M | <u>500,000</u> |
| Total | \$1,000,000 |

Measure M is a 20-year sales tax program that was approved in 1990 and is scheduled to sunset in year 2010. If a new tax measure is not approved at that time to replace Measure M, the City will lose about \$500,000 (current dollars) annually in revenues, in addition to the competitive grants. In addition, the Street Improvement Program Assessment District sunsets after 18 years in FY 2013/14. The City will have to identify a continuing source of revenue in the future if it is to maintain its street quality standards.

A few years ago, the Governor approved AB 2928 (formerly known as the local rehabilitation money from the Governor). The City of San Clemente has received about \$635,000 over three years. The Governor has frozen the release of AB2928 funds. These funds were utilized to rehabilitate other city streets, including arterials that are not part of the Street Improvement Program.

The Street Improvement Program Financing Plan included contributions from the General Fund and the Gas Tax Fund, in addition to the assessment. The table below shows the contribution projections from the various funds for the next five years.

| Program Year | Fiscal Year | General Fund Contribution | Gas Tax/Measure M Contribution |
|--------------|-------------|---------------------------|--------------------------------|
| 9 | 2003/2004 | \$579,630 | \$491,950 |
| 10 | 2004/2005 | \$597,020 | \$506,710 |
| 11 | 2005/2006 | \$614,930 | \$521,910 |
| 12 | 2006/2007 | \$633,380 | \$537,570 |
| 13 | 2007/2008 | \$652,380 | \$553,700 |

- The contributions are escalated at 3% annually.

In summary, the City's current annual funding for street rehabilitation and maintenance is as follows:

| | |
|--------------------------------------|--------------------|
| SIP projects | \$2,500,000 |
| Major Maintenance | \$ 500,000 |
| Slurry Seal | \$ 250,000 |
| Arterial projects (Gas Tax & Grants) | <u>\$1,500,000</u> |
| Total | \$4,750,000 |

Street Improvement Program Update

TABLE "A"

TEN YEARS FINANCIAL COMPARISON (FY 1995/96 to FY 2004/05)

| | ORIGINAL | ACTUAL | DIFFERENCE |
|--------------------------------------|---------------------|----------------------|----------------------|
| <u>ORIGINAL REVENUES</u> | | | |
| Street Improvement Assess. | 15,720,000 | 13,139,800 | (2,580,200) |
| Debt Service / Redemption fund (1) | (6,090,800) | (5,934,904) | 155,896 |
| Proceeds From Sale of Bonds | 6,000,000 | 6,566,890 | 566,890 |
| Transfer from General Fund | 5,410,300 | 5,131,230 | (279,070) |
| Transfer from Gas Fund / Measure M | 4,063,700 | 4,063,700 | 0 |
| SUB TOTAL | \$25,103,200 | \$22,966,716 | (\$2,136,484) |
| <u>OTHER REVENUES</u> | | | |
| Investment Earnings (2) | - | 1,739,766 | 1,739,766 |
| Other Revenues | - | 44,338 | 44,338 |
| Expenditures Other Than CIP (3) | - | (897,665) | (897,665) |
| SUB TOTAL | - | \$886,439 | \$886,439 |
| TOTAL REVENUES | \$25,103,200 | \$23,853,155 | (\$1,250,045) |
| <u>GRANTS / SAVINGS</u> | | | |
| State Local Transp Partn Program (4) | - | 1,741,571 | 1,741,571 |
| Other Grants | - | 422,845 | 422,845 |
| Savings from street CIP (5) | - | 3,933,500 | 3,933,500 |
| SUBTOTAL | - | \$6,097,916 | \$6,097,916 |
| Accelerated completed projects (6) | - | (2,790,400) | (2,790,400) |
| Additional Improvements (CDBG) (7) | - | (422,845) | (422,845) |
| Proposed Del Cerro Project | - | (815,000) | (815,000) |
| SUBTOTAL | - | (\$4,028,245) | (\$4,028,245) |
| CASH BALANCE | \$25,103,200 | \$25,922,806 | \$819,606 |

NOTES:

- (1) The bonds were sold earlier than original schedule
- (2) Minimal interest in the future years since bond funds will be spent.
- (3) One time cost of the bonds sale.
- (4) The program was eliminated in FY 1999/00.
- (5) Savings from completed street projects.
- (6) Fourteen streets were accelerated from beyond the first 10 years.
- (7) Improvements funded by the CDBG grant.

Long Term Financial Plan

General Fund Contribution

Over the Street Improvement Program's life, it was projected that the General Fund contribution would increase at a 3% per year inflation rate. The City Council, however, added a fiscal policy to the FY 1995/96 budget which states:

"The Council will review the Street Improvement Program each year at budget time and will transfer as much as possible from the General Fund and Gas Tax Fund to the Street Improvement Fund. The intention is to eventually eliminate the need for an assessment district. A public review process will be required in order for the City Council to extend the Street Overlay and Replacement Assessment District beyond the bond maturity date (year 18)."

The combination of the County's bankruptcy, the impact of Proposition 218 on the City's General Fund, and the Measure M sunset created substantial obstacles to achieving the Council's stated goal.

Expenditures

Overall, the majority of the completed street projects are about 5% to 20% under the original budget. As for the long-term expenditure side, it is extremely difficult to project the actual costs of street improvement projects beyond few years. There are many uncertainties including:

1. Projecting remaining pavement life is not an exact science. It is difficult to project the condition of a street more than two to four years into the future. Drought conditions help lengthen pavement life while wet winters and heavy traffic shorten pavement life.
2. Complete reconstruction is approximately twice as expensive as an asphalt overlay. If more miles of total reconstruction are needed than were projected, costs will increase. As seen in the past, the heavy trucks supplying one construction project on a street scheduled for an overlay can destroy the street, thereby doubling the repair cost. Adjacent streets are occasionally impacted as well.
3. Inflationary pressures have not as yet been a factor. A 3% annual inflation rate was built into the Street Improvement Program.

Schedule Modification

Since the approval of the program, 57 street projects were accelerated from their original schedule. Staff is recommending the following schedule modifications (refer to Table "B"):

- To accelerate ten street projects within the Shorecliffs Area from FY 2004/05, and to combine these street projects with others within the same area in FY 2003/04. Originally the street projects were divided into two fiscal years. It is prudent to combine these projects together due to their proximity to each other and commence the construction in late spring of 2004.
- To postpone four street projects in FY 2003/04 within the North Beach Area and combine them with other street projects within the same area in FY 2004/05. This is required in order to coordinate with a major drainage project within the same area. The drainage

Street Improvement Program Update

project will be funded in FY 2004/05. It is prudent to combine these projects to eliminate any conflicts and to capture more savings.

- To accelerate Calle Del Cerro street improvement project in FY 2004/05. Originally, Calle Del Cerro was scheduled to be rehabilitated in FY 2009/10. The pavement conditions are deteriorating very quickly and in order to avoid the possibility of total reconstruction of the pavement, staff is recommending accelerating the improvements of this street in FY 2004/05.

Funding appropriation for the accelerated projects will be required at the time of awarding the construction contract. There are sufficient funds available in the Street Improvement Program Fund due to the savings from completed projects.

TABLE "B"

| Proposed Schedule Modifications | | | | |
|--|--|-------------------|-------------------|------------|
| | Project Names | Original Schedule | Modified Schedule | Comments |
| | Shorecliffs Area: | | | |
| 1 | Via Arboleda from Via Montego to Via Alegre | 2003-04 | | |
| 2 | Via Bandita from Via Montego to Via Alegre | 2003-04 | | |
| 3 | Verbena from Via Montego to Via Alegre | 2003-04 | | |
| 4 | Via Casa Loma from Via Montego to Via Alegre | 2004-05 | 2003-04 | Accelerate |
| 5 | Via Lado from Via Montego to Via Alegre | 2004-05 | 2003-04 | Accelerate |
| 6 | Via Montecito from Via Montego to Via Alegre | 2004-05 | 2003-04 | Accelerate |
| 7 | Via Montezuma from Via Montego to Via Alegre | 2004-05 | 2003-04 | Accelerate |
| 8 | Via Santo Tomas from Via Montego to Via Alegre | 2004-05 | 2003-04 | Accelerate |
| 9 | Via Vistosa from Via Montego to Via Alegre | 2004-05 | 2003-04 | Accelerate |
| | North Shorecliffs Area: | | | |
| 1 | Calle Alondra from Mira Costa to Quieto | 2003-04 | | |
| 2 | Calle Quieto from Grande Vista to Grande Vista | 2003-04 | | |
| 3 | Calle Guaymas from La Veta to Mira Costa | 2004-05 | 2003-04 | Accelerate |
| 4 | Calle La Veta from Mira Costa to cul-de-sac | 2004-05 | 2003-04 | Accelerate |
| 5 | Grande Vista from Quieto to Vaquero | 2004-05 | 2003-04 | Accelerate |
| 6 | Via Nada from Grande Vista to cul-de-sac | 2004-05 | 2003-04 | Accelerate |
| | North Beach Area: | | | |
| 1 | Avenida Hacienda from Sacramento to Florencia | 2003-04 | 2004-05 | Postpone |
| 2 | Calle Las Bolas from Florencia to El Camino Real | 2003-04 | 2004-05 | Postpone |
| 3 | Boca De La Playa from cul-de-sac to Calle Las Bolas | 2003-04 | 2004-05 | Postpone |
| 4 | Avenida Pico from El Camino Real to Boca De La Playa | 2003-04 | 2004-05 | Postpone |
| | Rancho San Clemente Area: | | | |
| 1 | Calle Del Cerro from Avenida Pico to Avenida La Pata | 2009-10 | 2004-05 | Accelerate |

Long Term Financial Plan

Street Maintenance Program

The life of a new street is approximately 20 years. In order to extend the life of the street to about 45 years, a programmed preventive maintenance should be scheduled. The street should be slurry sealed on a seven year cycle and also overlaid every ten to fifteen years.

| | |
|-------------|---------|
| New street | Year 0 |
| Slurry Seal | Year 7 |
| Slurry Seal | Year 14 |
| Overlay | Year 20 |
| Slurry Seal | Year 27 |
| Overlay | Year 35 |

As part of the FY 1999/00 budget, the City Council re-established the City's Major Street Maintenance Program. Furthermore, the City Council, in July 2002, approved expanding the Major Street Maintenance Program to a \$500,000 program, and the Slurry Seal Program to \$250,000 program.

This Major Street Maintenance Program provides moderate and major maintenance service on streets that were not scheduled in the Street Improvement Program or improvements that were scheduled several years into the future.

Having a defined Major Street Maintenance Program will allow the City to decelerate the rapid deterioration of the City streets. This is particularly important for those streets that are not scheduled for full rehabilitation for several years out in the Street Improvement Program. The thin overlays will not last as long as complete rehabilitation, but they do not cost as much either.

The advantages are:

1. The effort will reduce maintenance costs by reducing the number of times the street maintenance crews have to return to the same street before it is rehabilitated.
2. The streets will have a better appearance and better ride quality.
3. The street may be saved for an overlay project instead of losing it to total reconstruction.
4. It will improve the image of the neighborhood at a reasonable cost.

Since the re-establishment of the City's Major Street Maintenance Program as part of the FY 1999/00 budget, thirty-one (31) streets were rehabilitated as listed below:

1. West Avenida San Antonio from El Camino Real to cul-de-sac.
2. West Avenida Ramona from El Camino Real to cul-de-sac.
3. West Avenida Cornelio from El Camino Real to cul-de-sac.
4. West Avenida Junipero from El Camino Real to cul-de-sac.
5. West Avenida San Gabriel from El Camino Real to cul-de-sac.
6. East Avenida de Los Lobos Marinos from Calle Alcazar to cul-de-sac.
7. Avenida Verde from Calle Alcazar to cul-de-sac.

Street Improvement Program Update

8. Calle Oso from Avenida Del Poniente to West El Portal.
9. West El Portal from Calle Oso to Buena Vista.
10. Monterey Lane from Avenida Victoria to Corona Lane.
11. Corona Lane from Monterey Lane to Avenida Victoria.
12. Avenida Santa Barbara from Avenida Victoria to Avenida Del Mar.
13. Acebo Lane from Avenida Santa Barbara to Avenida Del Mar.
14. Elena Lane from Avenida Victoria to Cazador Lane.
15. Cazador Lane from South Ola Vista to Avenida Victoria.
16. Via Del Campo from Via Manzana to Via Bienvenido.
17. Calle Patricia from La Esperanza to cul-de-sac.
18. Via Robina from Calle Patricia to cul-de-sac.
19. East Avenida San Antonio from El Camino Real to cul-de-sac.
20. East Avenida Cornelio from El Camino Real to cul-de-sac.
21. Police Department Parking Lot.
22. West Avenida Mariposa from West Escalones to El Camino Real.
23. West Avenida Marquita from La Paloma to El Camino Real.
24. La Paloma from Calle Puente to cul-de-sac.
25. West Escalones from Avenida Del Poniente to West Mariposa.
26. Avenida Barcelona from El Camino Real to Ola Vista.
27. Avenida Teresa from Avenida Salvador to cul-de-sac.
28. Avenida Acapulco from San Pablo to San Pablo.
29. Via Promontorio from Acapulco to cul-de-sac.
30. Paseo De la Serenata from Ola Vista to cul-de-sac.
31. Avenida Pelayo from Avenida Aragon to Avenida Florencia.

In addition, the following streets will be rehabilitated as part of the Major Maintenance Program during FY 2003/04:

1. Avenida Columbo from Avenida Teresa to cul-de-sac.
2. East Avenida Marquita from El Camino Real to Avenida de la Estrella.
3. East Avenida Mariposa from El Camino Real to Avenida de la Estrella.
4. East Escalones from El Camino Real to Avenida de la Estrella.
5. East Canada from El Camino Real to Avenida de la Estrella.
6. Avenida Mateo from El Camino Real to Avenida Monterey.

Conclusion

In summary, the Street Improvement Program is ahead of the originally approved schedule. One hundred and forty (140) street projects are complete and another three (3) are under construction. An additional thirty (30) projects are scheduled to be constructed within FY 2003/04 and FY 2004/05. Due to the savings in the street projects' costs, staff was able to accelerate and complete fourteen (14) street projects that were scheduled beyond the first ten years of the program. In addition, forty-three (43) other streets were accelerated within the first ten years of the program.

Long Term Financial Plan

The City will continue to monitor annual revenues and expenditures of the Street Improvement Program. It appears that the program's goals can be met in the foreseeable future. If current trends continue, the collector and neighborhood street rehabilitation program should be adequately funded and remain on schedule.

Recommendations

1. Approve and authorize the allocation of a General Fund contribution of \$597,020 for the coming FY 2004/05.
2. Confirm the City Council's continuing commitment to the fiscal policy requiring General Fund contributions to the program as resources become available.
3. Confirm the City Council's continuing commitment to the Major Street Maintenance Program and the Slurry Seal Program to provide a programmed preventive maintenance for the streets.
4. Approve the Street Improvement Program schedule modification:
 - a. To accelerate ten street projects from FY 2004/05 within the Shorecliffs Area, and combine them with other street projects within the same area in FY 2003/04 due to the proximity of these streets.
 - b. To postpone four street projects in FY 2003/04 within the North Beach Area and combine them with other street projects within the same area in FY 2004/05 due to the proximity of these streets.
5. Approve the Street Improvement Program schedule modification to accelerate Calle Del Cerro from the FY 2009/10 to FY 2004/05.

Council Action

All recommendations were approved by the City Council by a vote of 5-0 on February 3, 2004.

Street Improvement Program Update

EXHIBIT "A"

Completed projects

1. Via Cascadita from Via Socorro to Camino Capistrano. The project also included storm drain improvements.
2. Avenida Presidio (Phase I) from the San Clemente High School boundary to Calle Miguel, including one block of Calle Miguel.
3. Avenida Presidio (Phase II) from Calle Miguel to Calle Esperanza. The City utilized rubberized asphalt for the first time when paving the street.
4. Calle Real from the City limits to Via Del Campo.
5. Calle Bienvenido from the City limits to Via Del Campo.
6. Avenida Cabrillo from El Camino Real to Calle Seville. The project also included water improvements.
7. Avenida Valencia (Phase I) from El Camino Real to Ola Vista. The project also included the rehabilitation of the landscaped median. Median improvements were funded from the Lighting and Landscape District capital budget.
8. Avenida Valencia (Phase II) from Ola Vista to Calle Toledo. The project also included the rehabilitation of the landscaped median.
9. Calle Toledo from Esplanade to Avenida Valencia. The project also included major storm drain improvements.
10. Avenida Santa Barbara from Calle Seville to Ola Vista. The project consisted of complete reconstruction of the pavement and the installation of a new water line.
11. Avenida Buena Vista (Phase I) from the southern cul-de-sac to Avenida Pelayo. The project consisted of complete reconstruction of the pavement and the installation of a new water line and major storm drain improvements.
12. Avenida Buena Vista (Phase II) from Avenida Pelayo to the northern cul-de-sac. The project consisted of complete reconstruction of the pavement and the installation of a new water line.
13. Avenida Del Poniente from Calle Oso to Avenida Buena Vista.
14. Dije Court from Avenida Buena Vista to cul-de-sac.
15. Calle Frontera from Avenida Pico to Avenida Vista Hermosa.
16. Via Alegre from Via Montego to cul-de-sac.
17. Via Montego from Via Cascadita to Calle Vista Torito. The project also included sewer improvements.
18. Calle Vista Torito from Avenida Vaquero to Via Montezuma. The project also included storm drain improvements.
19. Calle Del Comercio from El Camino Real to San Luis Rey. In addition to the complete reconstruction of the pavement, the project also included water and storm drain improvements.
20. West Avenida Canada from Del Poniente to Buena Vista. The project consisted of complete reconstruction of the pavement, and also included new sidewalks and water improvements.

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21. Via Escalones from El Camino Real to West Canada. The project consisted of complete reconstruction of the pavement, and also included water improvements.
22. Avenida Palizada from El Camino Real to Calle Seville.
23. Calle Seville from Avenida Palizada to Avenida Victoria.
24. Loma Lane from Avenida Palizada to Avenida Palizada. The project consisted of complete reconstruction of the pavement and the installation of a new water line.
25. Avenida Salvador from Avenida Presidio to Calle Malaguena.
26. Calle Miguel from Avenida Presidio to Avenida Presidio. The project also included the installation of a new water system pressure reducing station.
27. Calle Nina from Calle de Soto to cul-de-sac.
28. Via Socorro from Camino San Clemente to Via Ballena. The project also included the installation of new water services.
29. Via Ballena from Via Cascadita to Via Socorro. The project consisted of complete reconstruction of the pavement.
30. Via San Andreas from Via Cascadita to Via Ballena. The project consisted of complete reconstruction of the pavement.
31. East Avenida San Juan from El Camino Real to Avenida Salvador. In addition to the complete reconstruction of the pavement, the project also included lining of the existing sewer main line and storm drain improvements.
32. Avenida Monterey (Phase I) from Avenida Victoria to Avenida Madrid. The project consisted of complete reconstruction of the pavement and new sidewalks on one side of the street.
33. Avenida Monterey (Phase II) from Avenida Madrid to Algodon.
34. Avenida Monterey (Phase III) from Algodon to Avenida Rosa. The project consisted of complete reconstruction of the pavement and the installation of a major storm drain line.
35. Avenida Rosa (100 block) from Ola Vista to Victoria. The project also included the installation of a major storm drain line.
36. Avenida de la Estrella, (Phase I) from Calle de los Molinos to El Portal.
37. Avenida de la Estrella, (Phase II) from Avenida Palizada to El Portal.
38. Calle Redondel from Avenida de la Estrella to Avenida de la Estrella. This project consisted of complete reconstruction of the pavement.
39. East Avenida Magdalena from South El Camino Real to Avenida Santa Margarita. The project consisted of complete reconstruction of the pavement.
40. Avenida Santa Margarita from Avenida San Luis Rey to East Avenida Magdalena. The project consisted of complete reconstruction of the pavement and the installation of a new water line.
41. Barcelona from Ola Vista to Esplanade.
42. Esplanade from South El Camino Real to Trafalgar Lane. The project also included the rehabilitation of the landscaped median.
43. Calle Conchita from cul-de-sac to Esplanade.
44. North La Esperanza from La Paz to Avenida Presidio.
45. De La Paz from La Esperanza to Avenida Palizada.
46. Avenida Caballeros from East El Oriente to West Avenida Palizada.

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47. El Levante. The project consisted of complete reconstruction of the pavement and the installation of a new water line.
48. Terra Vista Bahia from El Levante to cul-de sac.
49. Pizarro from North La Esperanza to El Levante.
50. West Avenida Cornelio from South Ola Vista to Avenida Del Presidente.
51. West Avenida Alessandro from West Avenida San Antonio to Avenida Del Presidente. The project consisted of complete reconstruction of the pavement, and also included water, storm drain improvements and the lining of the existing sewer line.
52. West Avenida San Antonio from West Avenida Alessandro to Avenida Del Presidente. The project consisted of complete reconstruction of the pavement, and also included water, storm improvements and the lining of the existing sewer line.
53. Calle Juarez from Calle Frontera to Guadalajara.
54. Calle Empalme from Avenida La Cuesta to Calle Familia.
55. Avenida Granada, Phase I from Ola Vista to Avenida Del Mar.
56. Avenida Granada, Phase II from Ola Vista to El Camino Real.
57. Avenida De La Grulla from Florencia to El Camino Real.
58. Sierra from Avenida De La Estrella to Avenida Las Flores.
59. Calle Campo from Avenida Sierra to end of pavement.
60. El Oriente from Avenida De la Estrella to Avenida Las Flores.
61. La Placentia from Avenida Sierra to end of pavement.
62. Revuelta Court from La Placentia to end of pavement.
63. Ola Vista from Rosa to Santa Barbara.
64. Avenida Rosa from Ola Vista to Victoria.
65. Alcazar from end of pavement to East San Juan.
66. East Cordoba, Phase I from Calle Alcazar to Ladera Lane.
67. East Cordoba, Phase III from Ladera Lane to Via Avila.
68. East Avenida Junipero, Phase I from Avenida Trieste to Entrada Paraiso.
69. East Avenida Junipero, Phase II from El Camino Real to Avenida Trieste.
70. Entrada Paraiso from Avenida San Juan to end of pavement.
71. Calle Abril from Calle Bienvenido to Calle Real.
72. Calle Mayo from Calle Bienvenido to Calle Real.
73. Calle Monterey from City limit to Calle Juno.
74. Via Sacramento from City limit to Calle Juno.
75. Calle Andalucia from Calle Bienvenido to City limit.
76. Via Manzana from City limit to Calle Real.
77. Calle Juno from Calle Bienvenido to Calle Mayo.
78. Buena Suerte from East Cordoba to Avenida San Juan.
79. South La Esperanza from Calle Patricia to East Avenida Cordoba.
80. Calle Puente (Phase I) from Avenida Palizada to Avenida Del Poniente.
81. Calle Puente (Phase II) from Avenida Del Poniente to Avenida Aragon.
82. El Portal from Del Prado to El Camino Real and Del Prado from Avenida Del Poniente to Aragon.

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83. Avenida Del Poniente from Calle Puente to El Camino Real.
84. Avenida Aragon from Calle Puente to El Camino Real.
85. Avenida Cadiz from Ola Vista to El Camino Real.
86. West Avenida Cordoba from El Camino Real to Calle Toledo.
87. Avenida Gaviota from El Camino Real to Valencia.
88. Avenida Trieste from Avenida Junipero to cul-de-sac.
89. Via. San Gorgonio from Avenida Vaquero to Vista Torito.
90. Via San Jacinto from Via San Gorgonio to Calle Vista Torito.
91. Via Corbina from Calle Vista Torito to cul-de-sac.
92. Via Montecito from Avenida Vaquero to Vista Montego.
93. Avenida Princesa from Avenida Presidente to Toledo.
94. Calle Del Pacifico from cul-de-sac to South Ola Vista.
95. Calle Marina from Calle De Los Alamos to West Los Lobos Marinos.
96. Calle Primavera from Calle De Los Alamos to Calle Roca Vista.
97. Calle Roca Vista from Calle De Los Alamos to West Los Lobos Marinos.
98. West Junipero from Ola Vista to Avenida Del Presidente.
99. Avenida De Los Lobos Marinos from Calle De Los Alamos to Del Presidente.
100. Calle Serena from Los Alamos to De Los Lobos Marinos.
101. Avenida Gaviota from Valencia to Calle Toledo.
102. Calle De Los Alamos from Gaviota to Avenida De Los Lobos Marinos.
103. Calle Lasuen from Calle De Los Alamos to West Los Lobos Marinos.
104. East Cordoba, Phase II from Via Avila to Via La Jolla.
105. West Avenida Santiago from South Ola Vista to El Camino Real.
106. East Avenida Ramona Phase I from El Camino Real to Entrada Paraiso.
107. East Avenida Ramona Phase II from Entrada Paraiso to cul-de-sac.
108. Avenida Serra from Avenida Palizada to El Camino Real.
109. West Paseo De Cristobal from El Camino Real to cul-de-sac.
110. Poco Paseo from Calle Toledo to La Rambla.
111. La Rambla from Calle Toledo to cul-de-sac.
112. Vista Marina from Trafalgar Lane to West Paseo De Cristobal.
113. Avenida Madrid from Avenida Victoria to Avenida Monterey.
114. Calle De Anza from San Carlos to Avenida Presidio.
115. Avenida Arlena from Esperanza to Cordoba.
116. Bella Loma from cul-de-sac to La Cuesta.
117. Calle Neblina I from Miguel to Empalme.
118. Calle Neblina II from cul-de-sac to Miguel.
119. Calle Familia from cul-de-sac to cul-de-sac.
120. Calle Delicada from cul-de-sac to cul-de-sac.
121. Calle Pescador from Miguel to Presidio.
122. Calle Rica from cul de sac to cul-de-sac.
123. Robles from Empalme to Presidio.
124. Avenida La Cuesta from Solano to Miguel.
125. Calle Sandia from cul-de-sac to Escuela.
126. Calle Salida from cul-de-sac to Escuela.

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- 127. Calle Del Juego from cul-de-sac to Escuela.
- 128. San Luis Rey from El Camino Real to Santa Margarita.
- 129. Calle Escuela from Presidio to Miguel.
- 130. Calle Fiesta from Empalme to cul-de-sac.
- 131. Calle Pueblo from Presidio to cul-de-sac.
- 132. Calle Villario from Presidio to cul-de-sac.
- 133. Calle Felicidad from Presidio to cul-de-sac.
- 134. Calle Dorado from Presidio to cul-de-sac.
- 135. Calle Guadalajara from Avenida Vaquero to Calle Vallarta.
- 136. Calle Vallarta from Avenida Vaquero to Calle Guadalajara.
- 137. Calle Frontera from Avenida Vista Hermosa to Calle Vallarta.
- 138. Calle Agua from Camino de los Mares to Calle Verano.
- 139. Avenida Palizada from Calle Seville to Avenida Del Mar.
- 140. Avenida Cabrillo from Calle Seville to Avenida Palizada.

Long Term Financial Plan

Economic Development Update

Objective

To update the progress made in the implementation of the City's Economic Development Plan and to provide projections concerning sales tax growth and business development trends.

Summary

The City's Economic Development Plan for Fiscal Year 2003-04 called for the City to continue focusing its program efforts on three specific areas: 1) Business Retention; 2) Business Marketing and Promotion; and 3) Reinvestment and Revitalization.

In conjunction with these three program initiatives, the City Council directed staff to undertake the following activities:

1. Based upon the availability of funding, continue to work closely with the Downtown Business Association, Chamber of Commerce and other stakeholders to implement public improvement projects and related programs for the Downtown area;
2. Working with the Downtown Business Association, provide appropriate staff support and assistance towards the objective of receiving Main Street Program Certification by the State of California and the final designation of the proposed Main Street District Area. In this regard, also ensure coordination of the City's proposed Downtown Strategic Plan and Downtown Visioning Program with the Downtown Business Association's Main Street Program efforts;
3. Continue to aggressively market and promote the recruitment and attraction of new business firms to the Rancho San Clemente Business Park and the Talega Business Park;
4. With respect to older commercial shopping centers, provide appropriate assistance and support for the revitalization of these centers;
5. Continue to provide staff support for the Central Business District Transition Program and the Los Molinos Public/Private Partnership Program;
6. Continue to diligently provide business ombudsman and developer advocacy services to the business community and continue to coordinate resolution and response to complaints and requests for business related support services;
7. Continue to market and promote the recruitment of a food market grocery store operation to the general area of south San Clemente; and
8. In concert with the efforts of the City's Planning Division to undertake a Specific Plan process, coordinate marketing and promotion of appropriate and viable economic development initiatives and projects for the North Beach area.

The three specific program areas, along with current year policy directions from the City Council, represent the underlying foundation and overall mission for the City's Economic Development program efforts and activities. A brief review of each program area is presented below.

- **Business Retention**

Business enterprises who have invested in our community represent an important tax base resource that must be nurtured and sustained. Notwithstanding the varying sizes and levels

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of capital investment of these firms, we recognize that these community business members pay local taxes, create employment opportunities and provide important goods and services to our residents and visitors. It is therefore vitally important that the City work closely with its business community and provide appropriate support and assistance to strengthen the City's existing retail, service and business/industrial base. In this regard, City staff works closely with the San Clemente Chamber of Commerce, Downtown Business Association, Los Molinos Business Advisory Committee, Rancho San Clemente Business Park Association and other established business groups to ensure the timely coordination of needs assessment and service delivery activities for existing local businesses.

- **Business Marketing and Promotion**

The City employs sophisticated economic modeling systems to evaluate the municipal service cost impacts of planned and future development. In order to ensure the City keeps pace with ever increasing service demands and attendant service delivery costs, it is imperative that the City expand and diversify its tax base by capturing new business investment and development opportunities. Also, in order to strengthen the City's competitive position in the regional market place, staff continues to utilize a variety of outreach strategies to effectively communicate the positive attributes, strengths and benefits that San Clemente offers to prospective business investors and developers.

- **Reinvestment and Revitalization**

There are specific commercial and industrial areas identified by the City which represent significant investment and employment generating resources for our community. Of particular importance is the Downtown or T-Zone area, Pico Plaza Shopping Center, K-Mart Shopping Center and the Los Molinos Industrial area. Business operators and property owners have worked with the City to upgrade their properties through reinvestment. In this regard, the City has developed and implemented a public/private partnership program which attempts to stimulate or in some cases match near term private reinvestment with a local government commitment of public resources for infrastructure improvement and appropriate regulatory land use support.

With these three program elements in place, we will proceed with a review of the progress that has been made with respect to certain economic development issues that were identified in the previous 2003 Long Term Financial Report.

Issue: **Sales Tax Leakage** – Curtail the outflow of sales tax dollars to other communities in the South County area by strengthening and expanding the City's retail tax base.

In its 1998 retail sales tax analysis report (Orange County cities), Ultra Research Inc. (URI) indicated that the City's taxable retail sales leakage was 53%. This leakage factor translated to a loss of \$350.4 million in all taxable sales and a reciprocal loss of sales tax revenue to the City of \$3.5 million. URI's sales tax analysis report for the calendar year ended 2001 reflected a taxable retail sales leakage factor of 43%, which translated to a loss of \$227.37 million in all taxable sales and a loss of sales tax revenues to the City of

Economic Development Update

\$2.27 million. This means that in a period of 4 years the City's sales tax leakage factor has been reduced by a factor of almost 20% and the amount of lost taxable sales reflects a reduction of \$123 million or 35%. Much of this improvement is reflective of the operation of the City's Plaza Pacifica Shopping Center which is anchored by Wal-Mart, Lowe's Home Improvement and Michael's Art Store.

In order to keep these numbers in perspective, it is important to understand that the estimated loss of sales tax is inferentially calculated on the basis of all cities and unincorporated areas in Orange County. In some cases the loss of sales tax dollars (leakage) for the City is based upon retail sales generators that the City does not currently have in the community and more than likely never will. Examples of this type of sales tax generator would be new car dealerships and shopping malls. According to data provided by the City's sales tax consultant, The HdL Companies (HdL), in 2000 the City was ranked 24th out of 34 cities in total taxable sales and a modest improvement was noted with a ranking of 23rd in total taxable sales in 2001 and in 2002 the City returned to a ranking of 24th (see Table 2). With respect to per capita taxable sales, the City ranked 28th in 2000, and once again a modest improvement was noted in 2001 with a ranking of 27th and in 2002 the City's ranking slid to a position of 30 out of the 34 cities (See Table 3). This is not a troubling finding because the City's population increased to almost 60,000, and it is extremely difficult to sustain or even increase per capita sales tax generation when your population is growing the way San Clemente's is.

Unfortunately, URI has advised staff that the State Board of Equalization has not yet completed its analysis and preparation of sales tax data by categories for the calendar year 2002. Therefore, the major taxable retail sales leakage sources (by category) previously provided in URI annual reports are not available for the printing of this year's LTFP report. Staff will present this information to the City Council when URI completes its analysis and makes this data available to the City.

Retail Sales Leakage by Category

| <u>1999</u> <u>Percent</u> | <u>2000</u> <u>Percent</u> | <u>2001</u> <u>Percent</u> | <u>Type of Retail Store</u> |
|-------------------------------|-------------------------------|-------------------------------|--|
| 90 | 89 | 89 | Auto Dealers and Auto Suppliers |
| 80 | 75 | 65 | Home Furnishings and Appliances |
| 56 | 40 | 36 | General Merchandise Stores |
| 75 | 77 | 16 | Building Materials and Farm Implements |
| 60 | 63 | 68 | Apparel Stores |
| 53 | 55 | 51 | Other Retail Stores |

Table I

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2002 Taxable Sales in Orange County Cities

| <u>City</u> | <u>Taxable Sales (1)</u> | <u>Ranking (2)</u> |
|------------------------|--------------------------|--------------------|
| Anaheim | \$4,729 | 1 |
| Irvine | 3,759 | 2 |
| Santa Ana | 3,510 | 3 |
| Costa Mesa | 3,190 | 4 |
| Orange | 2,513 | 5 |
| Huntington Beach | 2,117 | 6 |
| Newport Beach | 1,818 | 7 |
| Garden Grove | 1,590 | 8 |
| Tustin | 1,577 | 9 |
| Fullerton | 1,416 | 10 |
| Westminster | 1,333 | 11 |
| Mission Viejo | 1,298 | 12 |
| Brea | 1,261 | 13 |
| Buena Park | 1,231 | 14 |
| Lake Forest | 946 | 15 |
| Cypress | 874 | 16 |
| Fountain Valley | 818 | 17 |
| Laguna Niguel | 808 | 18 |
| San Juan Capistrano | 672 | 19 |
| La Habra | 660 | 20 |
| Laguna Hills | 610 | 21 |
| Yorba Linda | 526 | 22 |
| Placentia | 459 | 23 |
| San Clemente | 454 | 24 |
| Rancho Santa Margarita | 399 | 25 |
| Dana Point | 330 | 26 |
| Laguna Beach | 305 | 27 |
| Stanton | 297 | 28 |
| Aliso Viejo | 274 | 29 |
| La Palma | 228 | 30 |
| Seal Beach | 216 | 31 |
| Los Alamitos | 212 | 32 |
| Laguna Woods | 97 | 33 |
| Villa Park | 15 | 34 |

(1) In millions (Source: State Board Of Equalization)

(2) By decreasing taxable sales

Table II

Economic Development Update

2002 Taxable Sales Per Capita In Orange County Cities

| <u>City</u> | <u>Per Capita</u> | <u>Ranking</u> |
|------------------------|-------------------|----------------|
| Brea | 34,306 | 1 |
| Costa Mesa | 28,894 | 2 |
| Newport Beach | 25,145 | 3 |
| Irvine | 23,945 | 4 |
| Tustin | 22,889 | 5 |
| San Juan Capistrano | 19,419 | 6 |
| Orange | 18,955 | 7 |
| Laguna Hills | 18,730 | 8 |
| Cypress | 18,530 | 9 |
| Los Alamitos | 18,157 | 10 |
| Buena Park | 15,479 | 11 |
| Westminster | 14,915 | 12 |
| Fountain Valley | 14,681 | 13 |
| La Palma | 14,460 | 14 |
| Anaheim | 14,167 | 15 |
| Mission Viejo | 13,245 | 16 |
| Laguna Niguel | 12,749 | 17 |
| Laguna Beach | 12,588 | 18 |
| Lake Forest | 12,385 | 19 |
| Fullerton | 10,980 | 20 |
| La Habra | 10,917 | 21 |
| Huntington Beach | 10,905 | 22 |
| Santa Ana | 10,239 | 23 |
| Placentia | 9,532 | 24 |
| Garden Grove | 9,455 | 25 |
| Dana Point | 9,197 | 26 |
| Seal Beach | 8,797 | 27 |
| Yorba Linda | 8,683 | 28 |
| Rancho Santa Margarita | 8,257 | 29 |
| San Clemente | 7,986 | 30 |
| Stanton | 7,821 | 31 |
| Aliso Viejo | 6,448 | 32 |
| Laguna Woods | 5,376 | 33 |
| Villa Park | 2,440 | 34 |

Table III

Long Term Financial Plan

HdL has provided per capita sales tax data by retail sales categories which can be used to compare the City's performance with the County of Orange as a whole. Chart I below shows how the City's sales tax generation compares to the Orange County average for the four quarters, ending the fourth quarter 2002.

Taxable Sales Per Capita - 2002

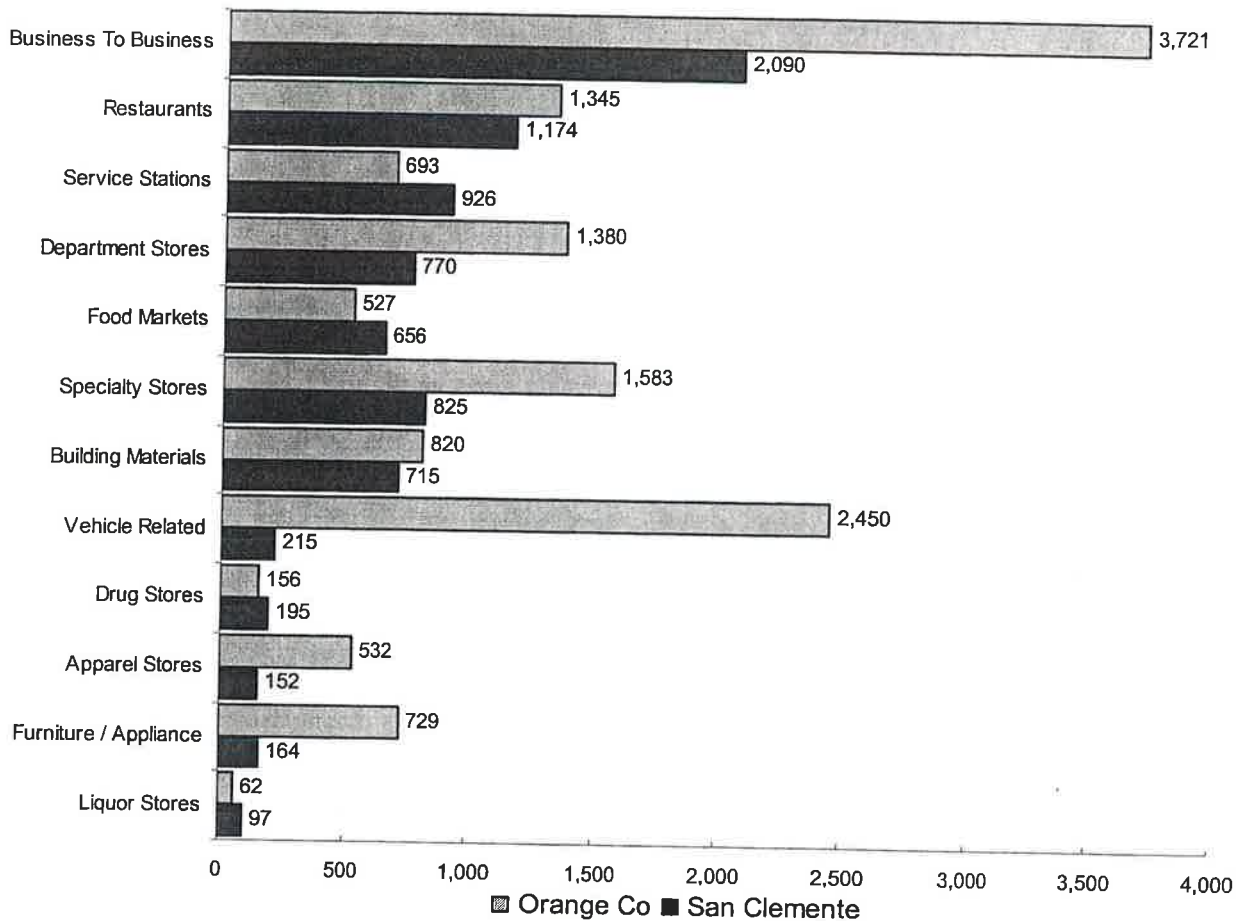


Chart I

This chart provides an interesting comparison of how the City's taxable sales match up to the County averages for the 2002 reporting period.

- Business to Business** – The City was 59% of the County average in 2001 and is 56% in 2002. The City's overall performance compared with the prior year has not significantly changed and the City's small percentage change merely reflects an overall decrease in business to business taxable transactions throughout the County for 2002.

Economic Development Update

- **Restaurants** – City was 96% of the County average in 2001 and is 87% in 2002. Although there was a modest year to year decline of 8%, the City's strategic location and easy access to and from the I-5 Freeway continue to provide strong support for the City's performance in this category.
- **Service Stations** – City was 130% of the County average in 2001 and is 134% in 2002. The City's comparative performance has increased by a modest 3 % from the prior year. Sales performance in this category has consistently been reflective of the City's location on the I-5 Freeway and, of course, the inclination by operators to charge a higher price for gasoline relative to other inland communities.
- **Department Stores** – City was 62% of the County average in 2001 and is 56% in 2002. Wal-Mart and Lowe's Home Improvement continue to be among the City's largest sales tax producers. The City's decrease in this category is partially reflective of the general downward trend throughout the County during the year.
- **Food Markets** – City was 128% of the County average in 2001 and is 124% in 2002. It is not clear why the City's performance in this category continues to be so high relative to the County average. It may well have to do with the City's location next to the I-5 Freeway and the fact that there are two State parks in or near the community.
- **Specialty Stores** – City was 73% of the County average in 2001 and is 52% in 2002. This represents a rather sizeable decrease over the prior year and the reasons underlying this weaker comparative performance are not known.
- **Building Materials** – City was 96% of the County average in 2001 and is 87% in 2002. There has been some sales erosion compared to the prior year; however, the decrease may be attributable in some measure to a softer regional economy.
- **Vehicle Related** – City was 20% of the County average in 2001 and is 9% in 2002. Not surprisingly, the City's continued declining performance in this category reflects the fact that there are no new car dealerships in the community and, excepting a few used car operations, residents have no other choice but to buy or lease their automobiles in other communities such as San Juan Capistrano, Mission Viejo, Irvine or the Oceanside-Carlsbad area.
- **Drug Stores** – City was 138% of the County average in 2001 and is 126% in 2002. While there was a year to year decrease in this category, the factors influencing the City's continued performance in excess of the County average are unknown.
- **Apparel Stores** – City was 35% of the County average in 2001 and came in at 29% in 2002. Historically, the community's resident consumers have had no choice but to go to other communities for their clothing purchases and, with the convenience of the Shops at Mission Viejo, this trend in the near term is not likely to change. There is, however, reason for optimism regarding the Marblehead Coastal project. A large percentage of the "Company" stores proposed for this development will be mid-scale and up-scale apparel stores. The regional draw of this project and local resident demand for quality clothing/apparel stores should produce a very positive sales performance increase starting hopefully in late 2005.
- **Furniture/Appliance** – City was 35% of the County average in 2001 and is 29% in 2002. Dewey's continues to contribute heavily in this category; however, the City has continued to lose ground for the past three reporting periods.

Long Term Financial Plan

- **Liquor Stores** – The City was 158% of the County average in 2001 and is 156% in 2002. Because the City is a beachside visitor-serving destination, a large portion of the City's performance in this category may be attributable to this important tourist-oriented seasonal business activity.

HdL has also provided sales tax data by selected categories extending over a period of 3 ½ years starting with the first quarter, 2000 to the second quarter, 2003. The sales tax trends developed from this information are reflected in Chart II. Please note there are two scales and the scale to the right applies only to Business to Business sales transactions.

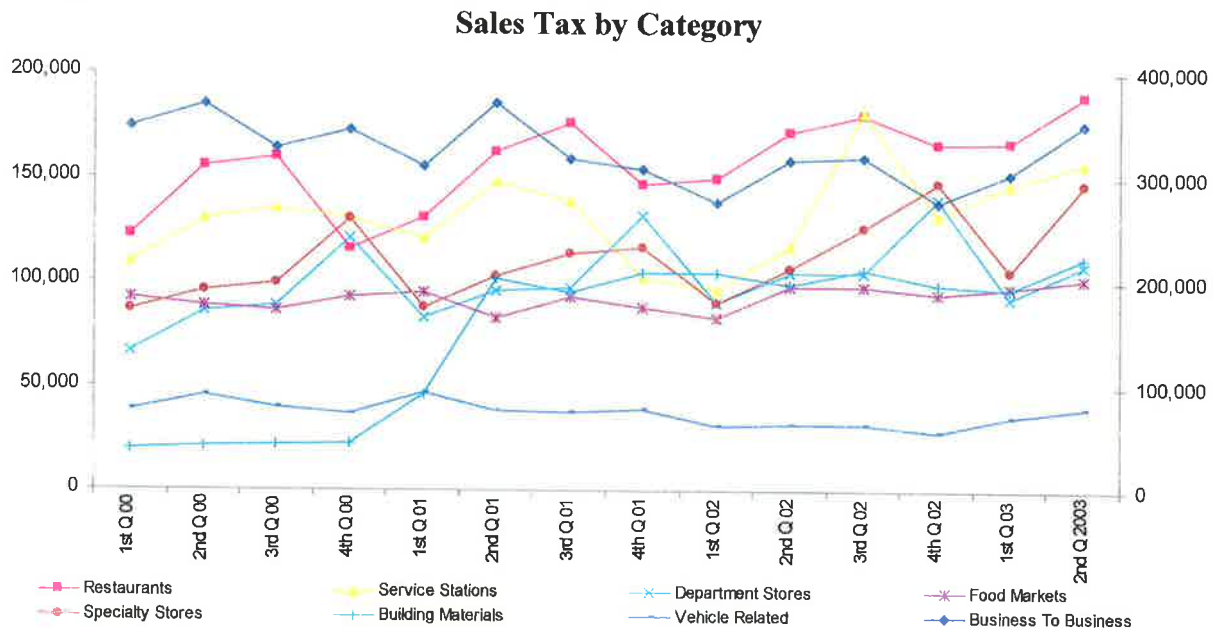


Chart II

- **Restaurants** – Overall, starting with Fourth Quarter, 2000, reflecting slow but sustained growth to the Second Quarter, 2003. Not surprisingly, it appears that the City's restaurant businesses are indeed seasonally sensitive and their performance generally weakens in the Fourth and First quarters.
- **Service Stations** – The performance for the City's service stations curiously mirrors the performance of the restaurants. The data reveals a distinct seasonal nexus between gasoline sales and restaurant sales. Overall sales tax performance shows steadily increasing revenue production through the Third Quarter, 2002, a steep Fourth Quarter decline and a moderate increase to the Second Quarter, 2003.
- **Food Markets** – Fairly static throughout the quarterly reporting periods.
- **Business to Business Services** – A general overall trending decline from the First Quarter, 2000 through the First Quarter, 2002 with a moderate upswing in the First and Second Quarters of 2003.

Economic Development Update

- **Specialty Retail** – Seasonally sensitive performance with significant decreases in all First Quarters and a significant increase in the Second Quarter of 2003.
- **Department Stores** – Even with seasonal influences both in the Fourth Quarters and First Quarters for the 3 ½ year reporting period, there is a general upward trending from the First Quarter, 2000 to the Fourth Quarter, 2002. The operation of Wal-Mart and Lowe’s Home Improvement is having a most beneficial effect on overall retail sales performance in this category.
- **Vehicle Related** – Minor variations in quarterly performance but generally declining through the Fourth Quarter, 2002 with a modest increase for the following two quarters.

Chart III below reflects how the various retail sales categories contributed by percentage to the total sales tax generated in the four quarters ending December 2002.

City of San Clemente - Total City of \$ 4,543,833

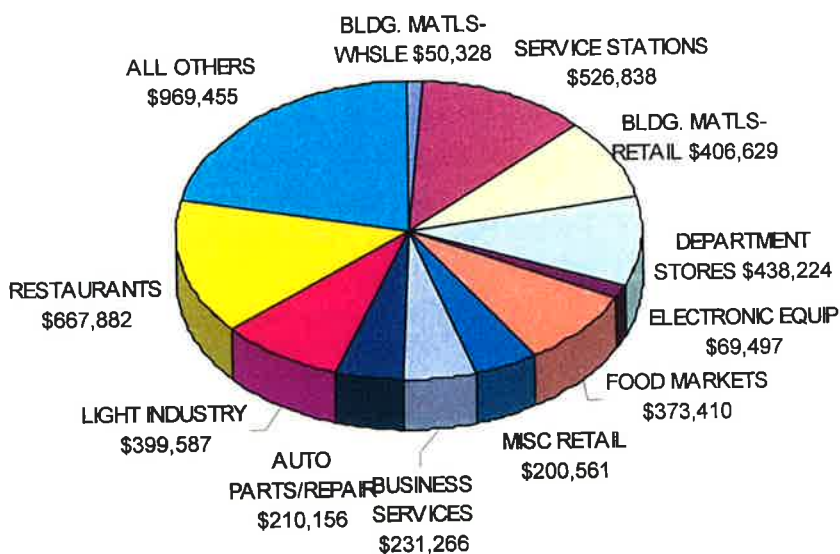


Chart III

Chart IV on the next page provides certain trending information which compares actual quarterly sales tax production from the Second Quarter, 1996, to the Third Quarter, 2002 on a four-quarter rolling average. It is particularly interesting to note that the down cycles reflected in the quarterly reporting periods correlate to the winter season wet months of the year. What this chart is telling us is that the months of January, February and March are slow months for sales tax generation, which also reinforces the notion that San Clemente is unquestionably a “seasonally sensitive” retailing community. It is also interesting to note that the first quarter dips appear to be in range with each other throughout the reporting

Long Term Financial Plan

period, but overall sales tax production continues to show stable growth. The left scale reflects quarterly receipts and the right scale is the adjusted annual total sales tax.

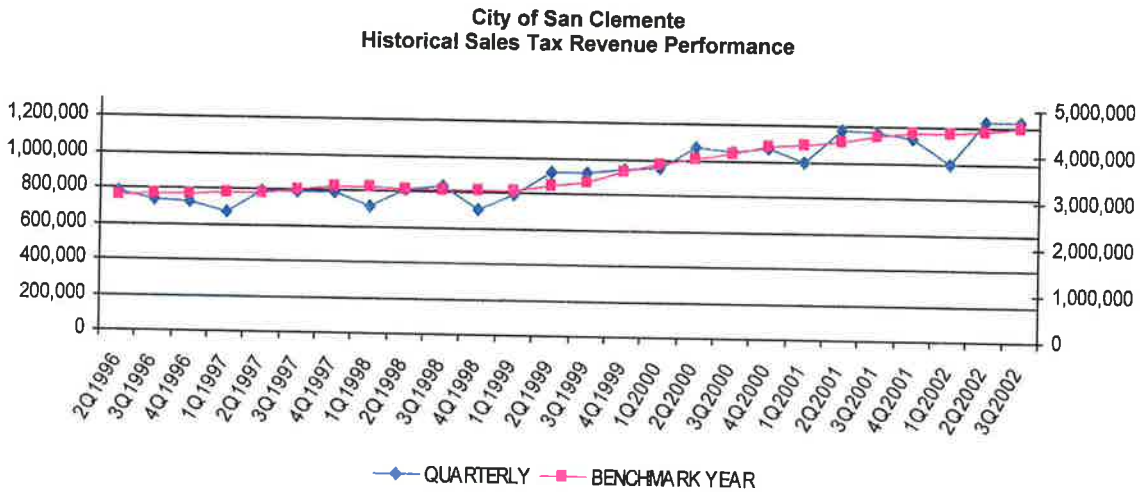


Chart IV

According to the City's annual financial forecast, Chart V below shows this projection of sales tax revenues extending out to Fiscal Year 2008-09. It should be noted that the percentage increase for Fiscal Year 2004-05 is 4.9%, is 6.0% for Fiscal Year 2005-06 and is constant at 4.1% for the remaining three fiscal years. These projections are driven by the assumptions provided by the Cal-State University Fullerton Business Forecast.

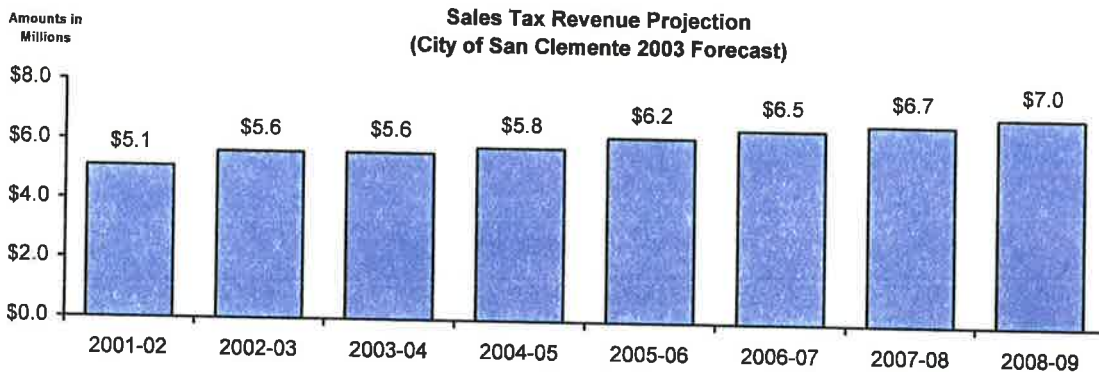


Chart V

The revenue projection in Chart V takes into account the new retail development that has been recently completed in the Plaza Pacifica Shopping Center project (430,000 square feet). The positive revenue production impacts associated with this project yielded an estimated \$280,000 during the Fiscal Year 2001-02 and another \$325,000 (Lowe's Home Improvement Center and Michael's Art Store) in Fiscal Year 2002-03. The balance of the Plaza Pacifica project was completed with the new Albertson's Grocery Store and other ancillary retail development (total of 140,00 square feet) in the second quarter of the calendar year 2002. The total amount of sales tax generated for Plaza Pacifica in 2002 was \$735,311. There is one

Economic Development Update

remaining pad (immediately east of Albertson's) that is nearing completion will be the location of a new 25,000 square foot Office Depot. When fully stabilized (end of 2004), it is estimated that Plaza Pacifica will generate approximately \$900,000 a year in sales tax revenue to the City.

Another major retail project that will have a significant impact on the City's sales tax generation is the Marblehead Coastal project. As currently approved, the commercial segment of this project (Marblehead Coastal Promenade) is comprised of 602,000 square feet which consists of 340,000 square feet of specialty retail uses (factory outlet/food court), 169,000 square feet of entertainment uses (theater/retail/restaurants) and 93,000 square feet of hotel and conference facility uses. The entire project is proposed to be developed in three phases extending over a period of seven years. The California Coastal Commission (CCC) approved this project in April of 2003 and the developer is completing final entitlement processing with the City. Based upon receipt of City planning approvals, it is hoped the developer will receive a CCC Coastal Development Permit by the third quarter of 2004 and project grading will commence shortly thereafter. The following assumptions are presented for the purposes of projecting the overall revenue impacts of this vitally needed project. It should be noted that these projections were shared with the developers of the Promenade and they concur with this information.

Phase I - 215,000 sq. ft. of Specialty Retail (Craig Realty) completed by 11/1/2005
FY 2006-07 sales tax projection is \$860,000 (\$400/sq. ft.)
104,000 sq. ft. of Entertainment and General Retail (SDC) by 11/1/2005
FY 2006-07 sales tax projection is \$338,000 (\$325/sq. ft.)
79,000 sq. ft. Hotel (141 Rooms) with ADR of \$119 and ADO of 65% 11/2005
FY2006-07 Transient Occupancy Tax (TOT) Revenue is \$398,000
Total estimated sales tax and TOT for FY 2006-07 = \$1,596,000 (Phase I)
Note: Not included in these numbers is a 13,550 Conference Center

Phase II - 124,500 sq. ft. of Specialty Retail (Craig Realty) completed by 6/1/2008
FY 2008-09 sales tax projection is \$529,125 (\$425/sq. ft.)
32,100 sq. ft. of General Retail and Restaurants (SDC) by 2/1/2007
FY 2008-09 sales tax projection is \$120,375 (\$375/sq. ft.)
Total estimated (additional) sales tax for FY 2008-09 = \$649,500 (Phase II)

Phase III - 33,000 sq. ft. of General Retail and Restaurants (SDC) by 4/1/2010
FY 2010-11 sales tax projection is \$132,000 (\$400/sq. ft.)
Total estimated (additional) sales tax for FY 2010-11 = \$132,000 (Phase III)

Utilizing the sales projections for the Plaza Pacifica Shopping Center and the phasing estimates for the Marblehead Coastal Promenade project, Chart VI on the next page provides an adjusted projection of sales tax revenues extending out to FY 2010-11.

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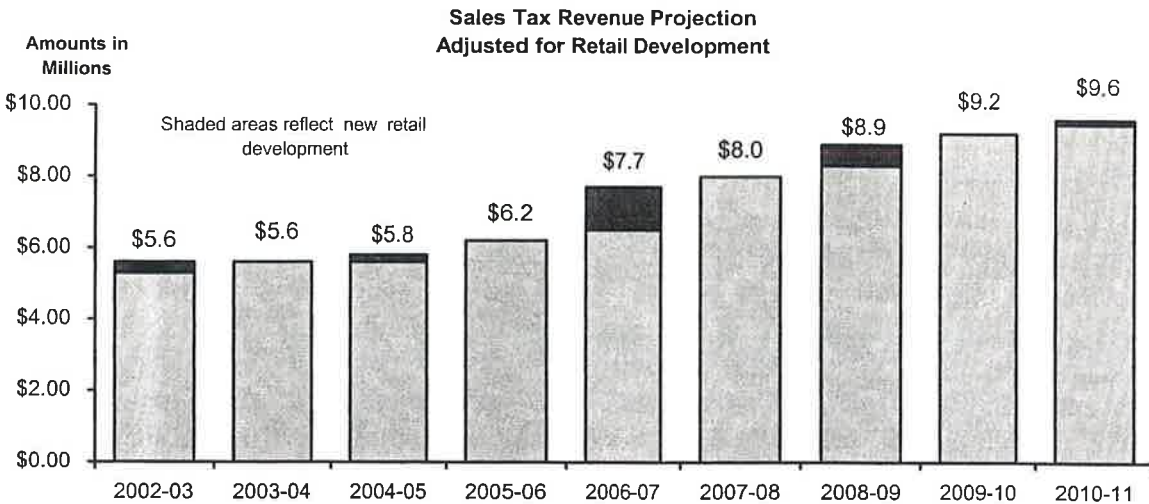


Chart VI

The importance of successfully completing the development of the Marblehead Coastal retail project cannot be overstated. The long term fiscal health of this community and its ability to continue to provide quality municipal services for its residents will, without question, be predicated on the development of this project.

Issue: Reinvestment and Revitalization – Encourage and stimulate reinvestment and revitalization in specific commercial and business/industrial areas in the community.

- **Downtown Revitalization – Central Business District Transition Program**
At the direction of the City Council, staff has worked closely with the leaders of the Downtown Business Association (DBA) to implement a revitalization program for the Downtown area known as the T-zone. The boundaries of the project are El Camino Real, from Palizada to Presidio, and Avenida Del Mar, from El Camino Real to Calle Seville including Avenida Granada and Avenida Cabrillo.

During the past seven years the City has assisted in the design and construction of new monument entrance signs, the fabrication of special brackets and installation of decorative hanging flower baskets, the design and installation of special uplighting systems in the tree wells on Avenida Del Mar, the installation of information kiosks for placement of promotional brochures, the design and installation of decorative vertical banners on El Camino Real, the installation of City entrance signs at Avenida Palizada and Avenida Presidio, and the placement of new decorative trash receptacles throughout the Downtown area. New decorative benches have also been placed in the bulbout areas on Avenida Del Mar. Last year the City completed the resurfacing of the public parking lots on Avenida Granada and Avenida Cabrillo, repainted the street light poles on Del Mar, installed new decorative globes on these street lights and effected repairs to the sidewalks on Del Mar. In conjunction with the physical improvements that have been made, the City has, in prior years, assisted the DBA in the funding and promotion of its

Economic Development Update

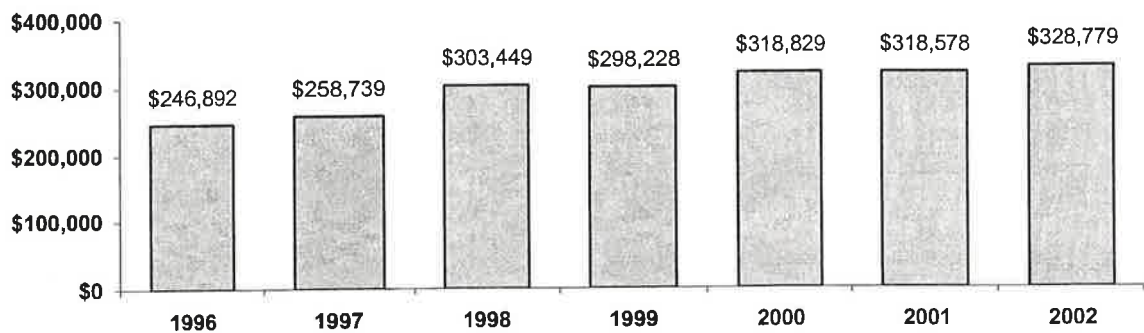
shuttle transportation program (now administered by the Chamber of Commerce) for the summer Beach Train program and also assisted in the funding of special marketing brochures. The City's investment in both hard and soft dollar costs for the CBD Transition program over the past seven years is estimated at \$300,000.

Because the Downtown is considered to be one of the most important historical and commercial assets for the community, the City Council appointed business and community representatives to serve on a special task force called the San Clemente Revitalization 2000 Committee. The Committee engaged in a thoughtful and thorough assessment of the types of program and project improvements that could be implemented with private developer impact funds to further strengthen and enhance the economic viability and aesthetic appeal of the Downtown area. The Committee made its recommendations to the City Council and as a result of the Committee's efforts and the City Council's policy direction to staff, over \$2 million in public improvements will be made in the Downtown area. The design of these improvements will be completed by the fourth quarter of calendar year 2003 and the construction phase will be commenced in March of 2004.

Coincident with these program investment efforts, the City has completed the creation of two "Rule 20-A" utility undergrounding districts for the area generally defined as El Camino Real from Ave. Granada to Ave. Cabrillo west to Seville. Over the next 5-7 years, the undergrounding of overhead utilities will significantly enhance the visual attractiveness of the Downtown. In consideration of these public investments, it is also hoped that additional private resources will be leveraged to strengthen existing businesses and attract new specialty retailing firms to the Downtown area.

The Chart below provides a 7-year recap of the total amount of sales tax revenue that has been generated by the T-Zone area.

T-Zone Downtown Sales Tax – Chart VII



- **Main Street Program**

Another program initiative supported by the City Council is the implementation by the Downtown Business Association of a "Main Street Program" for the Downtown area. In

Long Term Financial Plan

response to the City Council's support of the program, in 2001 the DBA Board of Directors formed a "Main Street Organizing Committee" for the express purpose of preparing a draft Main Street Certification Application. After conducting 15 meetings over a six-month period, the Organizing Committee completed the Draft Certification Application in late December 2001. Subsequently, the DBA Board of Directors, through a vote of the general DBA membership, approved new bylaws for its organization and it is their intention to make final revisions to the Certification Application for subsequent transmittal to the California Main Street Division of the State Trade and Commerce Agency. As a result of unanticipated budgetary cuts for the State, the Division responsible for processing applications has indicated that in all likelihood applications will not be accepted until sometime in late 2004. In conjunction with the DBA's Main Street Certification efforts, the City Council provided \$50,000 in FY02-03 funding support for early program implementation and the Council appropriated an additional \$50,000 for FY03-04 for continued support of the Main Street program.

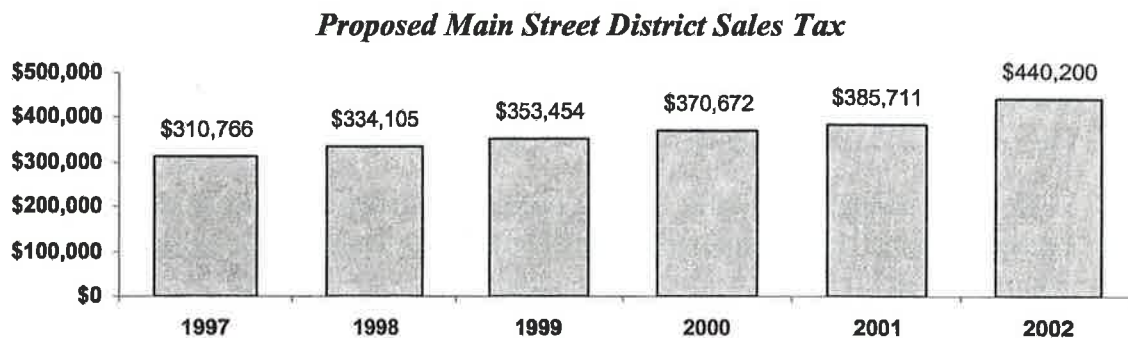


Chart VIII

The actual boundary of the proposed Main Street District conforms to the City's designated MU3 overlay zone and represents an area much larger than the traditional Downtown T-Zone (see below).

Long Term Financial Plan

The table below reveals interesting information about the business characteristics of the proposed Main Street District and its sales tax performance from calendar year 1997 through 2001.

Inventory of Businesses Summary

Main Street District Area

| No. of Businesses | Percentage of Business | Classification | Square Footage | Percentage of S.F. |
|-------------------|------------------------|-------------------|----------------|--------------------|
| 22 | 6.70 | Retail (Clothing) | 25,400 | 4.60 |
| 80 | 24.39 | Retail (Other) | 146,350 | 26.50 |
| 45 | 13.71 | Food Service | 69,100 | 12.51 |
| 9 | 2.74 | Medical Service | 12,380 | 2.24 |
| 119 | 36.28 | Service (Other) | 220,860 | 39.99 |
| 53 | 16.15 | Office | 77,880 | 14.10 |
| 328 | 100.00 | | 552,170 | 100.00 |

Sales Tax Generation

| Year | Sales Tax | Square Footage | Gross Sales/S.F. |
|------|-----------|----------------|------------------|
| 1997 | \$310,766 | 265,000 | \$117.27 |
| 1998 | \$334,105 | 265,000 | \$126.07 |
| 1999 | \$353,454 | 265,000 | \$133.37 |
| 2000 | \$370,672 | 265,000 | \$139.87 |
| 2001 | \$385,711 | 265,000 | \$145.55 |
| 2002 | \$440,200 | 265,000 | \$166.11 |

Project Area Sales Tax as % of Total Sales Tax

| Year | Area Sales Tax | % of Change | Total Sales Tax | % of Change | % of Total Sales Tax | % of Change |
|------|----------------|-------------|-----------------|-------------|----------------------|-------------|
| 1997 | \$310,776 | | 3,565,000 | | 8.72 | |
| 1998 | \$334,105 | 7.51 | 3,710,000 | 5.78 | 9.01 | 3.33 |
| 1999 | \$353,454 | 5.79 | 4,140,000 | 11.59 | 8.54 | (5.22) |
| 2000 | \$370,672 | 4.87 | 4,206,106 | 1.60 | 8.81 | 3.16 |
| 2001 | \$385,711 | 4.05 | 4,487,288 | 6.68 | 8.59 | (2.99) |
| 2002 | \$440,200 | 14.13 | 4,543,835 | 1.26 | 9.68 | 12.68 |

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Based upon this inventory, it is apparent that active retail uses constitute approximately 31.09% of all the businesses in the Main Street District while service uses (54.74%) represent the majority of land uses in the proposed project area. It is interesting to note that the average gross sales per square foot of District retail space ranges from \$117.27 in 1997 to \$166.11 in 2002. This compares to the projected gross sales of \$200 to 250 per square foot for such stores as Lowe's and Wal-Mart. The total amount of sales tax generated by the District area compared to the City's total sales tax revenues for the past six years reveals that District sales tax revenues represent an average of 9% of total sales tax revenues collected City-wide.

The implementation of a Main Street program for the revised Downtown area will address the need for professional management of the DBA's activities, the enhancement of architectural treatments and general reinvestment in the Downtown's buildings and properties. It will also focus on improved marketing and promotion for Downtown businesses, activities and special events and also provide information and direction concerning economic restructuring activities that will strengthen the overall business climate and performance of the Downtown area. It should be noted that as part of its program implementation efforts, the DBA has officially opened an office on Avenida Del Mar and retained the services of an interim Director and other paid professional staff.

- **Los Molinos Public/Private Partnership Program**

Several years ago, the City Council selected property owners and business operators in the Los Molinos business/industrial area to serve as a special Business Advisory Committee. The purpose of the Committee is to assist in guiding the City's efforts in stimulating interest and participation in the revitalization of this important commercial area. Primary emphasis has been placed upon the development of a partnership that encourages private investment in cleaning up and making more attractive the various properties in the Los Molinos area. In concert with these private investment efforts, the City has responded with the development of the West Pico Corridor Specific Plan which provides assurances with respect to current business uses and incentives concerning future land use and City funded infrastructure improvement programs.

In an effort to encourage future private reinvestment, the City has embarked on a major public works improvement program which calls for the design and installation of new storm drain system through Bonita Canyon to the MO2 Channel, the undergrounding of various utilities and the rehabilitation of Calle de los Molinos and Calle Valle. The various elements of this improvement project were expected to be completed by the fall of 2000 at a total cost of \$2.5 million. However, there have been numerous delays with SDG&E's design and construction of the undergrounding project and as a result the utility conversion and rehabilitation of Calle de los Molinos will not be completed until the summer of 2004. In addition to these improvements, the City Council annually appropriates funds to assist the Committee in beautifying area rights-of-way, installing decorative directional signage, the funding for an annual spring clean-up program and other improvements that are needed and recommended by Committee members. As a result of the public investment that has or will be made, the appearance of the Los

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Molinos area has significantly improved and several property owners and business operators are making future plans to improve their properties.

- **Revitalization of Older Commercial Shopping Center Projects**

During the past three years, several older shopping centers have undertaken significant improvements. M&H Property Management Inc., headquartered in the San Diego area, implemented the demolition of a three-story section of the existing Ocean View Plaza shopping center located on Camino De Los Mares and replaced it with a single level 25,000 square foot building pad. As part of its overall development program, M&H relocated Sav-On Drug into the newly created single story space, maintained the important presence of the Automobile Club of Southern California by relocating its offices elsewhere in the center, and they secured other new retailing and restaurant tenants for the remaining new space. In addition to the physical improvements and new tenants that have been introduced, M&H also reconfigured portions of the parking and traffic circulation making it more convenient and easier to navigate through the parking areas of the center. Sales tax performance for the period 1996 through 2002 for Ocean View Plaza is reflected below in Chart IX

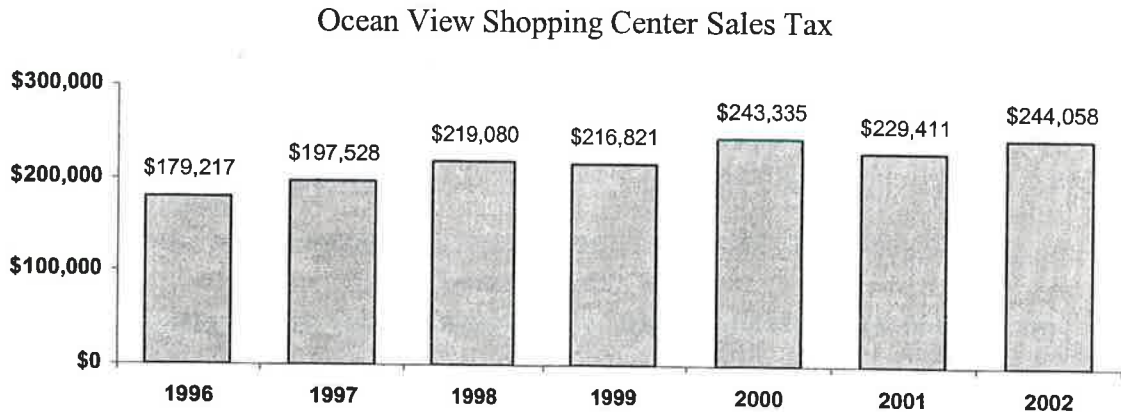


Chart IX

Companion to the reinvestment efforts at Ocean View Plaza, a local developer, Hunter Wilson, developed the Los Mares Theater complex and shopping center located directly across the street. This project is comprised of a six-screen movie complex operated by Krikorian Theaters, a major bank and a variety of in-line restaurants and retail shops. The five year sales performance of this center is reflected on Chart X on the next page.

Economic Development Update

Krikorian Center Sales Tax

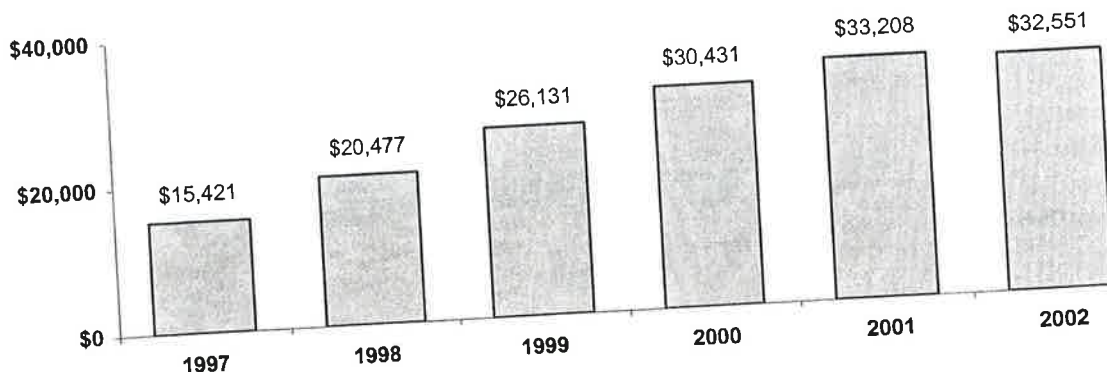


Chart X

Pico Plaza, located near the Avenida Pico/I-5 Freeway interchange on Via Pico Plaza, was acquired by MG Development in 1999 and the shopping center has undergone significant rehabilitation with new signage and facades. With the departure of Ralph's Grocery Store in 1994, Pico Plaza fell upon economic hard times and much of the center remained vacant and in a state of general disrepair until the former owners, Watt Family Enterprises, were able to land Staples Office Supply Store. Joining Staples in what was the former Ralph's store, is a furniture store and a variety of new in-line tenants have also been secured including a new restaurant, The Waffle Lady, in the former restaurant facility located on the left side of the drive entrance to the shopping center. Significant sales tax improvement is noted in 2002.

Pico Plaza Shopping Center Sales Tax

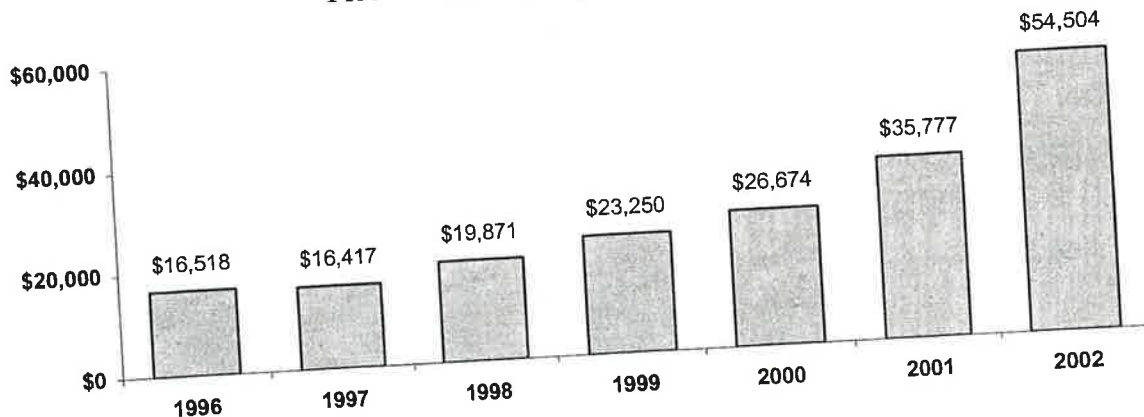


Chart XI

K-Mart Plaza is located on the west side of the I-5 Freeway on Camino De Estrella. The center is operationally divided by the K-Mart Store which controls approximately half of the center's physical space and parking resources and the remaining half is comprised of the new Pic N Save (formerly the Alpha Beta Grocery Store) and other in-line retailing

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space which has been recently rehabilitated by new owners, Burnham USA, located in Newport Beach. Also included under separate ownership in the center is the former Bank of America building which has become the site for a Kragen Auto Parts Store and Las Golondrinas Mexican Food.

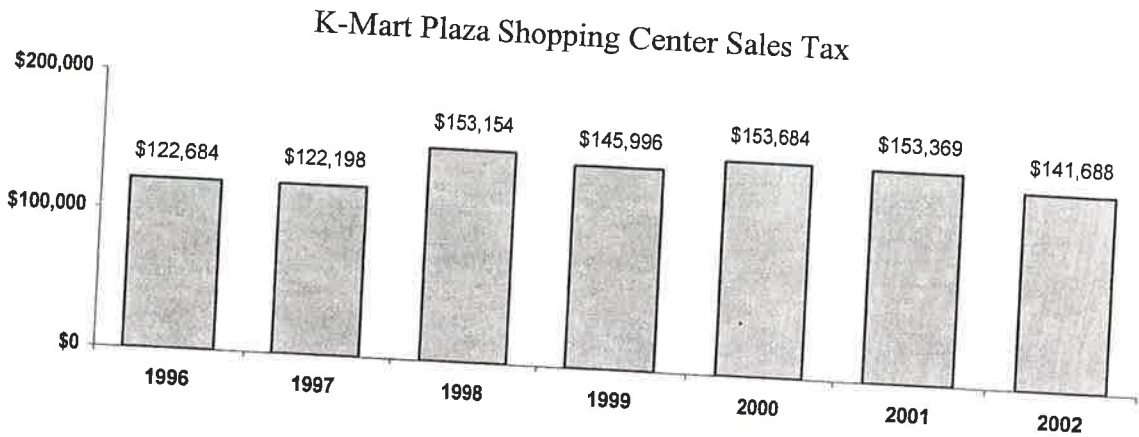


Chart XII

As previously referenced, the Plaza Pacifica Shopping Center has for the most part been completed and is comprised of 430,000 square feet of retail and restaurant uses. Lowe's Home Improvement Center opened in February of 2001 and the amount of sales tax revenue generated in combination with Wal-Mart and other shopping center tenants is reflected in Chart XIII below.

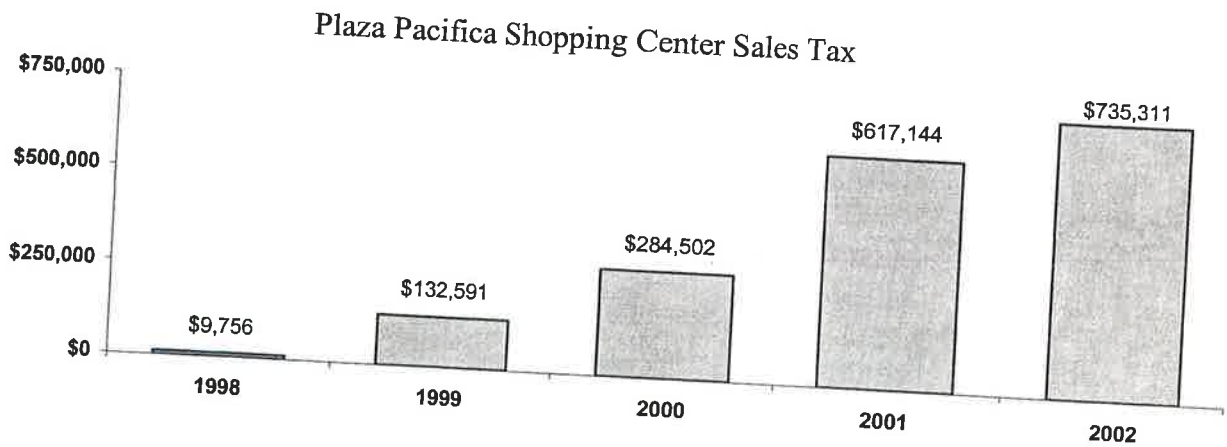


Chart XIII

Economic Development Update

The Gateway Village Plaza is a relatively new shopping center with its major anchor being Albertson's (formerly Lucky's). The center was sold last year and much of the space that had been vacant has now been occupied. The center's overall performance since its opening in 1994 has been reasonably stable; however, for reasons HdL cannot explain, the performance in 2002 took a precipitous decline.

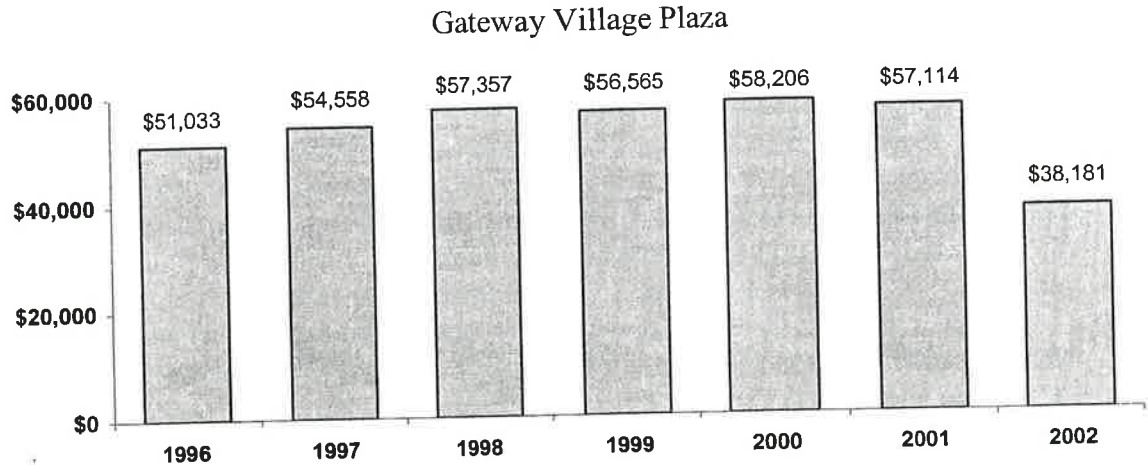


Chart XIV

The former Lucky's Center (now Stater Bros.), located immediately north of Ocean View Plaza, has been a stable performer; however, for reasons that are not clear, the center's performance has shown significant improvement starting in 1999. The actual increase in overall sales tax production from 1998 to 2000 is \$28,653 or an increase of 58 percent. Performance for 2001 was stable at the same level of sales tax production as the prior year and 2002 reflects an 8.7% increase.

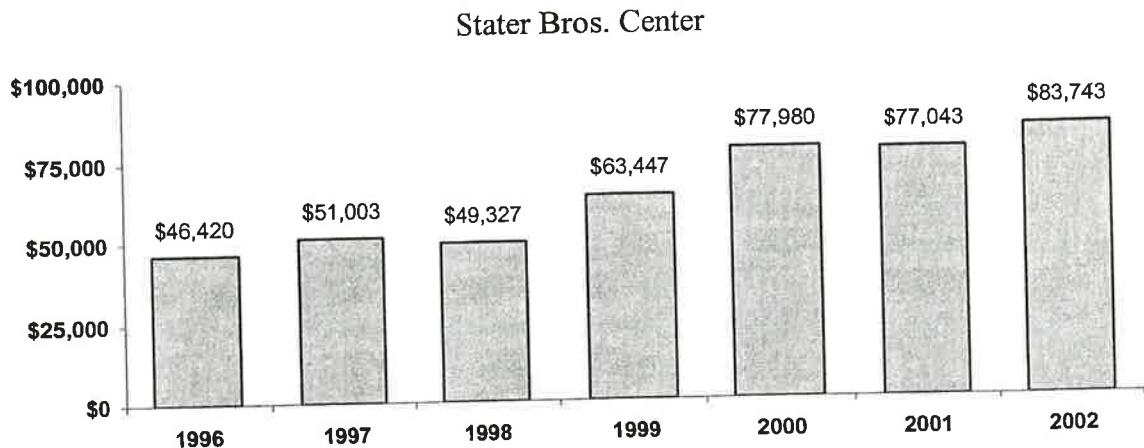


Chart XV

Long Term Financial Plan

Issue: **Increased Business Attraction to the City** – Maximize the City’s visibility and investment potential in terms of capturing new retail, business and light industrial development.

Over the past seven years, the City has enjoyed considerable success in its efforts to attract new businesses to the community. The new retail/entertainment developments (Plaza Pacifica, Marblehead Coastal Promenade, Los Mares Theater Complex – total of 1,077,000 square feet) previously referenced in this report are excellent examples of what has been or will be accomplished. Equally important has been the City’s demonstrated ability to facilitate and secure new development in the Rancho San Clemente (RSC) and Talega Business Parks. In the last quarter of 1993 there was a total of 1,805,351 square feet of existing R&D, Multi-tenant, Office and Auto related uses in the RSC Business Park. Since 1997, a total of 34 additional buildings have been built which has resulted in the addition of 821,000 square feet (46% increase) to the RSC Business Park. At the time of this report there are 33 buildings (561,089 square feet) for the Talega Business Park that have completed construction during the past 18 months. In the development pipeline for the Talega Business Park are an additional 12 buildings (131,000 square feet) that will start construction within the next six months. In addition to the two large business parks, there are 5 new buildings (180,000 square feet) in the development pipeline for the San Clemente Industrial Park, located on Fabricante near the CASA animal control facility. This means that in a period of seven years the City has increased its overall business park development by 1,690,089 square feet, an increase of over 93%.

According to Johnston Pacific, a commercial brokerage firm in the City, during 2003 the building sizes that sold in the Talega Business Park ranged from 4,000 to 86,000 square feet and sold for approximately \$126.00 to \$132.00 per square foot, depending upon size, percentage of office build-out and location. The current vacancy factor for light industrial space is 15% and the vacancy factor in office space is 75%. Lease rates have averaged \$1.00 to \$1.20 triple net per month for light industrial and \$1.75 to 2.10 full service gross for office space. Leasing activity in the Talega Business Park has been slow during 2003.

With regard to the RSC Business Park, buildings ranging in size from 3,700 to 9,000 square feet have been sold during 2003 for approximately \$135.00 per square foot. Lease rates for smaller industrial units (less than 3,000 square feet) are approximately \$.90 to \$1.00 per square foot triple net and for properties over 3,000 square feet the lease rates are approximately \$.80 to \$.85 per square foot triple net. The current vacancy factor for light industrial space is 9% and the vacancy factor for office is space is 40%. Overall, leasing activity in the RSC Business Park has been a bit more active during 2003, particularly in the last two months of the calendar year.

Notwithstanding current market conditions, the RSC Business Park will reach build out within the next two to three years. Therefore, it is important that additional business park uses be developed by Talega and, as part of its overall development plan; Talega set aside

Economic Development Update

approximately 60 net acres for the development of R&D, Multi-tenant, Warehouse and Office uses. The Talega Business Park has during the past two years produced an additional 561,089 square feet of various products and when completely built out (900,000 square feet), this development will result in the creation of additional 2,500 to 3,000 new jobs for the community. The new development recently completed in the Talega Business Park coupled with the new planned development in the San Clemente Industrial Park lends support to the fact that San Clemente continues to remain a strong and viable competitor in the regional market place.

Johnston Pacific has also provided comparative data for light industrial uses for South Orange County business park lease rate averages and for building sale pricing averages. Lease rates for RSC Business Park have increased from a low of \$.55 per square foot in 1993 to an average rate of \$.85 per square foot in 2003, an overall increase of 54%. From a regional market perspective, the Business Park's rents are below those of the Irvine Spectrum (\$1.27/sf) and Aliso Viejo (\$1.23/sf) and Rancho Santa Margarita (\$.90/sf). This is understandable considering San Clemente's geographic location relative to the Orange County Airport and the other competitive business center locations. From a sales price perspective, the Business Park has evidenced considerable strength showing a building sales price per square foot in 1993 of \$56.00 and a 2003 average sales price per square foot of \$135.00, an increase of 141%. Comparative average sales prices in the region show Irvine Spectrum at \$175 per square foot, Aliso Viejo at \$180 per square foot and Rancho Santa Margarita at \$135.00 per square foot (refer to Charts XVI and XVII). With respect to employment statistics, it is estimated that over 6,500 employees currently work in the Rancho San Clemente Business Park and at full build out that number will increase to 9,000.

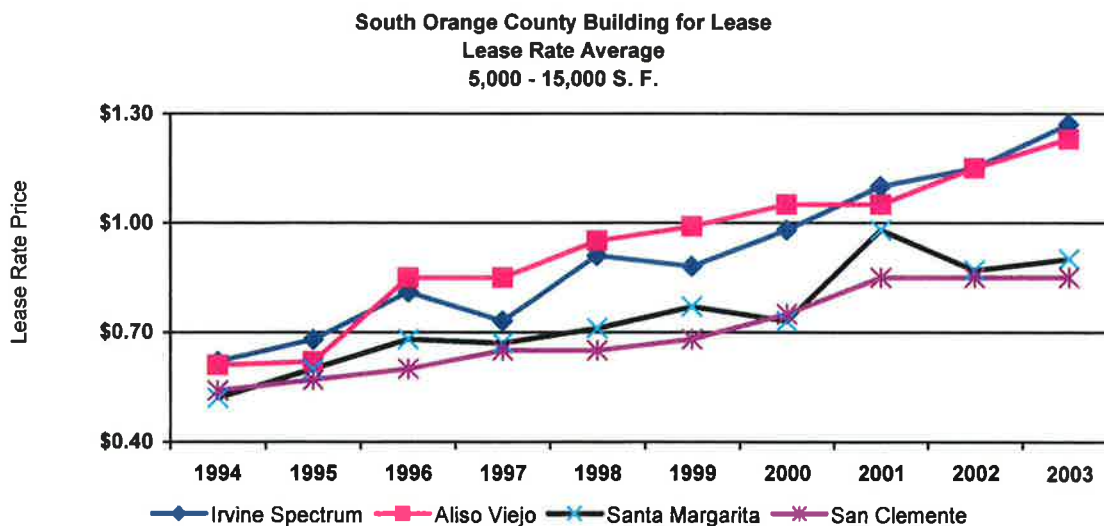


Chart XVI

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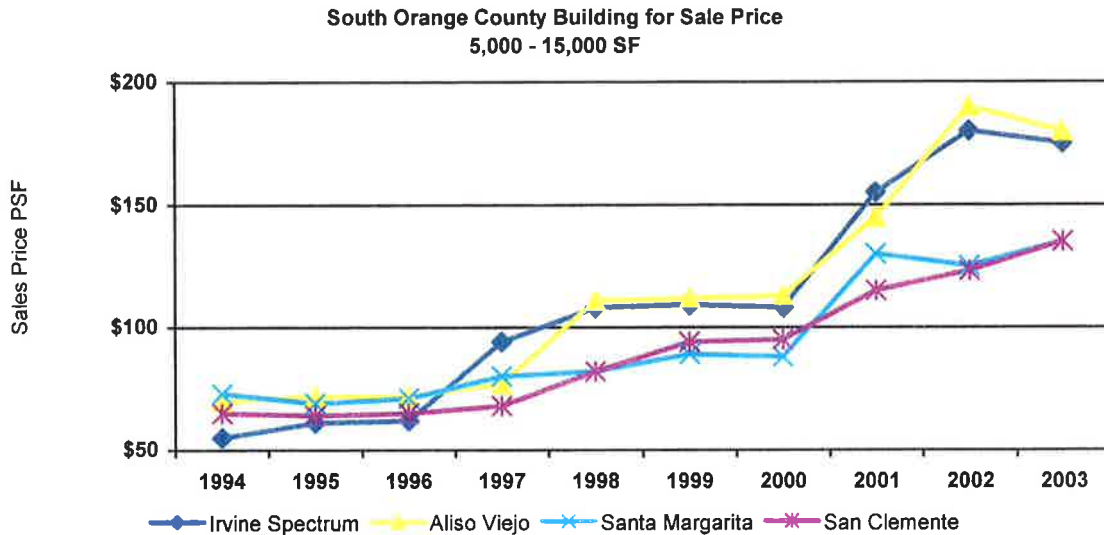


Chart XVII

Issue: New Grocery Store for South San Clemente – The City Council directed staff to market, promote and recruit a new grocery store for the south area of the community. Staff has contacted several firms who specialize in site evaluation and development for new grocery stores and staff has spoken directly with two of the major chain grocery store operators in Southern California. City staff undertook preliminary due diligence on prospective “candidate” sites in the south area and offered several alternative site configurations to one of the chains for their evaluation. Unfortunately, after an extensive evaluation of these site alternatives, the real estate executive for the chain store determined that the cost of the affected properties in San Clemente were just too expensive and he couldn’t make the numbers work for a new 55,000 square foot store. Since then, staff has been working with the property owner of the existing Ralph’s Shopping Center on south El Camino Real and there is a very real possibility that a new grocery store will be sited on this property. The property owner has for the past 9 months been involved in due diligence on the project and we believe he will be submitting a preliminary application in the new year with the Planning Division for processing of required entitlements.

Issue: Economic Development Potential for North Beach – The development of a new Specific Plan for North Beach has been on hold for several years. The reasons for delays have to do with the lack of available staff and financial resources coupled with more pressing planning program priorities elsewhere in the community. As Council is aware, a local developer had placed the Miramar Theater property into a 500 day escrow. However, the developer and property owner could not come to terms and the future development program for the Theater is uncertain. Because of its importance to the City’s overall economic development strategies, the Council has directed that the North Beach area be included in a “Downtown Visioning” process that will be initiated in the first quarter of 2004. With regard to other development options and alternatives for the

Economic Development Update

North Beach area, the fate of the Marblehead Coastal project is of critical importance to future marketing and development efforts. With the Coastal Commission's recent approval in April 2003 of the Marblehead Coastal project, the completion of required City entitlements and the commencement of construction appear eminent. The successful first phase implementation for this project will doubtless serve as a catalyst for other development initiatives in the North Beach area.

Issue: Expand Visitor Events – Promote the increase of visitor supported/generated commercial activities and events to capture a larger market share of available tax revenues.

Over the years, the Ocean Festival, the Chamber of Commerce's Fiesta Celebration and the Downtown Business Association's Classic Car Show have brought thousands of visitors into the community. Companion to these special events, the Pier Bowl and Downtown area have greatly benefited from the summer Beach Train program which has brought thousands of visitors on one-day excursions from the Inland Empire to our City. Other events that have proven to be valuable visitor draws are the DBA's monthly Arts and Craft Show, the City sponsored weekly Farmers Market and the annual Chamber of Commerce Chowder Cook-off. In addition to these events the City has staged one major international surfing tournament which included television media coverage as well.

Recommendations

1. Direct staff to continue to work closely with the Downtown Business Association, Chamber of Commerce and other stakeholders to implement public improvement projects and related programs for the Downtown area.
2. Working with the Downtown Business Association, provide appropriate staff support and assistance towards the objective of supporting and strengthening the Main Street Program. In this regard, also ensure coordination of the City's proposed Downtown Strategic Plan and Downtown Visioning process with the Downtown Business Association's Main Street Program efforts.
3. Continue to aggressively market and promote the recruitment and attraction of new business firms to the Rancho San Clemente Business Park and the Talega Business Park.
4. With respect to older commercial shopping centers, direct staff to continue to provide appropriate assistance and support for the revitalization of these centers.
5. Continue to provide staff support for the Central Business District Transition Program and the Los Molinos Public/Private Partnership Program.
6. Continue to diligently provide business ombudsman and developer advocacy services to the business community and continue to coordinate resolution and response to complaints and requests for business related support services.
7. Continue to promote and support the development of a new grocery store for the area of South San Clemente.
8. In concert with the efforts of the City's Planning Division to undertake a Specific Plan process, coordinate marketing and promotion of appropriate and viable economic development initiatives and projects for the North Beach area.

Long Term Financial Plan

Council Action

All recommendations were approved by the City Council by a vote of 5-0 on February 3, 2004.

Golf Enterprise Fund Analysis

Objective

To update the City Council regarding the general economic climate of the golf industry, create and report on a conservative five year financial forecast for the Golf Enterprise Fund, and to analyze the fund's ability to meet City Council policy objectives.

Background

The San Clemente Municipal Golf Course was designed by William Park Bell (Billy Bell Sr.) in 1928. Originally, nine holes were developed. In 1955, the layout was expanded to 18 holes. The course is a full service operation that is 6,415 yards long with a par 72. It includes a clubhouse with restaurant, driving range and pro-shop. Management of the course is based upon two City Council approved resolutions (attached) that spell out specific operations from fee structures to how reservations for tee times are provided. From a financial perspective, the course utilizes an enterprise fund to account for all revenues and expenditures, capital improvements and equipment purchases/replacements. The operation is a hybrid of both public and private enterprise. City personnel maintain the course and conduct starter operations. A private concession operates the pro shop, driving range, and cart rentals, and a second private concession operates the restaurant and bar.

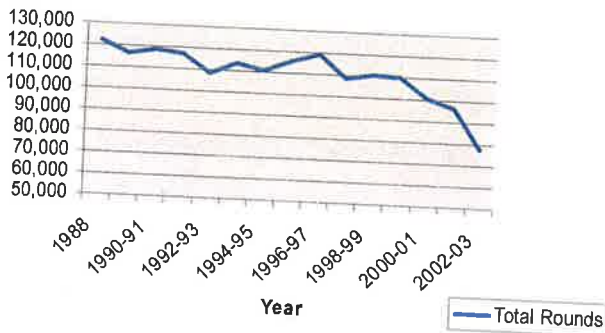
City Council Policy: 1. Provide a 100% self-sufficient, high quality golf course. 2. Maximize public recreational opportunities. 3. Ensure that the golf course is maintained in an efficient and effective manner. 4. Fully fund the Golf Operating Emergency Reserve, Golf Depreciation Reserve, and Golf Course Improvement Reserve as outlined in the Reserve Analysis portion of the Long Term Financial Plan. 5. Transfer \$425,000 to the General Fund on an annual basis. 6. City Res. No. 98-82, and Res. No. 02-86 set parameters for operational policies and fees.

Summary

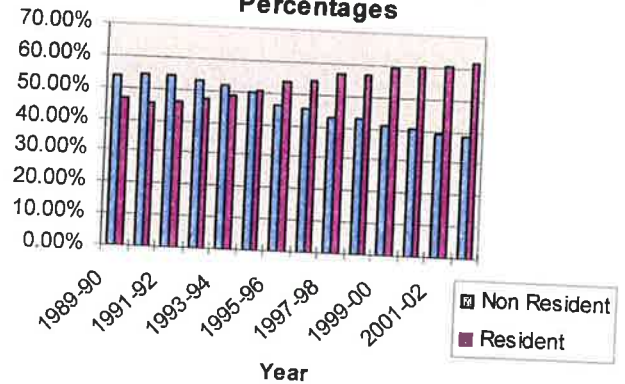
Over the past decade, the Golf Enterprise Fund has been experiencing the negative effects of an overbuilt golf industry. The golf industry experienced a period of unprecedented growth between 1990 and 2002. The number of golf courses grew by 32% in the United States, but this outstripped new player development as the number of golfers grew by only 13%, while total rounds played grew by 17%. The average net effect per course was a 10% drop in play over the period. However, this dilution of players among new courses affects some regions more than others. A 1999 study by the University of Wisconsin- Madison indicated that the metropolitan regions of southern California were among the most overbuilt areas of the U.S. Historical play figures at the Municipal Golf Course tend to support these findings. The number of regulation length golf courses in Orange County that are open to the public grew by 87% during this period, while play decreased by roughly 23% at the Municipal Golf Course, both figures exceeding the national average. This dilution of a relatively static pool of golfers with an increasing number of golf courses, is directly correlated to the drop in rounds at the Municipal Golf Course over the last decade.

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Total Rounds at San Clemente Municipal Golf Course



Resident v. Non Resident Play in Percentages



The Golf Operating Fund required a \$282,000 loan to balance in FY 2002/03, and staff is projecting an additional loan of \$192,000 in FY 2003/04. In addition, the five-year forecast projects that the Golf Operating Fund will continue to generate negative balances annually through FY 2008/09, resulting in a negative cumulative fund balance of \$423,000 (\$897,000 including 02/03 and 03/04 loans). The five-year forecast assumes that a proposed new clubhouse will be built as planned, with debt service on a \$1.75 million loan beginning in FY 2004/05. The forecast also assumes that no funding will be contributed to the Golf Course Improvement Reserve over the next five years.

It is the conclusion of staff that under current operating parameters, the Golf Course Operating Fund will be unable to meet the goals and objectives of City Council policies. Changes to operating policies and procedures (as contained in the operating resolutions), designed to increase rounds and overall revenue, are recommended. In addition, it is recommended that expenditures be reviewed and reduced where feasible.

Recommendations

Staff considers fee increases, the historical method of raising Golf Course Operating Fund revenues, not to be appropriate in the near future. Staff believes that increasing fees will reduce rounds and ultimately reduce revenues due to the highly competitive nature of golf courses. Staff will be recommending to the Golf Course Committee a number of revenue enhancements and expenditure reductions for the Committee's evaluation and recommendation to the City Council.

Council Action

All recommendations were approved by the City Council by a vote of 5-0 on February 3, 2004.

Environmental Program Update

Objective:

To update the City Council and the public concerning the progress that has been made managing issues relating to the coastal environment including coastal erosion and sand replenishment. These projects include continuation of the U.S. Army Corps of Engineers Feasibility Study, Coastal Canyons and Bluffs Management Guidelines, Opportunistic Sand Replenishment Policy, Sand Monitoring, and the Opportunistic Sand Replenishment Program.

Background

The Environmental Program consists of various projects and initiatives that collectively address environmental and related issues facing the City. The purpose, status, and fiscal impacts of current (FY2003-04) approved work plans, as well as other efforts, are discussed below.

U.S. Army Corps of Engineers Shoreline Erosion Feasibility Study

Purpose: The purpose of the U.S. Army Corps of Engineers (Corps) Feasibility Study is to investigate the causes of erosion along San Clemente's shoreline and to evaluate and recommend alternatives to correct this problem. The Feasibility Study phase is the second phase of a four-phase process which, if approved, will be followed by a design phase and ultimately a project to restore the City's beaches.

Phase I of the process was the completion of a Reconnaissance Study to determine if there was Federal interest in proceeding to a Feasibility Study. The study cost of \$100,000 was funded entirely by the Corps and resulted in Federal support of initiating a Feasibility Study, which is now in progress (Phase II). If the Feasibility Study determines that there is Federal interest in pursuing a sand replenishment project, Phase III of the project will begin, which is the Project Engineering and Design phase (Design). The Design phase is projected to cost \$1 million, with the Corps paying 75% of the cost, with a projected cost to the City of \$250,000 (25%). This phase is expected to take two years to complete. Phase IV will be the Construction phase, and is expected to cost approximately \$12 million, with the Corps paying 65% (\$7.8 million) of the cost and the City paying the remaining 35% (\$4.2 million).

Status: The Corps of Engineers' completed, and staff reviewed, a Draft Project Management Plan (PMP) which describes the tasks to be conducted during the Feasibility Study, along with the overall schedule and associated study cost. The Corps has finalized the PMP and entered into a cost-sharing agreement, which was approved by Council on September 5, 2001. The Feasibility Study is expected to conclude in the winter of 2004. The goal of the Feasibility Study is to determine if there is Federal interest in pursuing a replenishment project, and to determine the best method to place sand on San Clemente beaches with the highest degree of sustainability.

Fiscal Impact: Potentially significant. The City is required to fund 50% of the estimated \$1.7 million dollar cost of the Feasibility Study, which may come from City or non-Federal grant funds as well as in-kind services. The Council appropriated \$75,000 in FY02 toward the first

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year of the Feasibility Study and was awarded a State grant from the Department of Boating and Waterways (DBW) in the amount of \$425,000. The City has received one additional grant from DBW for the FY 2003 in the amount of \$150,000. The City will also receive approximately \$143,461 of in-kind credit for work performed for sand monitoring and an economic analysis. The table on the following page summarizes the funding sources for the Feasibility Study.

Feasibility Study Funding Sources

| | |
|-----------------------------------|-------------|
| Federal 50% share | \$ 850,000 |
| State grant for FY2001-02 | \$ 425,000 |
| State grant for FY 2002-03 | \$150,000 |
| City in-kind contribution | \$143,461 |
| City FY 2000-01 cash contribution | \$ 75,000 |
| City remaining cash contribution | \$ 56,539 |
| <hr/> | <hr/> |
| Total Feasibility Study Cost | \$1,700,000 |

Coastal Bluffs and Canyons Management Guidelines

Purpose: To create a comprehensive set of guidelines for the management of coastal canyons and bluffs.

Status: Over the past two fiscal years, the Beaches, Parks and Recreation Department has been in the process of developing a management plan to administer the City's important coastal bluffs and canyons. This project consisted of performing an inventory of the coastal bluffs and canyons. This inventory was used to develop management guidelines regarding the use of plant materials, drainage structures and methods, and access improvements along the canyons and bluffs. A multi-color educational brochure, describing suggested guidelines for owner improvements and related resources, was developed for property owners and is based on successful model templates used in Dana Point and other cities. The report and brochure was approved by the City Council in May 2003.

At the May 2003 City Council meeting, council directed staff to begin implementation of the guidelines as well as:

1. Investigate existing situations noted within the inventory relating to damaged drainage improvements.
2. Direct the City Attorney to develop ordinances relating to management of non conforming structures.
3. Instruct staff to develop ordinances for council consideration that establish standards for new construction.

Each of the above items is in the process and will be forwarded to council in the spring of 2004. Educational brochures will also be mailed to coastal and canyon residents in March 2004.

Environmental Program Update

Fiscal Impact: No impact. The City Council approved \$20,000 in the FY 01 budget and \$8,000 in FY 03 for this work effort.

Sand Replenishment Policy

Purpose: To develop a policy regulating the quantity, quality, and environmental impact of future sand replenishment or nourishment projects.

Status: A request was submitted to the City Council on September 5, 2001 to assign the Coastal Advisory Committee the task of creating a Sand Replenishment Policy. This task was approved and preliminary work began in November 2001. A consultant was hired to assist in researching the current regulations, parameters, and environmental impacts of sand replenishment.

The project involves obtaining parameters and regulations currently in effect, studying the natural processes in this coastal region in order to best mimic nature, and determining the environmental impacts of such projects. The draft policy was completed by the Coastal Advisory Committee on November 13, 2003, and is now ready for City Attorney review, with a projected date of going to the Parks and Recreation Commission and Council in early 2004.

Fiscal Impact: The total budget for this project is \$4,000 for consultant work, approved by Council in September 2001.

Sand Monitoring

Purpose: To provide necessary field data for sand nourishment studies, particularly the upcoming U.S. Army Corps of Engineers Shoreline Erosion Feasibility Study.

Status: A coastal engineering firm has been contracted to perform bi-annual sand monitoring, for five years, at 11 sites between Dana Point and San Mateo, with work beginning in October of 2001. This Sand Monitoring Program will meet the needs of the U.S. Army Corps of Engineers pending Feasibility Study on beach sand erosion.

The first monitoring survey was completed in October 2001, with the initial report released in December 2001. Historical data, from surveys taken from 1983-1988, were compared with this initial data. While one data set such as this is inconclusive, the data does point to an accelerated rate of erosion from 1983-88 (following the intense El Niño of 1983) and a reduced, but consistent rate of erosion from 1988 through 2001. Since that time, four additional surveys have been completed for the spring and fall of 2002 and 2003.

Fiscal Impact: The total budget for the five year semi-annual monitoring and reporting on 11 sites is \$117,000. This will be compensated by an in-kind credit towards the Feasibility Study as described above.

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Opportunistic Sand Replenishment Programs

Purpose: This program began in February, 2000, with an initial purpose to obtain permits for a one-time beach nourishment project and for other future opportunistic sand sources. The Lusk Development Company, the developer of the Marblehead Coastal project, agreed to pay the cost to obtain two permits. The first permit was designed for the placement of 30,000 cubic yards of sand (currently stockpiled on the project site) onto City beaches, subject to obtaining a Coastal Development Permit for the project. This project has been cancelled due to California Coastal Commission conditions placed on the Lusk Development Company to not remove the stockpiled sand due to environmental reasons.

The second permit, the Opportunistic Sand Replenishment Program, is designed to create a “streamlined” process and permit to allow for future sand nourishment projects, as opportunistic sand and funds become available. This project is still in the permit application process.

Status: The Final Mitigated Negative Declaration for the Opportunistic Sand Replenishment Program has been completed and was approved by Council on October 7, 2003. Final applications to various agencies, including the Coastal Commission, State Lands Commission, U.S. Army Corps of Engineers, and Regional Water Quality Control Board, are in the process. The permit process for the opportunistic replenishment permit is anticipated to be completed by summer 2004.

Fiscal Impact: Undetermined. The Lusk Company has agreed to obtain the specific permit for a one-time nourishment project, which was discontinued. Remaining funds were applied to developing the blanket permit for continuing nourishment project opportunities. The Lusk contribution is capped at \$75,000, which has now been expended. The City Council has authorized an additional \$35,000 in FY 04 to complete the approval process. Additional City funding contributions may be substantial for street repairs after the placement of sand is completed for each project and for sand sifting to remove fines from opportunistic projects.

Recommendation:

Receive and file with City Council making decisions as individual projects reach milestones.

Council Action

The recommendation was approved by the City Council by a vote of 5-0 on February 3, 2004.

State Impact Financial Analysis Update

Objective

This is the third consecutive year the City has addressed the impacts of the loss of control over local revenue and the associated shifts in revenue to the State due to a history of State budget crises.

Summary

The initial State Impact Financial Analysis paper was developed in FY 2001-02 and since then the State's budget situation has worsened. In FY 2002-03 this paper was updated and cited further shifts in local revenue by then Governor Gray Davis. This included reductions in funding for health care programs, education, and housing. Davis also proposed more actions to bring the budget into balance, such as tripling the cost of vehicle license fees for Californians. As this paper is updated for the City's 2003-04 fiscal year, the State still has not yet met the challenge of getting expenditures and revenues in line, nor has it realized that the solution to California's budget situation will not be found in the reduction of funding for local governments.

Many of the State's actions over the past 20 plus years have negatively impacted the City of San Clemente because the State has turned to local government to solve its budgetary problems. As the State confronted the FY 2003-04 budget, policymakers faced fiscal shortfalls that were the product of three years' worth of major imbalances between revenues and expenditures, which first opened up when revenues plunged during the 2001 economic downturn and stock market decline.

The State's fiscal situation deteriorated for a number of reasons, including the fact that Davis did not set aside sufficient funds when the economy was healthy and instead expanded government programs. Over time, this resulted in an imbalance of revenue and spending. Also, most of the easy, one-time budget fixes which included extensive borrowing and deferrals to produce a \$98.9 billion budget were used to close the FY 2002-03 budget gap. Davis relied on speeding up some tax collections and pushing expenditures into FY 2003-04 while these actions did little to help the budget deficit concerns in future years. This did not sit well with the voting public who took to the polls on October 7, 2003 to recall Davis. The public succeeded and installed Arnold Schwarzenegger as the new Governor.

On the positive side, the Legislative Analyst's Office projects overall State revenues for FY 2003-04 to total \$74.2 billion, a 4.7% increase over FY 2002-03. And, revenues from the State's major taxes are up by about \$2.2 billion, primarily due to higher personal income tax receipts.¹ On the downside, California policymakers face a substantial challenge in preparing next year's General Fund budget. Initially the State was facing a year-end shortfall of \$10.2 billion in FY 2004-05 assuming the vehicle license fee (VLF) rate increase remained in effect. However, because Governor Schwarzenegger rolled back the license fees, the shortfall will be substantially

¹ Hill, Elizabeth G. November 2003. "California's Fiscal Outlook: LAO Projections 2003-04 through 2008-09," Page 4. Legislative Analyst's Office.

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more – as much as \$14 billion since Governor Schwarzenegger enacted an emergency order to resume backfill payments to localities.

Since being elected, Governor Schwarzenegger vowed to keep his campaign promise to repeal the 300% increase in the VLF, which he did on November 18, 2003. The Governor went on record stating, “Because at the time the offset was eliminated, the State’s Director of Finance did not provide priority for the vehicle license fee offset over other State obligations of equal legal entitlement, and did not take into account funds available to the State through borrowing, the Director’s determination was in error, not a reasonable interpretation of the statute and the circumstances required by Revenue and Taxation Code section 10754 were not met.”

Failure to reinstate the backfill or some other means of reimbursement to local governments would have resulted in a \$3.6 billion loss in funding for essential local services provided by cities and counties. The VLF revenues are an economically stable resource and because the VLF is allocated to cities in relation to population, it tracks favorably with the growth in local service demand related to residential development. The Governor addressed this issue by asking the Legislature to appropriate these funds to make local governments whole during a special session of the Legislature that addressed California’s fiscal crisis.

On December 9, 2003, the Governor retreated on his promise to cover local governments’ loss of car-tax revenue and asked the mayors and county supervisors who are worried that the lost revenue won’t be replaced should look to the Legislature to make this happen.² The Legislature were considering three bills which were authored in late November and early December 2003 to restore the VLF backfill: SB 5X1 (Brulte), AB X5 3 (Cox) and AB X5 7 (Lowenthal). Two of these bills were addressed by the Assembly on December 11, 2003 and both failed on a largely party line vote. Since then, local governments mounted a strong lobbying effort aimed at getting Schwarzenegger to keep his promise and to warn of the consequences (elimination of public safety-related positions).

On December 17, 2003 the Governor announced that he believed he found a way to circumvent the Legislature and order the VLF backfill payments to continue immediately. The Governor invoked an obscure State law that administration officials say allows his director of finance to order emergency payments for various programs when they run over budget.³ The emergency order was enacted by the Governor. The legality of his actions have been questioned but not yet challenged. Next, the Governor and the Legislature will have to cut \$2.65 billion from other programs by June 30, 2004 to keep the budget in balance. Schwarzenegger proposes that the car-tax money be made up by \$1.9 billion in current year cuts and \$1 billion in higher than expected tax receipts as a result of the improving economy.

As the State takes more money from local government, it places more restrictions on cities’ ability to raise revenues despite the fact that cities and counties provide all of the frontline

² Nicholas, Peter, Evan Halper and Joe Mathews. December 10, 2003. “Schwarzenegger Retreats on Key Campaign Vows.” *The Los Angeles Times*, Page 1.

³ Halper, Evan, Peter Nicholas, and Nancy Vogel. December 18, 2003. “Governor to Speed Local Funds.” *The Los Angeles Times*, Page 1.

State Impact Financial Analysis Update

services to make neighborhoods safer, more livable and economically viable. The rates and bases of the three largest sources of general purpose revenues – the sales tax, property tax and VLF – are no longer under the control of the local agencies that rely upon them to fund essential services. As a result, these critical local revenues are subject to substantial political risk. When the State faces a financial crisis, local government is left in a vulnerable position as the State seeks to balance its budget by using local dollars, leaving local governments with less ability to ensure that local tax dollars stay in the communities they came from.

San Clemente was negatively affected during the recession of the early 1990's when the State took local revenue (property taxes) to meet its obligations to fund schools. To compensate, the City increased service user fees and implemented layoffs while contracting many services formerly provided by employees. Cities may once again have to contend with losing even more property taxes to the State as proposed in the Governor's FY 2004-05 budget.

This report provides an overview and analysis of how San Clemente has been impacted by the State's fiscal position and how the State has obtained greater fiscal control of local government, resulting in a decline of local influence on how tax dollars are spent. These issues are analyzed to show how they have caused the City of San Clemente to make major changes over the years in staffing levels and service delivery.

Background

For more than 20 years, local government has lost more control over its revenue to the State. The diversion of local funds has allowed the State to meet its funding obligations at the expense of important local services. Likewise, voters passed seven propositions in an 18-year period that focused on State-local finance – some which contributed to the reduction in local government revenue and more control over how cities raise revenue.

These financial challenges have forced the City of San Clemente and other cities to find creative ways to deal with permanent fiscal diversions. The City was hardest hit during 1992 to 1994 when staff reductions and cuts in operations were imposed, but through conservative fiscal policies and sound budgeting plans, the City has managed to cope with the State's tactics, although further shifts in revenue would be devastating considering the City's increasing service demands and growing population which was 60,701 in January 2003, a 6.7% increase from the prior year.

Once again, the State is experiencing a financial crisis and Governor Schwarzenegger who inherited California's largest deficit in the State's history, has proposed a hiring freeze and has declined to take his own \$175,000 salary. The Governor would also seek approximately \$1.5 billion in bonds to finance the deficit and said he would seek \$1.9 billion in cuts. He also has indicated that higher-than-expected State revenues might produce around \$1.6 billion. The Governor's administration considers the \$3.6 billion required to backfill locals for the VLF to be part of its inherited debt. Additionally, Governor Schwarzenegger will use a new law written into the budget this year to cut various State programs by 5% on his own authority. Those cuts will reduce just \$150 million of the cost of the \$2.65 billion payment the Governor is ordering. The Governor also proposed in his FY 2004-05 budget on January 9, 2004, to divert another \$1.3

Long Term Financial Plan

billion in property taxes from cities, counties, special districts and redevelopment agencies to fulfill the State's obligation to fund schools. This is a 25% increase in the current \$5 billion ERAF property tax shift swiped from local governments each year. The remainder of the cuts requires Legislative approval.

While State revenues are up 4.7%, (the economy is doing better) so are budget-related expenses. These expenses include the court ruling denying the use of bonds to pay state pension costs, the Southern California fires, lower savings than anticipated and higher Proposition 98 spending (triggered by the higher revenues). Proposition 98 was passed by voters in 1988 and requires that public schools receive about 40% of the State's revenues. By most estimates, there is a persistent \$14 billion imbalance between revenues and expenditures in the upcoming year. Without the VLF backfill triggered by the Governor's Executive Order, the State would probably end the fiscal year about \$601 million in the black (down from an original estimate of \$2 billion). The Legislative Analyst recommends that the legislature keeps all options open (both spending cuts and tax increases) in deciding how to address the deficit.

Respective roles of State vs. Cities

Time has proven that cities are perpetual creatures of the State. The State's uncontrolled spending has created further budget deterioration. This was also the case following fiscal year 1991-1992 when then Governor Pete Wilson faced the challenge of closing a staggering two-year budget shortfall of \$6 to \$10 billion. In fiscal years 1992-1993 and 1993-1994, in response to the serious budgetary shortfalls, the Legislature and administration turned to local government and permanently redirected over \$3 billion of property taxes from cities, counties and special districts to schools and community college districts.

Another example of the State's control over cities is the form of government. The State is divided into counties which are legal subdivisions of the State and, more importantly, Article XI of the California State Constitution dictates what cities can do. The City of San Clemente is a General Law City with a Council-Manager form of government. This form of government provides for the Council to set policy, approve the budget, pass local laws which are incorporated into the Municipal Code, and to give direction on matters concerning the City. The City Manager, appointed by the Council, is responsible for carrying out Council policy and direction, and supervising the administrative staff and functions of the City.

The root cause of the budget crisis has been misdiagnosed by State lawmakers, economic analysts, and the media. Most blame the crisis on a variety of economic, political, and fiscal factors all beyond the State's direct control. Those factors include (1) a national economic recession that has drained the State's revenue, (2) citizen resistance in the 1980s to new State taxes, (3) steep declines in federal aid during the 1980s, (4) new spending mandated by Washington, and (5) court-imposed spending requirements for education and corrections. Although each of those factors may be partially responsible for the deficit, they are of minor

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significance compared with the primary culprit: a decade of runaway State government expenditures.⁴

Despite Proposition 13, the Gann Amendment and other tax limits enacted in the late 1970s, California saw revenues grow by a healthy 8% per year over the 1980's. The downside of this revenue growth was that expenditures climbed by 11% annually. A bipartisan gasoline tax hike of 9 cents a gallon was narrowly approved by voters in 1990 on the basis of arguments that the State's 1978 expenditure limitation had starved the public sector. Politicians managed to obscure the reality that, since 1983, the State budget had expanded by 50% to \$54 billion, and that State spending had risen from 7.5 to 8.5% of Californians' personal income.⁵

Governor Schwarzenegger has vowed to change the "government as usual" approach to managing the State. Prior to his Governorship, former Governor Gray Davis and even some officials in the Legislature insisted that the States' fiscal troubles were a result of factors beyond their control--including federal spending policies, the downturn in the national economy and the energy crisis. In response Davis found ways to make up the budget gap through means that adversely impact local government. For this reason, local governments face enormous difficulties in completing their budgets on time because City officials are constantly worried about State changes in local revenues, with State budgets that continue to run past the beginning of the new fiscal year.⁶

Fiscal relationship between Cities and the State

The relationship between local government and State government is complex. In most states, local governments make decisions about how much property tax revenue they wish to raise. For this reason, among others, this fiscal relationship is more complicated and ambiguous in California than it is in most other states.⁷ In California, the property tax base and determination of the property tax rate are out of local control and have become more restrictive over time as a result of Proposition 13 and a series of other voter-enacted initiatives that have greatly reduced both local and State discretion and property tax revenue. By fiscal year 1995-96, real property taxes per capita were still 46% lower than their 1977-78 level. Over time the State legislature adjusted the allocations of the property tax in response to local pressure and State fiscal emergencies. After reallocating over \$3 billion of property taxes away from counties, cities and special districts to school districts, the State proceeded to decrease State aid to schools causing increased fiscal problems for cities and non-school jurisdictions. As a result, cities have had to

⁴ Cato Institute, Policy Analysis, Policy Analysis No. 152. "State Spending Spurge: The Real Story Behind the Fiscal Crisis in State Government." May 23, 1991, Writer: Stephen Moore.

⁵ Cato Institute, Policy Analysis, Policy Analysis No. 152. "State Spending Spurge: The Real Story Behind the Fiscal Crisis in State Government." May 23, 1991, Writer: Stephen Moore.

⁶ Coleman, Michael and Colantuono, Michael. August 2003. "Local Fiscal Authority and Stability: Control and Risk in California City Revenues." *Western City*.

⁷ Chernick, Howard, Professor of Economics Hunter College, City University of New York and Andrew Reschovsky, Professor of Public Policy and Applied Economics. March 2001. "Lost in the Balance: How State Policies Affect the Fiscal Health of Cities." University of Wisconsin-Madison.

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offset the reductions in intergovernmental aid with a wide variety of user fees and dedicated tax revenues from development.

State policies affect the fiscal condition of cities in many ways. On the revenue side, these include the amount and distribution of State aid, the types of taxes cities are allowed to impose, and the State's rules for the geographic distribution of user fees and taxes collected. For this reason, the City of San Clemente is looking forward to increasing its sales tax base with the development of Marblehead Coastal's designer outlet shopping center. Over the years, the City has also sought alternative financing sources. These include locally-generated taxing measures such as utility taxes and fees for sanitation, sewage treatment, and solid waste removal and urban runoff management. These actions have created a stronger relationship between service delivery responsibility and control over revenue sources to pay for them.

Local government's dependence on sales taxes is clearly evident when considering how many revenue sources have their proceeds restricted to certain types of uses. For example, City enterprise revenues--the rates and service charges paid by users of City-provided water, electricity, or other such utility-like functions--normally must flow back into the operation of the enterprise in question. Similarly, many State subventions and federal grants are earmarked for particular functions or programs. Sales and property taxes (along with VLF revenues) are the major single sources of discretionary income that may be used for general purposes by cities.

After years of the State legislature not requiring taxation on Internet purchases by carving out exemptions to the sales tax, State and local governments are seeing a decreasing sales tax base. The California Budget Project determined that taxable sales as a proportion of personal income in the State fell by more than a third between 1950 and 1995.⁸ This trend has further constrained California's local governments' ability to squeeze any growth from this abundant revenue source. Not surprisingly, the ratio of local sales tax revenues to personal income in cities has declined since the 1970s. Consequently, with the State's continuing fiscal crises, legislation for Internet taxation is gaining support.

What has changed?

Voter initiatives have often had a negative impact on local government revenues. California has the most liberal initiative process in the country, so this tool is used frequently, with confusion and a misunderstanding of the consequences. The voter initiatives that have had the greatest impact on local government are examined below.

Proposition 13

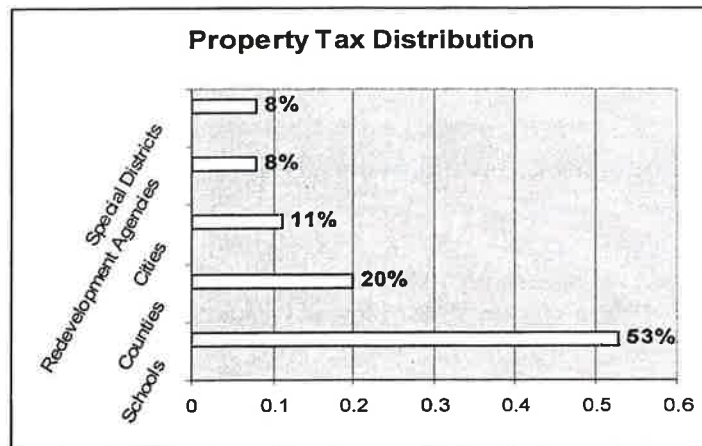
Proposition 13, which was passed by voters in 1978, sought to cap spiraling property tax rates and put a cap on increases of no more than 2% per year on those who owned homes before the initiative went into effect. Since then, local governments have had to get by with less money

⁸ Lewis, Paul G. and Elisa Barbour. July 1999. "California Cities and the Local Sales Tax." Policy Institute of California, San Francisco, CA.

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which has impacted service delivery. The State can no longer allocate money for its own purposes. Proposition 13 collects property tax and distributes it to local agencies according to a complex formula. Proposition 13 made it more difficult for local officials to raise new taxes by requiring a two-thirds majority vote. These constraints forced local government to turn to other revenue sources, so any problems that surface needing new taxation must be put to a vote.

The chart below outlines the current distribution of property tax dollars:



The share of self-controlled revenues has declined for local government (excludes public service enterprise revenues). Since the transfer of the property tax allocation authority to the State, local government has become more dependent on the State for the funds needed to carry out their obligations. The percentage of total revenues that are self-controlled for cities has declined from 66% in 1978 to 43% in 2002. Since the law has not changed, the percentage of total revenues that are self-controlled in 2002 is the same as the percentage in 1995.

Educational Revenue Augmentation Fund (ERAF)

In fiscal years 1992-1993 and 1993-1994, in response to serious budgetary shortfalls, the Legislature and administration permanently redirected over \$3 billion of property taxes from cities, counties, and special districts to schools and community college districts. These redirected funds reduced the State's funding obligation for K-14 school districts by a commensurate amount and enabled the State to balance its budget. (Schools and community colleges did not experience any change in their total revenues from this shift, merely a shift in the relative amounts of funding from the State's general fund and local property taxes).

The property tax monies were deposited into the Educational Revenue Augmentation Fund (ERAF). In fiscal year 1996-1997, cities, counties, and special districts deposited about \$3.4 billion of property taxes into ERAF. The amount of required ERAF contributions grows annually along with the property tax growth rate, which is estimated to be 3% in the budget year. The initial impact of the \$1.5 million ERAF shift from the City of San Clemente to the State in fiscal years 1992-93 and 1993-94 was devastating as cuts in programs, services, and staffing levels resulted. These property tax shifts for San Clemente comprised of cumulative losses of

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\$8,110,120 for FY 1992-93 and \$7,319,440 for FY 1993-94. There has been no sign that the annual ERAF shift is going to end; in fact, Governor Schwarzenegger's FY 2004-05 budget proposal looks to local government to help the State balance its budget and to meet its statutory requirement to fund schools. A proposed \$1.3 billion will be diverted from local governments to ERAF. For San Clemente, this means a loss of an additional \$521,630 annually in property taxes.

The fiscal shortfall in 1993 that resulted from the operating deficit and other critical capital needs, annual reserve needs and the property tax diversion was addressed by undergoing a comprehensive review of all programs provided by the general fund and reductions. In fiscal year 1993-94 San Clemente laid off or contracted nearly half of its full-time equivalent employees (FTE), going from 299 FTE's to 158 as a result of ERAF, which involved contracting public safety services (police and fire), prisons/jails, some parks and recreation operation and maintenance positions, some parks and landscaping and maintenance positions, fleet management and vehicle maintenance, some building and grounds maintenance and building security positions, solid waste collection services, some street repair positions, some tree trimming and planting services, and parking meter maintenance and collection positions. Currently the City has 172 FTE's and does not plan any increases in staff for the next fiscal year.

Proposition 218

Proposition 218, the "Right to Vote on Taxes" initiative was passed in November 1996 and amended the California Constitution (Articles XIII C and XIII D) which, as it relates to assessments, requires local government to have a vote of the affected property owners for any proposed new or increased assessment before it could be levied and required that two-thirds of the voters approve a special tax.

This impacted cities' ability to generate new revenues through various coping mechanisms that were implemented to provide services and led to voter resistance with the passage of Proposition 218, which placed new limits on local fees, charges, property-related assessments and taxes. In the past, cities were not required to obtain ballot approval before levying street lighting assessments; only City Council approval was required, even if there were protests.

The passage of Proposition 218 caused the elimination of the City of San Clemente's Lighting and Landscaping assessment district because assessments which are considered to be of "general benefit" could no longer be assessed, resulting in an annual loss in revenue of \$1.8 million. These general benefits included beach and park maintenance which represented the majority of expenditures within the district. Significant reductions in spending for local public programs and services resulted.

The impact of Proposition 218 on the City was severe. In fiscal year 1997-98, the City made reductions in costs and related services. The reductions which totaled \$1.8 million undoubtedly affected the quality of life in San Clemente, nevertheless the budget had to balance.

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City of San Clemente Reductions Due to Passage of Proposition 218

| <i>Program Reductions/Revenue</i> | <i>Savings/Revenue</i> |
|---|-------------------------------|
| <i>Reduction of liability insurance costs</i> | \$200,000 |
| <i>Emergency reserves reduced from targeted 8% to 5%</i> | \$250,000 |
| <i>Reduced Council Contingency reserve to \$100,000</i> | \$110,000 |
| <i>Eliminated program for improving sports fields for youth groups</i> | \$100,000 |
| <i>Eliminated management benefits</i> | \$38,000 |
| <i>Reduced renovation/upgrades to parks, beaches and streetscapes</i> | \$100,000 |
| <i>Eliminated 1 executive management position</i> | \$100,000 |
| <i>Contract Public Works maintenance</i> | \$430,000 |
| <i>Downgrade of 1 management position</i> | \$11,200 |
| <i>Eliminated bi-monthly newsletter</i> | \$23,000 |
| <i>Transfer of revenue from Golf Fund</i> | \$250,000 |
| <i>Increase parking meters to \$1/hour</i> | \$120,000 |
| Total | \$1.8 Million |

Data Sources: City of San Clemente Budget books.

General results/trends due to initiatives and State actions

State actions have endangered cities fiscal health causing them to lose local control of local revenues. Counties and schools have become totally dependent on the State for funding and today most State support now comes with restrictions on spending. City funding also has seen a change and is more subject to fluctuations in the economy and development activity which causes instability. Several development-related revenue sources are declining and are expected to stabilize at normal levels over the next few years.

Local government is doing all that it can with the resources available and many cities have looked to offset their declining share of local revenue by pursuing alternative sources of revenue, such as increasing the level of fees charged for residential development, seeking increases in sales tax revenues by encouraging retail businesses to locate within their jurisdictions, and encouraging development. There is more interest and reliance today on redevelopment and cities are more prone to "fiscalization" of land use, pursuing sales tax generating retail uses rather than housing/job generating commercial development.

The pursuit of sales tax dollars has led local governments to establish their development/land use decisions in favor of retail because of the net tax revenue they will generate for the City. The

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local sales tax is one of the few revenue sources with the potential for substantial growth as a result of City decisions and can be helpful in replacing City revenues that are taken by the State. The result is a "fiscalization" of land use that can have negative consequences for regional land-use planning. If cities are not careful to balance retail with other types of development, they run the risk of sacrificing the long-term fiscal and environmental health of communities for short-term gains in sales tax producing land uses. The City of San Clemente has remained cautious and ensures balanced sources of revenue and has never been dependent on sales tax revenue.

The State flexibility for spending has been reduced given mandates for funding levels in schools and spiraling cost for prisons and mandated social, and health programs, limiting the State funds for local programs and projects. Therefore, local governments have grown to rely on development fees and financing arrangements to provide public facilities such as schools, community centers and roads. San Clemente enters into developer agreements with developers who commit millions of dollars for infrastructure and community improvements and, in turn, give the developers reduced risk and legal assurances that the development rules won't change on their projects. This allows the City to fill community facility and infrastructure needs they otherwise would not be able to. Such mechanisms have become far more prevalent and important as the State and federal governments have withdrawn from providing funds for local public infrastructure.

Local response: Finding ways to replace lost revenue

The City of San Clemente's reaction to the State taking local revenues was to increase fees where appropriate in order to replace revenues lost while continuing to provide services. These actions have had mixed outcomes. Additional options are very limited without extreme consequences.

Business License Fee Increases

Business license fee increases took place on July 3, 1991 when the City Council adopted Ordinance No. 1055 and fees were increased significantly, creating a much needed increase in this revenue stream. Caps on fees were removed. As an example of the growth in this revenue source, by close of the 1988 calendar year the City collected \$250,000 for approximately 2,500 business licenses and, by the close of the 2003 calendar year, the City estimates it will collect \$778,000 for approximately 6,000 business licenses.

Golf Fund Transfers

As additional means of increasing revenue to the general fund for recreation programs, the City of San Clemente transfers \$425,000 annually from the golf fund to the general fund. This was implemented in fiscal year 1996-97 due to City-wide financial problems and is still in place today. The financial problems resulted from the passage of State Proposition 218 which stated that certain fees cities were charging were in fact taxes and to pass taxes a majority vote was required. A subsequent vote on a utility tax (Measure A) in San Clemente failed and prompted the need to transfer money from the golf fund to the general fund to cover recreation programs. Many general fund services were simultaneously cut to make ends meet.

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Street Assessment District Formed

The City created the Street Assessment District which was adopted by the City Council in July 1995. This program was established to provide a designated fund for the rehabilitation of City streets by restoring approximately 60 miles or one-half of the City's street system over 18 years. The program is funded by a combination of revenues from (1) Street Assessment District 95-1, which assesses all developed properties (the amount assessed totaled \$760,000 in fiscal year 2002-03); (2) the General Fund; and (3) the Gas Tax Fund. In addition, the Water, Sewer, and Storm Drain Funds pay for work done to various underground facilities in conjunction with the street work.

Even though almost half the streets included in the Street Improvement Program were originally scheduled to be rehabilitated in the first five years, the City has accelerated the program. Bonds were sold in the second year, versus the originally planned third year of the program. Bonds as well as program savings and grants obtained from the State, have allowed several projects to be constructed a few years earlier than originally scheduled.

Storm Drain Fee Increase

The City's efforts to control storm water and urban runoff pollution to improve local water quality needed to be increased after stringent regulations were imposed by the San Diego Regional Water Quality Control Board (SDRWQCB). In response to the City Council's direction, staff pursued a successful mail ballot election to increase the existing storm drain fee because funds were not available to cover the costs. The "Clean Ocean Water" Initiative passed by a 13.2% margin, or by 1,084 "Yes" votes. Of the 8,167 property owners whose ballots were validated, 4,627, or 56.7% voted "Yes", while 3,540 or 43.3% voted "No." The revenue collected from the fee increase funds various activities such as public education, increased enforcement, water quality monitoring and structural urban runoff treatment projects – all geared towards improving local water quality. The specific activities outlined include:

- *Increased public education;*
- *Dry weather water quality monitoring;*
- *Structural urban runoff treatment projects;*
- *Installation of systems to clean and filter storm drain runoff;*
- *Increased street sweeping;*
- *Increased storm drain capital projects; and*
- *Two new water quality inspector/enforcement staff positions.*

The amount of the new fees total \$1.7 million annually or \$8.5 million over the five-year fee implementation period. If the ballot initiative had failed, the City would have been faced with finding alternatives to fund the new requirements, such as possible staff and service reductions.

Greater Focus on Sales Tax Revenue

The City of San Clemente has developed a heavier reliance on new development to meet long term needs. The Marblehead Coastal project for example would bring over \$2 million in annual sales tax revenue to the City. This project proposes to develop factory designer clothing outlets,

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several restaurants and retail shops, a hotel with convention facilities and 313 single family homes. The plan won approval by the Coastal Commission on April 9, 2003. The City's Wal-Mart and Lowe's shopping center consists of several retail stores and an Albertsons grocery store, which since 2000 has contributed sales tax dollars to the City. Other smaller centers have been developed and the rehabilitation of older centers such as the K-Mart Center and the Pico Plaza has helped increase the City's sales tax base.

Local impacts of State revenue shifts

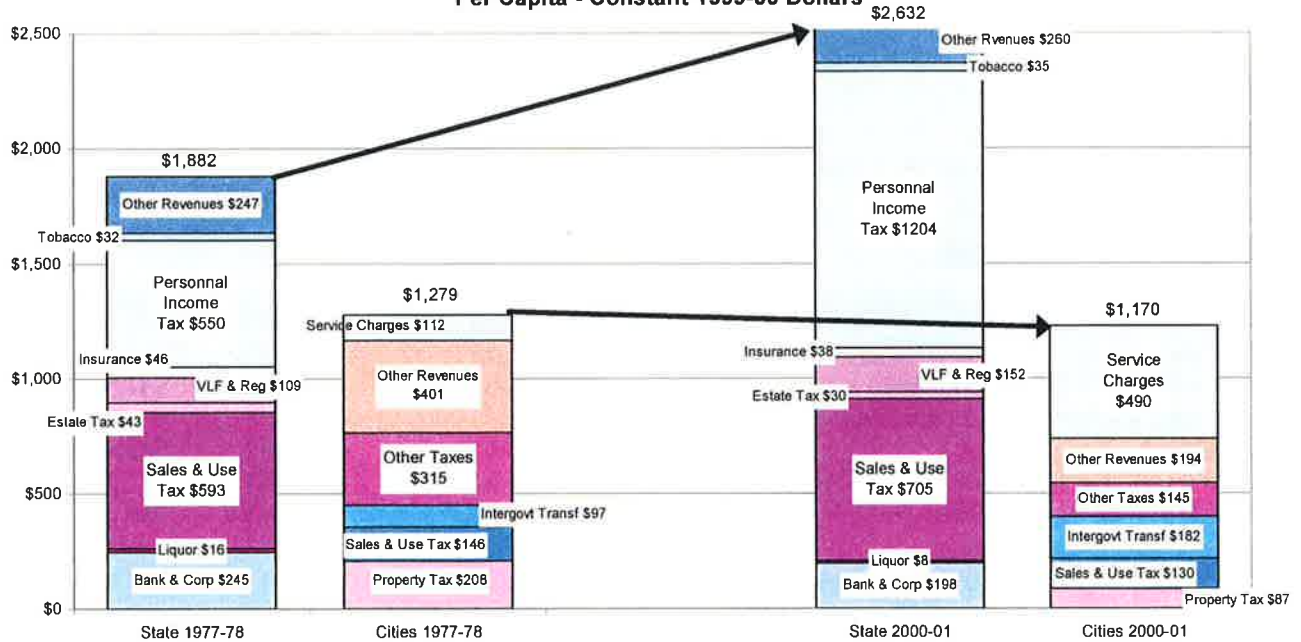
The noted reductions are in addition to significant cost reductions that have been implemented from the early to mid 1990's in response to a decline in revenue, including the property tax shift. Further cuts amounting to \$1 million were made to the City's programs and revenues because of the failure of Measure A in fiscal year 1997-1998. Since 1981, the City of San Clemente has lost \$23.5 million in revenue to the State. Once again, the City will face challenges as a result of the changing economic climate, which proves the natural volatility and cyclic nature of the economy, making the preservation of local revenue all that much more critical.

The below chart from the League of California Cities shows how cities' revenues have actually dipped below fiscal year 1977-78 levels while the State's have increased significantly when calculated in constant 1999-00 dollars. The State became dependent over the past few years on personal income tax growth (capital gains taxes) due to a strong stock market - a period of phenomenal growth that has now come to a screeching halt. An inequity continues, even more than 20 years later in the State-local fiscal environment as cities continue to lose control over their local dollars. Cities are also limited today, especially as a result of Proposition 218, in their ability to raise needed revenue, relying primarily on increases in fees for its services, such as recreation programs and residential development fees.

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California State and City Revenues

Per Capita - Constant 1999-00 Dollars



After Proposition 13, the State reduced or eliminated many subventions to local governments, representing a loss of over \$300 million annually to cities since 1981. These include liquor license fees, highway carrier's uniform business tax, financial aid to local agencies, cigarette taxes, trailer coach/mobile home fees and business inventory exemption reimbursements which equate to a \$4,930,960 cumulative loss for San Clemente and a \$327,130 annual revenue loss. The chart below itemizes the reductions specific to San Clemente.

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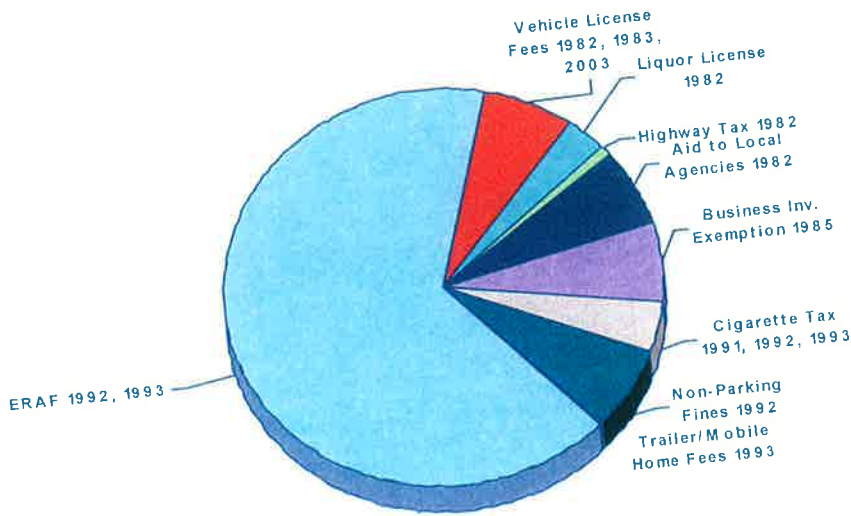
Estimated Revenue Losses Due to State Budget Actions City of San Clemente 1981-2003

| Revenue Item | FY Effective | Initial Year Loss | Continuing Annual Loss | 03/04 Cumulative Loss |
|--|--------------|----------------------|------------------------------|-----------------------------|
| <u>State Continuing Losses</u> | | | | |
| Liquor License Fees | 81-82 | \$20,410 | \$41,530 | \$716,470 |
| Highway Carries Uniform Business Tax | 81-82 | \$6,510 | \$13,250 | \$228,510 |
| Financial Aid to Local Agencies | 81-82 | \$42,514 | \$86,510 | \$1,492,420 |
| Business Inventory Exemption Reimb Repealed | 84-85 | \$51,890 | \$92,450 | \$1,451,570 |
| Admin Costs of Cigarette Tax Subventions | 90-91 | \$12,484 | \$17,260 | \$207,040 |
| Cigarette Tax Subventions | 91-92 | \$33,544 | \$45,020 | \$507,460 |
| 50% of Non-Parking Fines | 91-92 | \$103,825 | \$139,350 | \$1,570,680 |
| Remaining Cigarette Tax Subventions | 92-93 | \$20,531 | \$26,760 | \$281,740 |
| Trailer Coach\ Mobile Home Fees | 92-93 | \$3,334 | \$4,350 | \$45,750 |
| ERAF Property Tax Shift | 92-93 | \$591,000 | \$770,440 | \$8,110,120 |
| ERAF Property Tax Shift | 93-94 | \$591,000 | \$749,980 | \$7,319,440 |
| Subtotal | | | \$1,986,900 | \$21,931,200 |
| <u>State One-Time Losses</u> | | | | |
| Vehicle License Fees | One Time | 81-82 | \$219,186 | \$446,020 |
| Vehicle License Fees and Other Subventions | One Time | 82-83 | \$175,315 | \$336,140 |
| Vehicle License Fees | One Time | 2003 | \$740,000 | \$740,000 |
| Subtotal | | | | \$1,522,160 |
| Totals | | | \$1,986,900 | \$23,453,360 |

Notes:

Continuing and cumulative losses have been adjusted to reflect 2003 dollars based on Oct. 2003 U.S. CPI.
Excludes revenue losses applicable to Redevelopment Agency.
Data Sources: US Department of Labor, City of San Clemente Budget books, 1994 & 1995 Trend Reports.

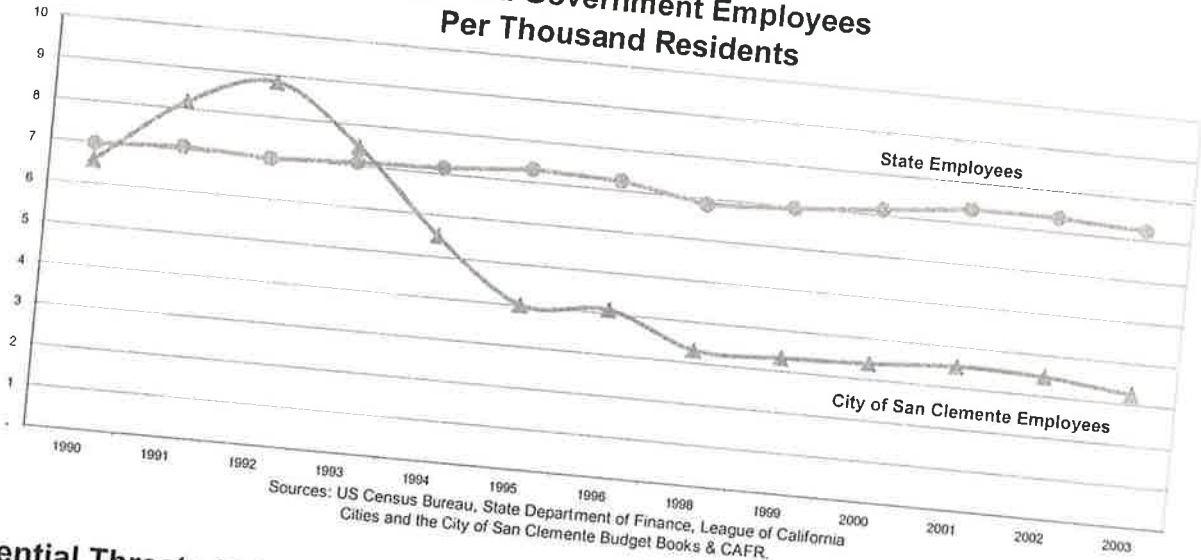
Distribution of \$23.5 million in losses to San Clemente (1981-2003)



As a result of the ongoing revenue shifts to the State, cities have had to discover more innovative means of providing services with less staff and less money, yet try to maintain the same standards in quality. In view of this, it has been documented that for over 20 years, State and Federal support to local government has dwindled, while the number of mandated programs and service demands has grown. For example, in 1974-1975, Federal, State, and County governments' contributions to support City operations equaled 21% of all City revenue. Today that support is less than 13%.

Additionally, State budgets have grown significantly over the past ten years while the local government budgets have not kept up with the population growth. The following chart shows that the City employees per thousand residents have dropped significantly from 6.58 in 1990 to 3.25 in 2002 while the State employees per thousand residents have increased from 6.98 in 1990 to 7.23 in 2002.

California Government Employees Per Thousand Residents



Potential Threats to Local Government

State Budget Shortfall

Just three years ago California had a \$14 billion surplus. Much of this revenue growth came from taxes on gains in the, then, rising stock market which began to decline resulting in reduced State income tax receipts from capital gains and stock options. Consequently, this resulted in substantially lower personal income tax, sales tax, and corporation tax revenues. In former Governor Davis' first term, California's budget went from a record \$14 billion surplus to a record \$38 billion deficit by the end of Davis' term while State revenues plummeted 15%, the largest drop since the Great Depression.⁹ The energy crises did not help matters as the State's cash reserves were being depleted by \$6 billion on spending for power purchases.

During Davis' first term in office which began in January of 1999, the surging stock market created a surplus of \$8 billion, then State income tax receipts just from taxpayers exercising stock options and taking capital gains on the sale of assets more than doubled from nearly \$8 billion in fiscal year 1998-99 to \$17.6 billion in fiscal year 2000-01.¹⁰ State spending over the past four years increased by 28% while spending increased by 36%. The State Treasury's cash flow was plentiful and the Governor and lawmakers from both political parties increased State spending to expand programs, especially educational programs that forced the State into future spending. The State also embarked on a major expansion of health care coverage for uninsured children, more college scholarships and raises for State employees, while lawmakers also refunded money to taxpayers in the form of reduced motor vehicle fees. State leaders chose to tie up the dot.com windfall in permanent programs, so now that the State is back to more normal revenues with an improving economy, it is in a crunch.

⁹ Rabin, Jeffrey, L. October 29, 2002. "State Spent its Way into Budget Crisis." *The Los Angeles Times*.

¹⁰ Rabin, Jeffrey, L. October 29, 2002. "State Spent its Way into Budget Crisis." *The Los Angeles Times*.

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Last year, the State Controller was forced to take out a \$7.5 billion payday loan to avoid running out of cash to pay its bills.¹¹ Because the State used short-term revenue growth that could not be sustained (income tax/capital gains) to address program needs and political interests, the result was an immediate economic crisis with the predictable collapse of the stock market gains in recent years. The State continued their "shift and shaft approach" to budget management by redistributing revenue under their control or delegating program responsibilities.

This State budget crisis is the most serious in history. To deal with the immediate shortfall, Davis, in fiscal year 2002-03, proposed spending reductions and budget adjustments totaling \$10.2 billion over the next two years with \$1.43 billion in reductions on programs affecting cities. Now it is Governor Schwarzenegger's turn to propose mid-year spending reductions that will produce budget benefits that not only improve the general fund's projected year-end balance but that will carry forward into FY 2004-05 to reduce the State's budget problems. From what is known so far, the following items and revenue losses will impact San Clemente:

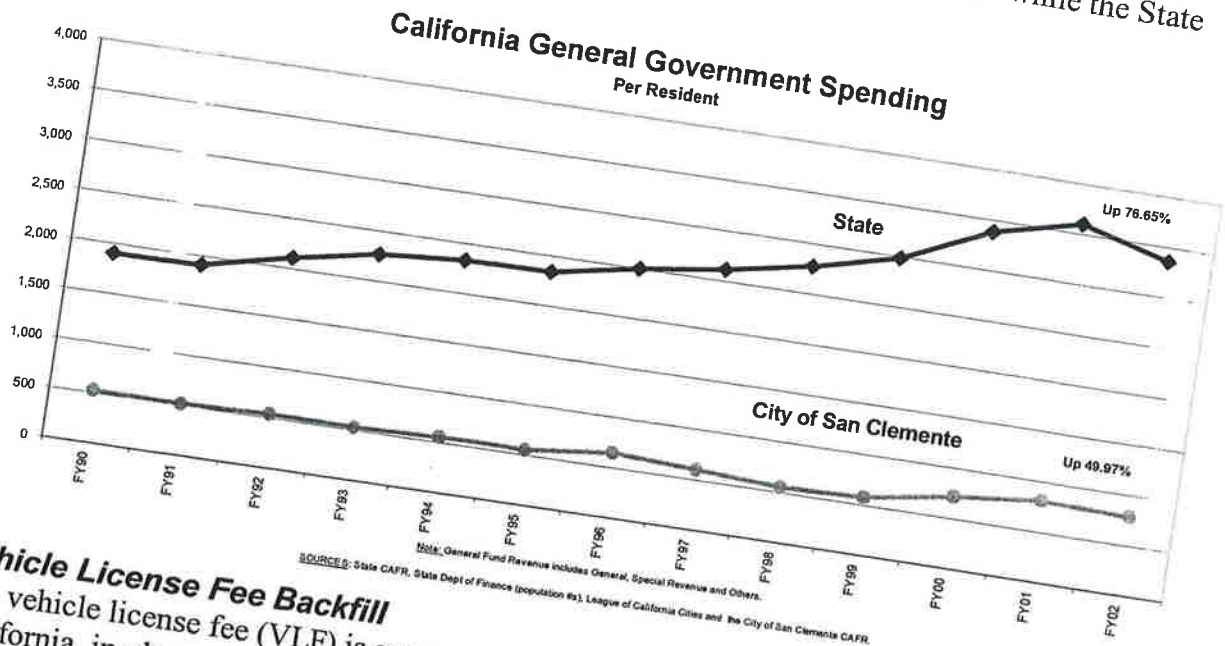
- *Triple-flip 1/4 cent sales tax*: if the State implements the swap for 1/4 cent of local sales tax for an equal amount of property tax to create a dedicated revenue source, the City could lose \$17,000 in interest.
- *Vehicle license fee backfill*: a loss of \$740,000 as a result of the State borrowing three months worth of the VLF backfill without interest until 2006.
- *COPS grant*: the State plans to reduce the law enforcement COPS program by \$16,000 from COPS grant.
- *Booking fees*: gain of \$57,000 from restoration of subvention.
- *State mandated claims*: there have been no reimbursements for State mandated projects since 2002. The total loss to San Clemente is \$165,850.
- *Redevelopment Agency*: an estimated loss \$73,730 in RDA tax increment is expected.
- *Traffic Congestion Relief Act (AB 2928)*: further elimination of apportionments to local agencies for street and road maintenance. The total estimated impact for San Clemente for FY 2004-05 is \$200,624 (Governor Davis' Budget took \$184,537 in these funds from San Clemente in FY 03-04).

Despite experiencing a budget crisis and economic recession that hit California hard for about five years, the State continued to expand costs and programs in the 1990's at a time when cities were forced to cut back and be even more efficient. Since 1990, the City of San Clemente has

¹¹ Demarco, Peter. May 13, 2002. "Don't Raise Taxes Or Cut Education Funds To Solve Your Budget Crisis, Assembly GOP Warns Davis: Republicans Call For New Spending Limits To Prevent Another Fiscal Train Wreck." California State Assembly Republican Caucus.

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seen a 49.97% increase in its general governmental spending per resident while the State government has experienced a 76.65% increase.



Vehicle License Fee Backfill

The vehicle license fee (VLF) is an annual fee on the ownership of a registered vehicle in California, in place of taxing vehicles as personal property. The VLF is paid to the Department of Motor Vehicles (DMV) at the time of annual vehicle registration. The fee is charged in addition to other fees, i.e., the vehicle registration fee, air quality fees, and commercial vehicle weight fees. The VLF is local governments' third largest source of general purpose tax revenues (after the property and sales taxes) and the majority of VLF goes directly to fund law enforcement, fire protection, emergency medical response and health care.

Proposition 47, passed by voters in 1986 constitutionally guaranteed that VLF revenues are sent to local governments, although the State retains authority over the amount of revenues that are collected and the method of their distribution and the legislature holds the authority to alter the level of VLF revenues. Under the law, local governments are backfilled by the State general fund for any loss of revenue due to VLF reductions and the local government VLF backfill mechanism occurs automatically without being subject to the annual budget process.

Because of the State's budget deficit, Davis tripled the VLF, returning the fee to pre-1998 levels. The State ended the backfill of two-thirds of VLF on June 20, 2003 while the State then "borrowed" three months of backfill without interest until 2006. Without Governor Schwarzenegger's Executive Order on November 17 which rescinded the increase, the average annual fee would have increased from \$64 per car to \$148.¹² If the backfill had not been appropriated to local governments, cities and counties would have experienced a \$3.6 billion

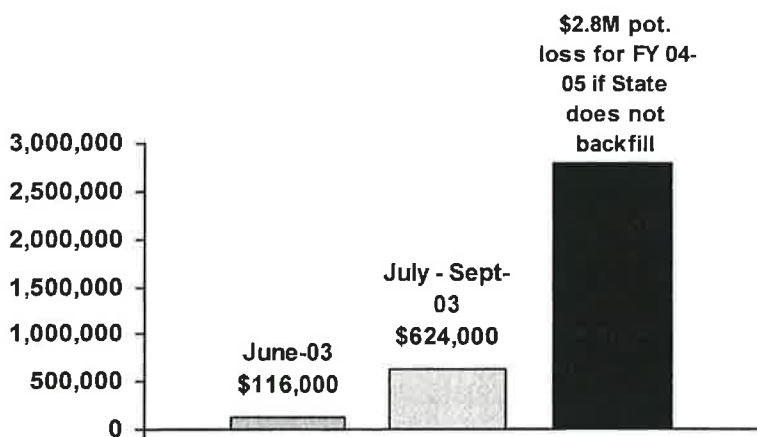
¹² Quach, Hanh Kim and John Howard. December 19, 2002. "Davis projects deficit of \$34.8 billion." *The Orange County Register*.

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loss. San Clemente would have experienced a \$2.3 million loss in FY 03-04 without the VLF backfill.

The City of San Clemente's VLF currently represents 9.5% of the City's general fund revenue. If the VLF backfill had not been restored, San Clemente would have lost two-thirds of its total VLF revenues. The City received \$2,944,823 in VLF in FY 2002-03 and will receive \$3,382,200 for the current fiscal year if the Governor continues to restore the backfill to local governments in FY 2004-05. The elimination of the VLF backfill would have resulted in a \$2.8 million loss in FY 2004-05, which would have jeopardized the City's police, fire and emergency medical services. Prior to the VLF reinstatement, the State began withholding the backfill on June 21, 2003. San Clemente has lost approximately \$740,000 for the months of June, July, August and September. The State has indicated that the amounts withheld for the current fiscal year will be repaid in mid-2006.

VLF Loss to State



If the State's current solutions to the budget crisis fail, there is always the chance the State will revisit withholding VLF backfill from local governments in FY 2004-05. If this were to happen, cities and counties would need to find a way to keep their services and programs going or make reductions, while balancing their own budgets. Any reductions will seriously impair the ability for City officials to keep their communities safe and strong. Overall, California cities will lose approximately \$1 billion of this critically needed revenue if the State shifts a portion of the vehicle license fees and counties will lose \$3 billion. Cities and counties already operate on very lean budgets, so these cuts will negatively affect services that impact all members of the community. Some communities will have to make reductions to after-school youth programs, senior center activities, and others will eliminate road maintenance programs. Other cities would be forced to raise fees for recreation programs, permits and licenses.

Governor Schwarzenegger will have to enforce the spending reductions currently called for in the State budget; at the very minimum he will have to be prepared to immediately reduce State spending by \$7 billion. To have achieved an additional \$3.6 billion in VLF-driven reductions it would have required legislative authorization, although administrative flexibilities within the current budget make it possible for Governor Schwarzenegger to make program reforms and

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resulting fund transfers to accomplish these savings. This would require expert and aggressive internal management reform of virtually every state operation under the authority of the Governor.¹³

2% Assessment Appeals Case

A court case filed during fiscal year 2001-02 in Orange County that limits assessed valuation increases is of potentially great but as yet uncertain significance. For properties that had previously been granted a reduction in assessed value to reflect reduced market values, county assessors routinely increased assessed value by more than 2% in a single year when the local real estate market had recovered. Citing Propositions 13 and 8, in December 2001 the Orange County Superior Court ruled this practice unconstitutional.

County assessors in California uniformly interpret the provisions of Proposition 13 and 8, adopted by voters in 1978, as permitting assessed value growth in excess of 2% when reassessing a property that had previously been granted a reduction due to market value declines. Their methodology conforms with implementing legislation passed in response to Proposition 13 and 8, and codified into the California Revenue and Taxation Code.

Pursuant to the code, county assessors set the taxable value of real property as the lower of market value on the lien date or a figure that the Orange County assessor calls the Factored Base Year Value (FBYV). To establish the FBYV, the base year value is set (at the market value when purchased for all property acquired after 1975), then it is increased annually by the value of any new construction plus the lesser of inflation or 2%. Assessors keep track of the FBYV, and each year compares it to market values. When a property's market value falls below its FBYV, the property is granted a reduction in assessed value. Annually the assessor compares the property's FBYV with its market value, and as soon as market value exceeds the FBYV the assessed value is restored to the FBYV. Assessors "recapture" the market decline. The adjustment to allow the recapture may result in a rise in assessed value greater than 2% in a single year.

In the case before the Superior Court, the Orange County assessor had increased the property owner's value by approximately 4% in a single year. The Superior Court found this to be unconstitutional, stating that it violated the requirement that "in no event shall the percentage increase for any assessment year...exceed two % of the prior year's value."

This court's decision contradicts an unpublished decision at the Appellate Court level in 1994. Initially the Orange County Superior Court case applied only to the taxpayer who brought suit, although on December 12, 2002, Orange County Superior Court Judge Watson ruled that the case should be certified as a class action case and open to all those who might be eligible. Judge Watson set a January 30, 2003 court date for the Court to determine if the Tax Collector would be required to issue notices to taxpayers. At the hearing, the Court granted the motion, but immediately put a hold on its implementation pending further review by the appellate courts on

¹³ DeMaio, Carl. October 10, 2003. "New Analysis Confirms Failure of State Budget Deal \$16.5 Billion Deficit Greets Schwarzenegger." Government Redesign for Reason Foundation and President of the Performance Institute.

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this entire case. Therefore, no notices were issued by the Tax Collector at that time. The case has been moving its way through the appellate courts and an Oral Argument was scheduled for January 7, 2004. All briefs have been filed by various government agencies. A final ruling on the case can be expected within a few weeks following the Oral Argument.

Differing circumstances combined with differing interpretations of the potential impact of the case have led to widely varying estimates by counties of the potential revenue impact. Individual counties' estimates range from several hundred thousand dollars to many millions. In a letter to the Orange County Board of Supervisors from the Orange County Auditor-Controller on January 29, 2003, rough estimates were presented of the potential impact of the 2% assessment appeals case on agencies in Orange County. The estimated allocation of refunds to homeowners in San Clemente is \$2 million for FY 1998-99 through FY 2002-03 and the estimated future reduction in the allocation of the City's secured tax base is \$608,000.

Conclusion

The State of California's budget problems are considered the worst in the nation. This means local government will again be facing a difficult road ahead and there are no quick and easy solutions. Despite the decisions of local leaders regarding their communities and their local budgets, the decisions made by State and Federal legislators oftentimes affect the amount of local taxes paid by citizens and the control that local governments have over local circumstances.

Budget Proposals

In late November 2003, the Governor announced a list of \$1.9 billion in proposed current year budget cuts. The cuts focus primarily on health and welfare programs. The cuts could possibly present critical challenges to a local government, depending on the severity because the cuts would result in increasing pressure on cities to respond with support to individuals who need access to these programs locally. Under the Governor's proposal, transportation spending would be cut by \$530 million and health and human services by \$440 million this fiscal year, while education would absorb \$160 million in cuts this year and next. The Governor's proposed budget for FY 2004-05 calls for even more cuts -- \$1.3 billion from local governments. It also would cut from transit projects and health care for the low income.

On the eve of December 11, 2003, the Assembly approved the Governor's California Recovery Plan although it did not at the time address the fiscal crisis now affecting cities and counties. As addressed previously in this paper, the Governor since proposed to fund local governments for the \$3.6 billion loss, protecting local governments from losing any of their VLF payments. The Assembly acted overwhelmingly, to approve the deficit bond funding package, AB5X 9 (Orepeza) and a proposed constitutional balanced budget amendment, ACA5X 5 (Orepeza).

The Governor will have a chance to ask voters in March 2004 to consider his proposal to borrow \$15 billion to wipe out the state's existing deficit. The Governor proposes paying off the deficit bonds with general fund revenues over 15 to 20 years. Passage of the bond measure is considered critical to the Governor's restructuring plan. However, in a poll taken in mid January by the Policy Institute, 35% of California voters back the bond measure, 44% oppose it and 22% are

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undecided.¹⁴ The Governor will also seek approval for his spending cap which is also slated for the March ballot.

Some of the highlights of the Governor's budget plan that is backed by the Assembly and the Senate. The plan includes a balanced budget requirement which serves as an important step in the right direction to solving the budget crisis and prevent the state from facing such a disastrous situation again. The deal points in the budget plan include:

Bond Package Relies on ¼ Cent Local Sales Tax "Triple-Flip"

The deficit bond funding package is described as 15-year financing, based on the "triple-flip" arrangement with a dedicated revenue source (1/4 cent of the sales tax). The term of the financing is estimated to be eight to nine years, if accumulated revenues in the proposed General Fund reserve account established in ACA5x 5, called the Budget Stabilization Account, are also dedicated to debt service payments.

Budget Requirement

Amend the current requirement for the Governor to present a balanced budget to also require the Legislature to adopt and the Governor to sign only if balanced. The Legislature will be prohibited from authorizing bonds for deficit closure after the current bond is authorized by the voters.

Mid-year adjustments to ensure balance

Governor may, at his discretion, declare a fiscal emergency and call a special session and present a package of bills to bring the budget back into balance. Legislation takes effect immediately without need for an urgency clause. This keeps the required two-thirds vote on appropriations and taxes, but allows a simple majority for statutory changes that do not currently require a two-thirds vote.

Reserve Requirement

Beginning with FY 2006-07, 1% of the estimated General Fund revenue will be transferred into a Budget Stabilization Account of the General Fund. In FY 2007-08 this would increase to 2% and in 2008-09 and thereafter a 3% increase would be implemented. Transfers will be "trued up." If the Governor declares fiscal necessity, the Legislature by a two-thirds vote, may reduce or eliminate the transfer for the fiscal year in which the Governor declared necessity to do so.

Bond pre-payment. At the end of each fiscal year, the Controller shall transfer 50% of the BSA balance into a sinking fund that may be used only for pre-payment of the deficit reduction bonds or the fiscal recovery bonds. Once a total of \$5 billion has been so transferred, this requirement ceases.

Limits on Reserve. Once the \$5 billion total has been reached, the Bureau of State Audits (BSA) will continue to build a balance until it reaches 10% of General Fund Revenues. When that

¹⁴ Priority Focus. January 16, 2004. "City Officials Ponder ERAF Shift, Governor's Bond Measure. League of California Cities.

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occurs, the requirement to transfer shall not be in effect for the fiscal year in which the 10% is achieved.

Spending from the Reserve. If the Governor declares a necessity, the Legislature may authorize a transfer of funds from the BSA back into the General Fund with a two-thirds vote.

General Obligation Bond

Amend the General Obligation Bond bill to state intent of Legislature that bonds be retired within 15 years.

Having experienced cyclical downturns in the economy in years past, the State must be better prepared by setting aside reserve funds for the downturns so it is better able to handle the deficits without ever facing the problem again of borrowing billions from the future to pay today's and yesterday's debts. With this latest proposal, the State can build up reserves and establish a "rainy day" fund – a key element in the agreement.

Unforeseen Expenditures

Unforeseen incidents like 9-11 caused local governments to face new costs to increase security within their municipalities. The City of San Clemente's paid \$25,000 by the end of FY 2001-02 to provide increased security lighting outside of City buildings, security lock systems on buildings, police and fire services, and computer security upgrades. As first responders, local government must plan, budget and prepare for unforeseen expenditures. Since the 9-11-related security measures implemented in FY 2001-02, the City has not incurred further expenditures and does not anticipate any expenditure for fiscal year 2003-04.

League of California Cities Local Initiative

The League of California Cities prepared the "Local Taxpayers and Public Safety Protection Act," an initiative slated for the November 2004 ballot. Passage of this initiative is essential for the protection of local revenues. The initiative was proposed in response to the Legislature taking away billions of local tax dollars over the years, forcing local governments to either raise local fees or taxes to maintain services, or cut back on critically needed local services.

The initiative would change State law and increase local control over local taxes and give residents the ultimate say on whether their local tax funds should be spent for local or state services. The initiative protects the revenues and services of local governments of every size, scope, region and fiscal condition. The initiative advocates restoring control over tax dollars that are used to provide critical local services including police, fire, emergency and trauma care, public health, libraries, criminal justice, and road and street maintenance. As demonstrated previously, the Legislature has been taking away billions of local tax dollars each year, harming local governments' ability to provide these critical services. This initiative strengthens the requirement that if the State mandates local governments to implement new or expanded programs, then the State will reimburse local governments for the cost of those programs.

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Conservative Local Fiscal Policies

The numbers are clear. At the local level, employee numbers have decreased while the opposite is true for the State. Each year local governments are asked to provide more with less. The City of San Clemente must address service demands resulting from an increase its population growth and cannot continue to slash municipal spending without facing unfavorable consequences.

Having weathered rough times due to the continuing State revenue shifts and past economic downturns, the City of San Clemente remains fiscally conservative, allowing it to plan for the future. This position however, will be jeopardized if the State takes more money from the City. For instance, if the State fails to provide replacement funding for the VLF backfill loss after the recent commitment to fund cities for six months has passed. Unfunded mandates and forced losses in local revenue to the State may further hinder the ability of cities to respond to the needs of the public, making the current fiscal environment threatening as cities are yet to know the full impact of the State's budget plan.

Unquestionably, the State-local fiscal relationship is dysfunctional, requiring a major overhaul, and local government must continue to work towards local control of their revenue and push for stable sources of tax money that will remain under local control. It once seemed that immediate reform was unlikely given the complexity of the State's budget crisis but this may no longer be the case considering the March 2004 ballot initiative.

For the past three years, local governments have watched the State sink deeper in debt and wrestle with its largest budget crisis ever. Just three years ago the State had a \$14 billion surplus. It is important that the Legislature not postpone adopting major solutions such as ongoing spending reductions and/or revenue augmentations. Cities must keep a close watch on this coming budget year to see if Governor Schwarzenegger will change "government as usual" and end the practice of taking local revenues to meet the State's funding obligations.

LOCAL GOVERNMENT RESPONSE

| LOCAL RESPONSE | IMPLEMENTATION |
|---|--|
| Aggressive and sophisticated lobbying | <ul style="list-style-type: none"> - Letters to legislators and Governor. - Mayor/Council visits to Sacramento. - Partner with League of California Cities. |
| Educate the public on State budget situation and address how they will be affected utilizing outreach and educational tools | <ul style="list-style-type: none"> - Presentations at local service clubs. - Staff presentations to Councilmembers at televised Council meetings. - Articles in the City's quarterly magazine and the Sun Post News. - Information posted on City website. |
| Seek constitutional protection of local dollars | <ul style="list-style-type: none"> - City Council and staff to provide <u>impartial</u> informational materials on the "Local Taxpayers and Public Safety Protection Act" initiative as is lawfully provided. |
| Hold State electeds accountable | <ul style="list-style-type: none"> - Meet directly with State electeds. - Inform the public of direct or secondary impacts of State actions and how their elected representatives voted. |

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| City must continue long term planning to ensure stability during these times | <ul style="list-style-type: none">- Fiscal policies include reserves.- Balanced revenue sources through development and land use control.- Balanced operating spending and revenue growth. |
|--|--|

Recommendations

Staff recommends that City Council direct staff to:

1. Use the information discussed herein; work with other cities towards local control of local revenue and push for stable sources of tax money that will remain under local control -- revenue that the State will not be able to take away.
2. Share this information with other cities and seek input in analyzing the impacts of State revenue shifts on their own jurisdictions.
3. Provide impartial informational materials on the "Local Taxpayers and Public Safety Protection Act" initiative as may be lawfully provided by City representatives and share this paper as it relates to San Clemente's loss of local revenue.
4. Report back to Council as progress is made.

Fiscal Impact of Recommendation

Unknown.

Council Action

All recommendations were approved by the City Council by a vote of 5-0 on February 3, 2004.

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